POWER PLAY

CALIFORNIA IS CONSTRAINED IN ITS ABILITY TO RESPOND TO THE ENERGY CRISIS BY THE DOCTRINE OF FEDERAL PREEMPTION

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The ultimate resolution of the California energy crisis of 2000-2001 will take place in both state and federal courts and will most likely be determined by a liberal application of the doctrine of preemption. The cases brought in the midst of the crisis may be decided on the basis of a particular variant of the preemption doctrine known as the filed rate doctrine, which gives primacy to rates and tariff provisions approved by the Federal Energy Regulatory Commission. The FERC regulates, among other things, the wholesale price of electricity in interstate commerce. The Ninth Circuit already has applied the filed rate doctrine to find that Governor Gray Davis's "commandeering" of $1 billion of electric supply contracts was unlawful. The court found that the governor's action contravened tariff provisions that the FERC approved. Another important application of the preemption doctrine is likely to arise as the federal bankruptcy court considers the Pacific Gas and Electric Company (PG&E) plan of reorganization.

The roots of the recent California energy crisis are in a December 1995 California Public Utilities Commission (CPUC) decision[1] coupled with legislation—Assembly Bill 1890—that was passed unanimously by the California Legislature in August 1996.[2] The 1995 CPUC decision and AB 1890 provided for a massive restructuring of the operations of the California investor-owned utilities—PG&E, Southern California Edison Company, and San Diego Gas & Electric Company (SDG&E). Instead of generating electricity for sale to their retail customers, the utilities would buy the bulk of their electricity supplies through the wholesale market at the short-term or "spot" prices established on a daily basis. The supplies would be purchased through a new entity, the California Power Exchange (PX), which was created by the legislation.[3]

The price for electricity purchased through the PX would be set on the basis of the price of the last kilowatt hour (kwh) of electricity that would be needed in order to meet the forecasted demand by the utilities for the day ahead. Policy makers thought there would be intense competition among generators to sell into the PX's wholesale market—and they believed that the market clearing price for electricity that the PX would sell to the utilities would be near or even below approximately 2.5 cents per kwh.

Additional electricity would be needed to follow the fluctuations in retail load that regularly occur throughout the day. Electricity necessary to meet the consumer demand would be procured by another new entity, the California Independent System Operator (ISO), which

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was also created by AB 1890.[4] The primary responsibility of the ISO was the reliable operation of the California electric transmission grid. To the extent to which the utilities retained generation facilities, they would be required to sell the output from the facilities to the PX. However, the utilities divested themselves of much of their generation capacity, including all of their gas-fired generation facilities.

The utilities feared that the restructured electric market would result in "stranded" generation costs for two reasons. First, divested facilities were expected to be sold at less than book value. In addition, the utilities were concerned that the low forecasted wholesale prices would be insufficient for the utilities to recover the costs of the generation that they retained. As a result, the utilities would be left with costs that would be stranded to the extent that they were unrecoverable. In order to permit the utilities to recover the anticipated stranded costs, AB 1890 established a cap on utility retail rates set at the level of 1996 rates. Policy makers believed that the cost of providing transmission and distribution services plus the cost of the energy purchased at wholesale from the PX and the ISO would be below the rate cap. The gap between the rate cap and actual costs would provide "headroom" that would permit the utilities to recover their stranded costs by 2002. If the utilities recovered their stranded costs earlier than 2002, the rate cap would then be lifted, with rates presumably dropping to a level below the cap. To the extent to which the utilities did not recover their stranded costs by December 31, 2001 (or March 31, 2002, for certain specifically identified costs), the utilities would be required to write off their remaining uncollected stranded costs.

The AB 1890 scheme worked well from the implementation date, March 31, 1998, until late spring 2000. For over two years, with some relatively minor summertime aberrations that probably should have been warning signs, the wholesale price of electricity purchased by the utilities from the PX remained low. Sometimes, prices were extremely low. However, by June 2001, wholesale prices started to increase to alarmingly high levels. Instead of 2.5 cents per kwh, or $25 per megawatt hour (mwh), the prices paid by the ISO for the electricity needed to meet the fluctuating demand and to keep the electricity grid in balance soared. In June, the ISO imposed a $750 per mwh cap on the price it would pay for electricity necessary to follow the retail load. This effectively became the cap on PX prices as well. The ISO price cap was reduced to $250 per mwh by August 2000.

