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# "Federal Pre-emption in Energy Regulation"

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The major blackout in the northeastern states in August 2003 brought the energy situation in the United States once again to the forefront of the newspapers and the public minds. As described by the U.S. Department of Energy, on August 14th the northeastern U.S. and southern Canada suffered the worst power blackout in history. Areas affected ran from New York to Michigan and Ohio to Toronto and Ottawa, Ontario. The blackout impacted approximately 50 million customers at tremendous costs to the economy in that area. Some groups have been predicting that such a blackout would/could occur. Many placed the blame on an aging electric infrastructure and federal and state regulatory programs which were seeking to reduce the costs of power to consumers but were not ensuring the reliability of that power. Whatever position one takes, that blackout brought again to the front page of newspapers throughout the world the importance of electric power, and energy generally, to the economies of the U.S. and Canada, and of much of the world.

Why is this relevant to an analysis of pre-emption in the energy industry? Because it is this type of event which causes politicians to seek quick fixes to avoid such occurrences in the future. Such an event causes federal regulators to immediately call for legislative hearings to determine what was the cause and try to affix blame. And, those hearings and investigations will put more pressure on achieving a federal solution – which may result in reduced authority to the states – because of the regional/national nature of the impacts.

The purpose of this paper is to focus on the element of pre-emption of federal law over state and local law as related to current energy regulation and proposed new legislative and regulatory initiatives.

## Overview

The energy industry has been in an evolutionary process for several decades – through Congressional action and federal regulatory initiatives – with the regulatory goal stated as seeking to achieve more efficiency, greater transparency between energy suppliers and service providers and consumers, and increased cost-benefits to consumers. states have responded in varying ways to the federal actions. In prior IMLA papers the author has discussed in more detail the evolution of the gas and electric industries over the past decade, and the varying attempts to achieve modifications to the energy regulatory scheme through federal legislation.[1]

New legislation currently being considered by Congress would increase federal pre-emption of energy regulation, particularly in the electric industry, in an effort to push further the evolutionary process. In addition, in attempting to continue the process of changing the energy industry, the chief federal energy regulator, the Federal Energy Regulatory Commission ("FERC") has considered and proposed certain initiatives that would further pre-empt state authorities in the electric industry. While these efforts in Congress and at FERC are new, the issue of pre-emption has been present in the natural gas industry and hydroelectric industry for decades, providing a framework to consider the new pre-emption efforts. Even with new

[1] *See, e.g.,* "Restructuring of the Energy Industry: Local Governments as Consumer Aggregators – Evolving state and federal Law," IMLA 2000 Annual Meeting (August 2000); "Responding to Utility Restructuring: A Non-Owner's Perspective," IMLA 1999 Annual Meeting (September 1999); "Utility Deregulation Today And In The Future: Major Issues Caused By Utility (Electric & Gas) Restructuring," IMLA 1999 Mid-Year Seminar (April 1999); "Where Utility Deregulation is Today: A Multi-state Review," IMLA 1997 Annual Conference (November 1997); "The Evolving Gas and Electric Power Industries: New Opportunities for Local Governments," IMLA 1996 Annual Meeting (October 1996); "Local Governments as Utility Operators, Regulators and Energy Users: A New Regulatory Scheme," IMLA 1996 Mid-Year Seminar (April 1996).

legislation and new regulatory actions, the issues raised by increased pre-emption are not likely to be resolved quickly.

## Background on Energy Regulation Pre-emption

Briefly stated, an analysis of pre-emption in the context of energy regulation begins with the Commerce Clause of the U.S. Constitution. Under Article I, Section 8, Clause 3, the Constitution states: "The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several states, and with the Indian Tribes; . . . Article VI, Clause 2 of the Constitution further provides: "This Constitution, and the Laws of the United states which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every state shall be bound thereby, any Thing in the Constitution or Laws of any state to the Contrary notwithstanding."

In 1920, Congress enacted the federal Water Power Act which established federal jurisdiction in the predecessor to the FERC (*i.e.*, the Federal Power Commission) over the licensing of hydroelectric projects affecting federal lands or navigable waters or projects using the surplus water or waterpower of a federal dam. In 1935, the Federal Water Power Act was redesignated Part I of the new Federal Power Act which added federal jurisdiction over the interstate transmission of electric power, the wholesale sales of power, and the utilities engaged in such transmission and sales. In a similar manner, in 1938 Congress passed the Natural Gas Act which established federal jurisdiction, also in the predecessor to the FERC, over the interstate transmission of natural gas (including certificate authorizations to construct and operate, and rate regulation), the sales for resale of natural gas in interstate commerce, and the companies that performed such activities.