Even with wholesale prices capped, the utilities found themselves incurring wholesale purchased power costs that dramatically exceeded the amount that they could recover through their capped retail rates. PG&E, for example, claimed that it could only recover approximately $54 per mwh through its capped rates, but it was paying multiples of that amount on the wholesale market. PG&E stated that between June 2000 and January 31, 2001, the utility's wholesale transmission and electric costs exceeded the revenues available from frozen retail rates by approximately $8.3 billion.

The utilities argued at the CPUC that they had recovered their stranded costs during the time that wholesale purchase power costs had been low. Thus, the utilities concluded, the AB 1890 cap on retail rates should be lifted. The CPUC disagreed. The commission refused to lift the rate freeze, and it refused to allow the utilities to recover undercollected purchased power costs after the end of the rate freeze.

COMPLAINTS FILED BY UTILITIES

On November 13, 2000, Edison filed a complaint in the U.S. District Court for the Central District, in Los Angeles, claiming that under the filed rate doctrine, the CPUC was required to allow Edison to pass through to retail ratepayers the unexpectedly high costs that Edison was incurring by purchasing electricity at wholesale prices from the PX and through the ISO.[5] PG&E filed a similar suit in the Northern District.[6] The PG&E complaint was subsequently transferred to the Central District so that both the Edison complaint and the PG&E complaint were assigned to U.S. District Court Judge Ronald Lew.

In its complaint, Edison contended that the state-imposed prohibition on Edison's ability to recover its purchased power costs had been preempted. Edison argued that Congress has occupied the field of regulation of wholesale sales and electric power and that California's restrictions on Edison's recovery of the cost of electricity on the wholesale market regulated by the FERC "stand as an obstacle to the accomplishment of federal objectives and conflicts with federal law."[7] More specifically, Edison argued that the filed rate doctrine requires the state to permit Edison to recover in retail rates all of Edison's "FERC-approved and authorized costs for its wholesale purchases of electric power from the Power Exchange (including electricity procured by the Independent System Operator) and its transmission of electric power in interstate commerce, all as established pursuant to tariffs on file with and approved by the FERC."[8]

The U.S. Supreme Court first articulated the filed rate doctrine in 1951 in *Montana-Dakota Utilities Company* v. *The Northwestern and Public Service Company*.[9] The Court held that rates established in power sales contracts filed with and accepted by the FERC's predecessor, the Federal Power Commission (FPC), were binding on federal courts.[10] A party to the contracts "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 the court can authorize commerce in the commodity on other terms."[11] The filed rate doctrine was extended beyond federal courts to preempt state courts and regulatory agencies.[12] Evolution of the doctrine culminated in the Supreme Court decision in *Nantahala Power and Light Company* v. *Thornburg*,[13] in which the Court explained the preemptive effect that the FERC's rate jurisdiction has on federal courts, state courts, and state regulatory agencies:

> [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 in retail rates that the FERC-approved wholesale rates are unreasonable. The 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.[14]

Specifically, a state regulatory agency does not have discretion about whether to decide to pass through in retail rates the costs that a utility might incur in paying federally approved wholesale rates: "When 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 rates to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate....[S]uch a 'trapping' of costs is prohibited."[15]

On April 12, 2001, Edison requested and obtained a stay of the district court proceeding. Ultimately, Edison negotiated a settlement with the CPUC. The settlement was submitted to the judge for approval on October 2, 2001—and the judge approved the settlement on October 5, 2001. A consumer group, The Utility Reform Network (TURN), sought a stay pending appeal of the settlement, but the judge denied a stay on November 9, 2001. TURN's subsequent request for a stay from the Ninth Circuit was denied on November 28, 2001. Thus, the Edison suit under the filed rate doctrine has, at this point, resulted in a settlement with the CPUC that, absent further action by the

Ninth Circuit, will be binding on the CPUC.

The Edison settlement set Edison on the path to becoming creditworthy as early as March 1, 2002. Both Edison and PG&E defaulted on payments to the ISO and the PX on January 17, 2001. As a result, both utilities ceased being creditworthy. In order to keep electricity flowing, the state of California, through the Department of Water and Resources, began purchasing electricity on behalf of the utilities.

As noted in the settlement, Edison incurred approximately $6.355 billion of debt (referred to as "back debt") related to the purchase of electricity. The CPUC permitted Edison to raise retail rates by 1 cent per kwh in January 2001 and another 3 cents per kwh in March 2001. In June, 2001, however, wholesale electricity prices dropped dramatically to precrisis levels. The combination of rate increases and dropping wholesale prices enabled Edison to start collecting revenues in excess of current costs. That created the opportunity for a settlement.

Under its settlement, Edison agreed to absorb $300 million of its unrecovered costs. After subtracting that amount from Edison's back debt and subtracting cash on hand that Edison has accumulated as a result of charging higher rates, the remaining amount of back debt to be paid down by Edison was approximately $3 billion as of the end of October 2001.

Edison will forego paying dividends of $400 million per year for 2002, 2003, and possibly 2004. If the freeze on paying dividends extends to 2004, Edison shareholders will contribute $1.2 billion in foregone dividends toward amortizing Edison's obligations in addition to the shareholders' absorption of $300 million. In return, the CPUC has agreed not to lower Edison's retail rates below their current level through the end of 2003, unless the back debt is recovered. If the debt has not been recovered by the end of 2003, the CPUC agrees to set rates up to, but not higher than, the current level to enable Edison to recover the remaining amount of back debt over 2004 and 2005. As a result of the settlement, Edison released the CPUC from all claims in Edison's district court lawsuit.

PG&E is taking a different approach. PG&E is continuing with its litigation of the filed rate doctrine issue. On May 2, 2001, Judge Lew concluded that certain CPUC decisions were integral to PG&E's claims. However, because the decisions were not yet final, PG&E's claims were not yet ripe for review. Lew granted a CPUC motion to dismiss PG&E's complaint, but the dismissal was without prejudice. The judge provided that "PG&E may refile its action once the CPUC interim orders it challenges become final decisions."[16]

Upon the CPUC's denial of rehearing of the orders that at the time of Lew's order had not become final, PG&E refiled its complaint. This time, PC&E filed in the U.S. District Court for the Northern District, in San Francisco. Once again, PG&E raised the argument that under "well-established principles of federal preemption, PG&E is entitled to recover its wholesale transmission and power purchase costs in its retail rate revenues because such wholesale costs were incurred pursuant to federal law and tariffs filed with and approved by the Federal Energy Regulatory Commission."[17] PG&E noted that CPUC President Loretta Lynch acknowledged that the filed rate doctrine "requires States to pass through to utility customers the costs of electricity that [is] purchased subject to federal tariffs."[18] PG&E is asking the district court to issue an order declaring that the CPUC's prevention of PG&E from recovering its entire interstate electricity transmission and wholesale power purchase costs and retail rates is preempted by federal law.

More specifically, PG&E is arguing that under Section 201 of the Federal Power Act (FPA),[19] the FERC has exclusive jurisdiction to regulate the sale of electric power at wholesale and the transmission of electric power in interstate commerce. This has been acknowledged by the CPUC: "The Federal Power Act (FPA) confers exclusive jurisdiction over rates, terms, and conditions for sales for resale (wholesale sales) on the FERC."[20]

PG&E noted that on July 25, 2001, the FERC issued an order in *San Diego Gas and Electric Company* v. *Sellers of Energy and Ancillary Services into Markets Operated by the California System Operator Corporation and the California Power Exchange*,[21] holding that the rates under which wholesale power generators and marketers sold wholesale electric power into the California market satisfied requirements for being filed rates under the FPA and are subject to the filed rate doctrine. Even though the wholesale rates charged to PG&E were filed rates and are subject to the filed rate doctrine, the CPUC has denied PG&E the opportunity to recover these costs both currently and after the end of the rate freeze.

There is an exception to the requirement that regulators allow utilities to recover wholesale purchased power costs in retail rates, first articulated in 1983 in the case of *Pike County Light and Power Company* v. *Pennsylvania Public Utilities Commission*.[22] Under the *Pike County* exception, a utility can be denied the opportunity to recover costs incurred as a result of buying electricity at wholesale rates established by the FERC if the purchase in and of itself, apart from the rate that was paid, was imprudent.

It would be difficult to argue that the *Pike County* exception would apply in PG&E's case, however. Starting on March 31, 1998, all of PG&E's wholesale electricity procurement costs were incurred as a result of purchases of electricity under the PX and ISO tariffs established by the FERC. The CPUC has repeatedly declared that purchases made by utilities from the PX as well as from the ISO would be considered reasonable and not subject to retroactive review of whether the purchases were prudent. For example, in the 1995 decision in which the CPUC first charted the path for electric utility industry restructuring in California, the CPUC said that the utilities would be allowed "simply [to] pass on to [their] customers the cost of electricity as revealed by the [PX] over the billing cycle," explaining that this was preferable to allowing the utilities to enter into long-term contracts that would require "contentious regulatory proceedings" to determine the reasonableness of PG&E's procurement costs.[23]