Subsequently, the Natural Gas Act was amended to grant to companies that received a certificate to construct and operate a natural gas pipeline the right of eminent domain – to obtain pipeline rights-of-way. Note that because the Federal Power Act did not establish federal regulation over the construction of electric transmission lines, there was no parallel provision in the Federal Power Act. Under the Natural Gas Act and Federal Power Act, as subsequently

amended, states and municipalities were exempted from federal regulation. Legislation over the years has amended the Federal Power Act and Natural Gas Act, which form the cornerstone of federal regulation of energy. However, the federal jurisdiction over electric transmission has never been extended to the certification of transmission lines or the right of eminent domain.

It is well established through Supreme Court cases that the FERC's regulatory authority (and that of its predecessor agency) pre-empts the field of energy regulation – with respect to the licensing of hydroelectric projects on navigable waters,[2] with respect to interstate transmission and sales of natural gas,[3] and with respect to the regulation of interstate electric power transmission and wholesale power rates.[4] Based on the pre-emption by the Natural Gas Act and the Federal Power Act, and the bar to state action under the Commerce Clause, the federal government has generally been viewed as occupying the field of law. However, as the Courts have noted, not every state statute that had some indirect effect on interstate energy is pre-empted, and not every federal regulatory initiative is covered by the federal occupation of the energy field.

## Existing Federal Energy Regulation Pre-emption

As described above, under the Natural Gas Act the federal government has jurisdiction over the siting of interstate natural gas pipelines, and the issuance of a certificate to construct and operate an interstate natural gas pipeline provides the right of eminent domain to facilitate acquisition of the right-of-way necessary for such construction. However, the FERC has not attempted to preclude state and local governments from enforcing their own requirements. In fact, the FERC's certificates for construction of interstate pipeline facilities generally require confirmation of compliance with applicable state and local requirements. Given the potential for the addition of eminent domain to the federal electric regulatory authority under currently

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[2] *See, e.g., First Iowa Hydro-Electric Cooperative v. FPC*, 328 U.S. 152 (1946).
[3] *See, e.g., Illinois Gas Co. v. Central Illinois Public Service Co.*, 314 U.S. 498 (1942); *Northern Natural Gas Co. v. state Corporation Commission of Kansas* [372 U.S. 84 (1963)].
[4] *See, e.g., New York v. FERC*, 535 U.S. 1 (2002) ("*New York* case").

pending legislation, as discussed below, the FERC's policy on interstate natural gas facilities and the use of eminent domain may become very relevant to the electric industry.

The FERC's policy on interstate natural gas facilities has been to recognize the importance of state and local determinations on safety and environmental concerns, so long as such requirements and/or determinations do not undermine the force and effect of the federal certificate. Therefore, the FERC has found that the Natural Gas Act pre-empts state and local laws to the extent that enforcement of such laws or regulations would conflict with the exercise of the FERC's Natural Gas Act jurisdiction. Furthermore, according to the FERC's interpretation of the Natural Gas Act provisions, the state or local government cannot apply its regulations in a manner which undermines the force and effect of a certificate issued under the Natural Gas Act – by prohibiting or unreasonably delaying the authorized construction. This has posed significant concerns to state and local governments; however, the issue has been generally resolved through compromise and most disputes have not found their way into the courts. Case law has provided the basic concepts to be applied, but the exact balance between the federal pre-emption with respect to natural gas pipeline certificates and the state/local government concerns is not established and is very fact-dependent.

Once the FERC has issued a certificate for the interstate pipeline, under the Natural Gas Act the pipeline certificate holder can take necessary rights-of-way through eminent domain proceedings (in the local federal or state courts). However, under FERC policy and court precedents, the issue of the public interest in such condemnation has been decided by the FERC's issuance of the certificate. Therefore, essentially the FERC decides the balance between the "public interest" of the new pipeline construction and the potential state and local interests potentially opposing such construction for interstate natural gas facilities.

As noted above, while the FERC holds certificate jurisdiction over interstate natural gas pipelines, FERC does not hold certificate jurisdiction over interstate electric transmission lines. Therefore, siting of electric power lines is subject to state jurisdiction – which could be troublesome in a national electric power grid, as contemplated by federal regulators. Thus, as

discussed further below, Congress is considering giving to FERC additional authority over the siting of interstate power transmission lines.

Further, as mentioned above, the energy industry has been in a period of evolution, particularly over the past 28 years, since enactment of the multi-faceted National Energy Acts of 1978 and the Energy Policy Act of 1992. Through a number of regulatory initiatives particularly since 1992, the FERC has attempted to open up electric and natural gas markets to increased competition. But the FERC's jurisdiction does not cover local distribution of natural gas or electric power; under current law, states have retained such jurisdiction. Therefore, the FERC's initiatives have been limited in their ability to effect broad competition. This constraint has been viewed as particularly problematic with respect to the electric power industry, which depends on an extensive grid with connecting power lines crossing numerous state boundaries.