The CPUC reached the same conclusion as late as June 2000, when wholesale prices were starting to rise precipitously in California: "[We] find that [the utilities] may procure electricity through the CalPX day ahead, day of, and block forward markets and similar markets and qualified exchanges, and the ISO imbalance energy market, and deem the prices paid for these products as reasonable."[24] That same decision further stated:

> Under the Pike County doctrine, a series of state and federal cases have recognized the right of the states to review the prudence of a utility's purchasing decisions. That is, the state cannot refuse to let the utility pass through its wholesale costs based on the unreasonableness of the wholesale rates. However, the state can decide that the utility's decision to pay the wholesale rates was unreasonable in light of the availability of more economical power from alternative sources. The Commission therefore has oversight of power purchases for retail sale. The basis of the "buy" requirement is the Commission's determination that utility purchases through the CalPX are deemed reasonable.[25]

Clearly, it is going to be difficult for the CPUC to contend that the *Pike County* exception to the filed rate doctrine applies to PG&E. PG&E's chances of success appear to be good, based on other decisions that are being issued on other aspects of the California electricity crisis. One such decision is the September 20, 2001, opinion of the Ninth

Circuit in *Duke Energy Trading and Marketing, L.L.C.* v. *Davis*.[26] The decision found that Governor Davis's "commandeering" of various PX contracts was unlawful, given the filed rate doctrine.

In addition to operating its day-ahead market, the PX operated a forward market through its CalPX Trading Services (CTS) division. Both Edison and PG&E entered into block forward contracts offered through the CTS for the delivery of electricity during specified future periods. The PX's rate schedule, approved by the FERC, provided that a "default in the CTS [forward] market will be deemed to be a default in the Core [day-ahead] Market and vice versa."[27] The rate schedule provided that if a participant in the CTS block forward market "fails to pay any sum or to perform any other obligation to CTS or to CalPX when due, then CTS may, in its sole discretion and without further notice to the defaulting CTS Participant or regard to formalities of any kind...do any or all of the following in any order: (e) sell or liquidate as agent or attorney-in-fact for the defaulting CTS Participant, any Matches or cancel any bilateral deliveries it may then hold in the CTS market..."[28]

On January 17, 2001, Edison and PG&E defaulted on their obligations in both the CalPX Core day-ahead market and the CTS forward market. The PX then commenced efforts to sell Edison and PG&E contractual rights for delivery of electricity through 2001 under the utilities' block forward contracts. Governor Davis declared a state of emergency on January 17, 2001, and on February 2, 2001, he issued an executive order "commandeering Edison's block forward contracts to be held subject to the control and coordination of the State of California."[29] On February 5, 2001, Davis issued a similar executive order commandeering PG&E's block forward contracts. By commandeering the contracts, Davis made them available to the state Department of Water Resources, which commenced purchasing electricity from generators after Edison and PG&E ceased to be creditworthy.

Duke Energy Trading and Marketing, LLC, sought injunctive relief against Davis, alleging that the governor's orders commandeering the block forward contracts were preempted by federal law and thus violated the supremacy clause. The Ninth Circuit recognized both the *Nantahala* decision and the filed rate doctrine.[30] The court found that Davis's commandeering orders conflicted with PX tariff provisions that provided for liquidation of the utilities' block forward contracts if the utilities defaulted in making payments for electricity purchased under the contracts. The governor's orders "directly nullify the security and default mitigation provisions of the FERC-approved CTS rate schedules, and hence cross the 'bright line' between state and federal jurisdiction established by the FPA."[31] Moreover, the court found that "Governor Davis could not simply have decreed that [PG&E and Edison]'s debts to their wholesale suppliers be forgiven. And yet his commandeering orders...were the functional equivalent of such an obviously impermissible decree."[32] Further, "Governor Davis's commandeering orders effectively rewrote the terms of the CTS rate schedule, depriving wholesale suppliers such as Duke of their bargained-for collateral and default mitigation rights."[33] Accordingly, the Ninth Circuit remanded the matter to the district court "with instructions that judgment be entered in favor of Duke Energy and that an appropriately tailored injunction against Governor Davis's commandeering orders be entered forthwith."[34] PG&E is likely to be heartened by such decisive language in the Ninth Circuit's *Duke Energy* decision.

THE PG&E BANKRUPTCY

PG&E, however, is not relying exclusively upon its district court lawsuit in its effort to return to creditworthiness. On April 6, 2001, PG&E declared bankruptcy under chapter 11 of the federal Bankruptcy Code, and on September 1, 2001, PG&E submitted a plan of reorganization. In the plan, PG&E observed that it filed for bankruptcy only "after the California Public Utilities Commission...ignored the Debtor's repeated requests to allow it to recover in its retail rates the costs the Debtor was incurring to buy electricity for its customers."[35] PG&E stated that by the date of its bankruptcy petition, April 6, 2001, PG&E had incurred approximately $8.9 billion in procurement costs, including $2.3 billion attributable to PG&E's own generation.

Under PG&E's plan, PG&E would "disaggregate" its operations into four lines of business based on the company's historical functions: retail gas and electric distribution, electric transmission, interstate gas transmission, and electric generation. PG&E would continue to provide retail gas and electric distribution subject to CPUC jurisdiction. Control of the new companies providing electric transmission (ETrans), interstate gas transmission (GTrans), and electric generation (Gen) would be transferred to PG&E's parent, PG&E Corporation, as a result of which the electric transmission, interstate gas transmission, and generation businesses would fall under the exclusive ratemaking jurisdiction of the FERC. PG&E plans to return to creditworthiness by, among other things, paying all "allowed" ISO, PX, and generator claims within 10 days after the confirmation date for the plan. The ISO, PX, and generators are to receive cash for 60 percent of the "allowed" claims and long-term notes issued by ETrans, GTrans, and Gen equal to 40 percent of the claims.[36]

The key to the PG&E plan is the creation of ETrans, GTrans, and Gen and the transfer of jurisdiction over electric transmission, gas transmission, and generation activities from the CPUC to the FERC. On November 30, 2001, PG&E filed a variety of applications at the FERC to put the plan into effect.

The CPUC strongly objects to this diminution of the scope of its jurisdiction under the plan. Federal preemption law is likely to play an important part in determining the ultimate success of the plan. If CPUC approval is required for PG&E's divestiture of its gas transmission, electric transmission, and generation activities, the plan is likely to be stymied. If, however, Judge Dennis Montali—the judge presiding in the PG&E bankruptcy—approves the plan and the approval preempts state action, the plan may succeed.

The precedent established in the Public Service Company of New Hampshire (PSNH) bankruptcy case provided comfort to PG&E that its reorganization plan, if approved by the federal bankruptcy judge, would preempt state agency action. In *In re Public Service Company of New Hampshire*[37] Judge James E. Yacos of the U.S. Bankruptcy Court for the District of New Hampshire addressed whether the federal Bankruptcy Code—particularly 11 USC Section 1123(a)(5)—preempts state regulatory review of restructuring transactions that the PSNH proposed in its chapter 11 plan of reorganization.

Yacos began his discussion of whether Congress intended Section 1123 of the Bankruptcy Code to preempt state regulatory review by examining the history of amendments to the Bankruptcy Code.[38] The judge found that the omission of prior statutory language regarding regulatory approval by public utility commissions from the Bankruptcy Reform Act of 1978[39]—coupled with the retention of similar approval provisions relating to other heavily regulated industries, such as railroads—demonstrated that Congress intended public utility reorganizations to be free from state agency regulation.[40] The subsequent addition of the introductory clause "[n]otwithstanding any otherwise applicable non-bankruptcy law" to Section 1123 also illustrated congressional preemptive intent.[41] Additionally, the judge noted that amendments to chapter 9 of the Bankruptcy Code dealing with municipal reorganizations explicitly included regulatory agencies in the process for approving restructuring plans.[42]

Yacos reviewed the traditional paradigms of federal preemption: express, implied, and conflict preemption. The judge found that Section 1123(a)(5) supports a finding of express preemption, noting that the plain language of Section 1123 speaks for itself. The presumption that Congress says what it means to say applies when specific references to regulatory agency actions appear in other sections of the Bankruptcy Code but are absent from the section at issue.[43]

Yacos also stated that implied preemption could be established due to the fact that New Hampshire's regulatory requirements were an obstacle to Congress's preferred method of achieving bankruptcy reorganizations.[44] The judge rejected arguments that state police powers support allowing the regulatory process to continue. Yacos found that federal preemption is more likely when the state police power involved is economic regulation rather than health or safety.[45]

In addition, the judge found that federal preemption under Section 1123(a)(5) flows naturally from the fact that Congress created a dual regulatory system for public utilities with the enactment of the Federal Power Act.[46] The judge noted that federal laws dealing with public utilities have been held to preempt state regulatory authority.[47] Yacos also reiterated the concerns of other courts that litigation costs and fragmented proceedings in various forums would hamper restructuring in corporate reorganizations.[48]