As part of its continuing evolution of the electric power industry,[5] and in response to the *New York* case, last year the FERC proposed to implement a new initiative for the electric industry termed standard market design ("SMD") in an effort to remedy undue discrimination and other impediments to creating a "robust" regional power markets.[6] While some entities supported the FERC's proposed actions, others argued that the proposed rule far exceeded the FERC's jurisdiction under the Federal Power Act, and impinged on state regulatory authorities. In April 2003, the FERC modified its proposed actions in its "White Paper on Wholesale Power Market Platform." In that White Paper, the FERC indicated it would not assert jurisdiction over the transmission component of bundled retail services, would not infringe on state jurisdiction over resource adequacy requirements and regional transmission planning requirements, would look to regional state committees to determine how firm transmission rights are allocated, would

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[5] As a follow-up to its prior Order No. 888, *et seq.* [FERC Stats. & Regs. ¶ 31, 036 (1996) (and subsequent related orders); and Order No. 2000, *et seq.* [FERC Stats. & Regs. ¶ 31, 089 (1999) (and subsequent related orders).

[6] *See, Remedying Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design*, Notice of Proposed Rulemaking, Docket No. RM01-12, issued July 31, 2002.

phase-in implementation, and would look to the regional transmission organizations ("RTOs") or independent system operators ("ISOs") and the regional state committees to determine the appropriate regional approach for allocating the costs of new transmission. These 'clarifications' by the FERC as to where it is planning on going in a final rule on these issues have softened the objections, but some entities still believe the FERC is seeking to expand its jurisdiction under the Federal Power Act.

## Potential Federal Electric Legislation

Since issuance of the FERC initiatives over the past decade, the states have responded at varying speeds in requiring their local utilities to provide separate delivery and commodity services, and in permitting customers to choose their energy suppliers. Given the disparate responses by the states, Congress has debated over the past decade whether it should mandate an affirmative state response within a time certain, but has reached no resolution of the issue. As a result, the federal regulators have become frustrated with the limitations to their ability to implement a competitive national market particularly for electric power.

Last Fall, the Senate passed comprehensive energy legislation addressing many issues including natural gas and electric power regulation (S. 517). However, the House failed to pass its own version of such legislation before adjournment. This April, the House passed a broader energy bill (H.R. 6) – and in July the Senate retreated to its bill passed last Fall, rather than lose the opportunity to pass any energy legislation at all this term. As described in more detail below, the House bill contains a number of pre-emption provisions; the Senate bill is considerably more scaled back in this area.

Under the two proposed bills, there are six areas where pre-emption is an issue: (1) electric facility siting/eminent domain; (2) open access requirements on public power utilities; (3) FERC jurisdiction over wholesale power terms and conditions in an unbundled wholesale market; (4) the refund potential in bundled sales; (5) a requirement vs. voluntary directive for utilities to join an RTO; and (6) a deferral of the FERC's original SMD proposed rule.

On the issue of transmission line siting, as described by Secretary of Energy Spencer Abraham recently, the modernization of the electric power grid may cost consumers $50 billion and will likely involve 30,000 miles of new high-voltage transmission lines over the next decade. Local opposition to such power lines is expected – and, thus, the reason for the legislative provision on siting, which gives power to the federal government to approve siting of interstate transmission lines where a state does not have the power to grant such rights-of-way or has failed to grant such authority despite congestion. To facilitate such transmission line construction, the House bill would provide the right of eminent domain to a utility granted authority for construction – much the same as currently exists for natural gas pipelines, as discussed above.

The House and Senate bills now are in conference – where representatives from the Senate and the House leadership are attempting to craft a bill that will pass both houses and can be signed by the President. In addition, House and Senate leadership has indicated it may even extend the current proposed legislation by addressing (through the conference committee) matters such as blackout countermeasures including strengthened reliability provisions. These additional matters may raise additional pre-emption concerns which will be discussed at the IMLA Annual Conference.

## Conclusion

The tension between federal and state regulation of the energy industry will continue, even after passage of a comprehensive energy bill this year (if the conferees can reach agreement, and such bill becomes law). The goal stated by the Congressional leadership is to achieve a compromise energy bill before the end of the year – whether it can be done is open to debate. However, perhaps the August 2003 blackout provided the necessary nudge to stimulate a compromise. If legislation is enacted, the forum for discussion of such issues will likely focus at the FERC, as the agency attempts to implement the federal legislation. Based on the strong positions taken to-date in the pre-emption debate, there will also likely be court actions, contesting the legislation and FERC's implementation.