In a February 7, 2002, memorandum decision in *In re Pacific Gas & Electric Company, Debtor*,[49] U.S. Bankruptcy Court Judge Dennis Montali adopted a more tempered view of the extent to which federal bankruptcy law preempts state law. Although Montali said that he "does not disagree with most of the *PSNH* analysis," Montali did disagree to the extent that Yacos found "that Section 1123(a)(5) explicitly preempts or overrides all contrary nonbankruptcy law."[50] In Montali's view, "there is no express preemption of nonbankruptcy law that permits a wholesale unconditional preemption of numerous state laws...."[51] That would not doom PG&E's disaggregation proposal, however. There was still "at least some preemptive intent" in the Bankruptcy Code, "which would preempt a state regulator's absolute veto power over bankruptcy restructuring."[52] Thus, PG&E's plan could still "be confirmed if Proponents are able to establish with particularity the requisite elements of implied preemption."[53]

Montali asked, "Does the Bankruptcy Code expressly or impliedly preempt California laws so that Proponents may ignore them and seek to obtain confirmation of the Plan?"[54] Montali examined the legislative history of Section 1123 and found no support for the express preemption claimed by PG&E: "The legislative history of Section 1123(a) simply does not support the revolutionary significance that PG&E attributes to the amendment."[55] Moreover, "Congress did not draft Section 1123 as a blanket preemption of state law."[56] Thus, Montali "rejects outright Proponents across-the-board, take-no-prisoners strategy."[57]

However, there still could be implied preemption. Montali found a 1994 Ninth Circuit decision, *Baker & Drake, Inc.* v. *Public Service Commission of Nevada*,[58] to be controlling. Montali thought that a passage in *Baker & Drake* was a "template" for addressing the preemption issue:

> As we view these cases, they suggest that federal bankruptcy preemption is more likely (1) where a state statute facially or purposefully carves an exception out of the Bankruptcy Code, or (2) where a state statute is concerned with economic regulation rather than with protecting the public health and safety.[59]

In Montali's view, the "same principle" had been adopted in *PSNH* when Yacos found that "federal preemption is more likely when the state 'police power' involved is economic regulation rather than health or safety."[60] Montali concluded there were "clear signals" in *Baker & Drake* as well as in *PSNH* "that suggest there can be implied preemption."[61] Furthermore, the reference to "economic regulation rather than...protecting the public health and safety" suggested that a "balancing test" would be appropriate in determining whether or not there was preemption.[62]

Unless Montali's memorandum decision is modified on appeal or by the judge himself, PG&E will not be able to rely on *PSNH* or express preemption of state law as extensively as it thought it could. PG&E still has a chance of prevailing on preemption grounds, however, if it meets Montali's balancing test. "At this stage," Montali observed, "the court cannot say as a matter of law that Proponents will be unable to establish implied preemption of otherwise applicable state laws at the confirmation hearings."[63] Thus, federal preemption may still play a prominent role in PG&E's bankruptcy as well as in PG&E's district court action against the CPUC.

ANTITRUST CASES

Preemption law is also likely to play an important role in deciding a set of cases that involve electricity generators. A number of antitrust cases[64] have been filed in California courts alleging that generators that sold into the wholesale electric market have violated either California's antitrust statute, the Cartwright Act,[65] or the California Unfair Competition Law.[66] The cases are coordinated in San Diego Superior Court as *Wholesale Electricity Antitrust Cases I and II*.[67] The plaintiffs contend that the defendant generators, either unilaterally or through concerted action, manipulated prices charged in the PX and ISO wholesale markets.

The central problem facing the plaintiffs is that the defendants' power transactions were made pursuant to tariffs approved by the FERC. The tariffs established the price-setting mechanisms for the PX and ISO markets. The FERC reviewed and approved the tariffs as a means of achieving "just and reasonable" rates before it permitted the PX and ISO markets to operate:

> Here, the central transactions, wholesale sales of energy and interstate commerce, were governed by FERC-approved rules and FERC jurisdictional ISO and PX. Those transactions thus fall within FERC's jurisdiction.... Further, the centralized wholesale spot electricity markets operated by the California ISO and PX were established (and had been modified) subject to FERC review and approval.[68]

The plaintiffs seek lower rates through damages. Relief apparently would be the difference between 1) the price actually charged and filed with the FERC and 2) the price that allegedly would have existed but for the defendants' wrongful conduct. The question of whether the generators should make refunds, however, is up to the FERC, not state courts.

The actions in state court were filed in late 2000 and early 2001. After removal to federal court, the cases were consolidated and assigned to U.S. District Judge Robert Whaley, sitting by designation in the Southern District of California. The plaintiffs filed motions to remand to state court. On July 31, 2001, Whaley remanded the cases to state court. The judge adopted the plaintiffs' argument that the filed rate doctrine and preemption defenses could be raised and decided in state court as well as in federal court. However, Whaley noted that the filed rate doctrine and federal preemption may provide an "absolute defense" to the plaintiffs' claims.[69] He observed that under the filed rate doctrine, "a plaintiff may not recover damages on the theory that anticompetitive activities artificially inflated the rates charged for a good or a commodity when the rates charged were submitted and approved by the appropriate federal agency."[70]

The defendant generators argue that under the filed rate doctrine, claims challenging rates subject to federal agency jurisdiction are nonjusticiable in any court.[71]

Courts enforce this nonjusticiability rule to preserve the exclusive jurisdiction of federal agencies and to protect the congressional goal of uniform interstate regulation.[72] The filed rate doctrine thus requires all courts to "give effect to Congress' desire to give FERC primary authority over interstate wholesale rates, and to ensure that the rates do not interfere with this authority."[73] A court observed, "The filed rate doctrine prohibits a party from recovering damages measured by comparing the filed rate and the rate that might have been approved...."[74] Another stated, "It would undermine the congressional scheme of uniform rate regulation to allow a state court to award as damages a rate never filed with the Commission and was never found to be reasonable within the meaning of the [Federal Power] Act."[75]

The plaintiffs in the antitrust cases seem to contend that the filed rate doctrine may not apply insofar as the generator defendants were charging market rates. However, the FERC has found that the filed rate doctrine applies equally to market-based rates: "The filed rate doctrine and its corollary, the rule against retroactive ratemaking, apply to market-based rates."[76]

Thus, while federal preemption seems to be a key to Edison and PG&E working their way out of the consequences of the restructuring of the operation of California utilities, it may be even more decisive in precluding antitrust actions in California state court against generators. As a result of the application of federal preemption law, many of the issues lingering from the electricity crisis of 2000-2001 are likely to be resolved in 2002. ■

[1] Decision 95-12-063, 64 CPUC 2d 1, *as modified by* Decision 96-01-009, 64 CPUC 2d 228.
[2] 1996 Cal. Stat. 854, effective Sept. 24, 1996, codified in relevant part at PUB. UTIL. CODE §§330-398.5 (2001).
[3] PUB. UTIL. CODE §330.
[4] *Id.*
[5] Southern Cal. Edison Co. v. Lynch, No. 00-12056-RSWL, Complaint for Plaintiff (C.D. Cal. Nov. 13, 2000).
[6] Pacific Gas & Elec. Co. v. Lynch, No. 01-3023 (N.D. Cal. Aug. 6, 2001).
[7] Southern Cal. Edison, No. 00-12056-RSWL, Complaint for Plaintiff, at 10.
[8] *Id.*
[9] Montana-Dakota Utils. Co. v. The Northwestern & Pub. Serv. Co., 341 U.S. 246, 251-52 (1951).
[10] *Id.* at 251-52.
[11] *Id.*
[12] Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571 (1981).
[13] Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953 (1986).
[14] *Id.* at 966 (citations omitted).
[15] *Id.* at 970 (citation omitted).
[16] Pacific Gas & Elec. v. Lynch, slip. op. at 39 (C.D. Cal. May 2, 2000).
[17] Pacific Gas & Elec. v. Lynch, No. 01-3023 (N.D. Cal. 2001), Complaint for Plaintiff, at 1.
[18] *Id.* at 2.
[19] The Federal Power Act, 16 U.S.C. §§824 *et seq.*
[20] Decision 95-12-063, *supra* note 1.
[21] San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs. into Markets Operated by the Cal. Sys. Operator Corp. and the Cal. Power Exch., Docket No. EL00-95-004.
[22] Pike County Light & Power Co. v. Pennsylvania Pub. Utils. Comm'n, 77 Pa. Commw. 268, 273-74, 465 A. 2d 735, 737-38 (Pa. Commw. Ct. 1983).
[23] Decision 95-12-063, *supra* note 1.
[24] Final Opinion Regarding Policies Related to Post-Transition Ratemaking, Decision 00-06-034, 2000 Cal. PUC LEXIS at *57 (June 8, 2000).
[25] *Id.* at *71, n. 27.
[26] Duke Energy Trading & Marketing, L.L.C. v. Davis, 267 F. 3d 1042, 1046 (9th Cir. 2001).
[27] *Id.* at 1046.
[28] *Id.* (citing PX CTS Rate Schedule §6.7.6).
[29] *Id.* at 1047.
[30] *Id.* at 1056 (citing Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953, 966 (1986)).
[31] *Id.*
[32] *Id.* at 1057.
[33] *Id.*
[34] *Id.* at 1059.
[35] In re Pac. Gas & Elec. Co., No. 01-30923, Plan of Debtor, at 3 (Bankr. N.D. Cal. Sept. 20, 2001).
[36] *Id.*, Plan of Debtor, at 81.
[37] In re Pub. Serv. Co. of New Hampshire, 108 B.R. 854 (Bankr. D. N.H. 1989).
[38] *Id.* at 863.
[39] The Bankruptcy Reform Act of 1978, 11 U.S.C. §§101 *et seq.*
[40] In re Pub. Serv. Co. of New Hampshire, 108 B.R. 854, 864-65.
[41] *Id.* at 865.
[42] *Id.* at 865-66; 11 U.S.C. §943(b)(6).
[43] In re Pub. Serv. Co. of New Hampshire, 108 B.R. at 888.
[44] *Id.* at 882-85.
[45] *Id.* at 870 (citing LAURENCE TRIBE, AMERICAN CONSTITUTIONAL LAW 437 (2d ed. 1988)); *see also* Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528 (1985) (abandoning the distinction between traditional and nontraditional state powers in the preemptive context).
[46] In re Pub. Serv. Co. of New Hampshire, 108 B.R. at 889.
[47] *Id.* at 890.
[48] *Id.*
[49] In re Pac. Gas & Elec. Co., Debtor, 2002 Bankr. LEXIS 122 (N.D. Cal. Feb. 7, 2002), Memorandum Decision Regarding Preemption and Sovereign Immunity.
[50] *Id.* at *45.
[51] *Id.* at *3.
[52] *Id.* at *46.
[53] *Id.* at *4.
[54] *Id.* at *17.
[55] *Id.* at *37.
[56] *Id.* at *34.
[57] *Id.* at *69.
[58] Baker & Drake, Inc. v. Public Service Comm'n of Nevada, 35 F. 3d 1348 (9th Cir. 1994).
[59] *Id.* at 1353.
[60] In re Pub. Serv. Co. of New Hampshire, 108 B.R. 854, 869 (Bankr. D. N.H. 1989).
[61] In re Pac. Gas. & Elec. Co., Debtor, 2002 Bankr. LEXIS 122, at *23.
[62] *Id.*
[63] *Id.* at *56.
[64] *See* Gordon v. Reliant Energy, San Diego Sup. Ct. No. GIC758487; Hendricks v. Dynegy Power Mktg., Inc., San Diego Sup. Ct. No. GIC 758565; Sweetwater Auth. v. Dynegy Inc., San Diego Sup. Ct. No. GIC 760743; The People of the State of Cal. v. Dynegy Power Mktg. Inc., San Francisco Sup. Ct. No. 318189; Pier 23 Rest. v. Pac. Gas & Elec. Energy Trading, San Francisco Sup. Ct. No. 318343; Bustamante v. Dynegy Inc., Los Angeles Sup. Ct. No. BC249705.
[65] The Cartwright Act, BUS. & PROF. CODE §§16720 *et seq.*
[66] The California Unfair Competition Law, BUS. & PROF. CODE §§17200 *et seq.*
[67] Wholesale Electricity Antitrust Cases I and II, JCCP Nos. 4204 and 4205.
[68] San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Serv., 96 F.E.R.C. ¶61,120, at 61, 513 (July 25, 2001).
[69] Hendricks v. Dynegy Power Mktg., Inc., 160 F. Supp. 2d 1155, 1165 (S.D. Cal. July 31, 2001).
[70] *Id.* at 1165.
[71] Markus v. AT&T Corp., 138 F. 3d 46, 58, 61 (2d Cir. 1998).
[72] *See, e.g.*, County of Stanislaus v. Pacific Gas & Elec. Co., 114 F. 3d 858, 862 (9th Cir. 1997), *cert. denied*, 522 U.S. 1076 (1998).
[73] Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953, 966 (1986).
[74] H. J. Inc. v. Northwestern Bell Tel. Co., 954 F. 2d 485, 488 (8th Cir. 1992).
[75] Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571, 579, 101 S. Ct. 2925 (1981).
[76] San Diego Gas & Elec. Co. v. Sellers, 96 F.E.R.C. ¶61, 120, at 61,506 (July 25, 2001).