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In a seven-to-two decision, the Supreme Court this year opened the door for more exceptions to circumstances where federal regulation prevents application of state antitrust laws. Under *Oneok v Learjet*, the court held that claims of natural gas purchasers under a state's antitrust laws are not barred by federal 'field preemption,' even though the Federal Energy Regulatory Commission (FERC) had authority to regulate the conduct that caused the damage.[1]

Congress passed the Natural Gas Act (NGA) in 1938.[2] That Act strikes a delicate balance between state and federal areas of control over the natural gas industry. The NGA gives the FERC jurisdiction to regulate the rates pipeline companies charge to wholesale distributors engaged in interstate commerce. To enhance the FERC's ability to regulate those rates, the NGA also gives it the authority to regulate 'any rule, regulation, practice or contract affecting such rate.' In *Oneok*, the Supreme Court was asked to decide whether the NGA occupies the field of natural gas pipeline regulations so pervasively that the California antitrust laws are barred by federal field pre-emption when applied to pipeline companies.

The NGA grants federal authority to FERC to regulate the transfer of natural gas from the pipeline company to the wholesaler, but it leaves within the domain of state control the transfer from the drilling company to the pipeline company and the sale from the wholesaler to the retailer.[3] In general, this scheme reflects the way most natural gas is brought to the consumer. The method of transporting natural gas to the consumer begins with a drilling company, which extracts the resource and sells it to the pipeline company, which then transports the natural gas and sells it to a wholesaler, which then sells it to a retailer.[4] The middle step in the transaction may be regulated federally, if in interstate commerce, while the first and last steps are regulated by the states, which creates significant questions regarding the federal field pre-emption doctrine.

The plaintiffs in *Oneok* were California commercial consumers who purchased natural gas directly from the pipeline company as opposed to a local retailer. They contended that the pipeline companies engaged in a conspiracy to manipulate natural gas indices, which artificially inflated the rate they paid. The alleged index-price manipulation 'affected both federally regulated wholesale natural-gas prices and non-federally regulated retail natural gas prices.'[5]

The plaintiffs chose to sue under California antitrust law rather than the Sherman Act, probably because the state laws they sued under allow as a remedy not merely 'treble damages' (ie, three times the amount by which prices were artificially inflated), but the full consideration paid for the products at issue. This means that in a hypothetical situation where the alleged misreporting caused prices that 'should have been' US$3 per mmBtu to be US$3.02 per mmBtu, the Sherman Act antitrust remedy would be $0.06 per mmBtu (the rate differential of US$0.02, trebled), while the California state law full-consideration remedy would be the full US$3.02 per mmBtu, a 50 times greater recovery.

The plaintiffs filed their complaint in California state court and the defendants removed the matter to federal court on the ground that the claims were completely preempted by federal law. The district court granted summary judgment for defendants, finding that the NGA pre-empted the state antitrust claim. The doctrine of field pre-emption, which is what the district court invoked in dismissing the action, stems from the Supremacy Clause of the United States Constitution, which stipulates that federal law 'shall be the supreme law of the land'.

There are two types of pre-emption. Field pre-emption occurs when Congress has expressed an intent to occupy an entire field, thus barring state regulation in that field, even if the regulation is complementary to the federal occupation.[6] Field pre-emption is a distinct doctrine from conflict pre-emption. Conflict pre-emption is also used to invalidate state laws, but it applies only when enforcement of the challenged state law would frustrate enforcement of the federal law.[7] The Ninth Circuit reversed the district court's decision and the defendants petitioned the Supreme Court to hear the matter.[8]

Arguments before the Supreme Court

The defendants argued before the Supreme Court that the application of state antitrust laws to natural gas pipeline companies is impermissible because Congress intended to occupy the entire field of wholesale natural gas rates and therefore, there is no room for additional state regulation. Specifically, section 717d of the NGA gives the FERC the authority not only to set rates for natural gas pipeline companies, but also to regulate any practice that effects those rates. The defendants claimed that because the activity sought to be regulated by the California antitrust laws directly affected wholesale rates, the case fell under the umbrella of § 717d.

Although the alleged activity in question also affected retail rates and retail purchasers brought the action, the defendants argued that under *Federal Power Commission v Louisiana Power & Light Co*, the FERC has the sole authority to regulate activity that affects both retail and wholesale rates. The defendants also relied heavily on *Northern Natural Gas Co v State Corporation Commission of Kansas* and *Schneidewind v ANR Pipeline Co* for the proposition that when a state action has the effect of regulating a practice that directly affects the federally regulated rates charged by the pipeline companies, that action is pre-empted by the NGA. The defendants explained that states could still regulate activity that 'is only tangentially related to jurisdictional rates.'[9] This limitation, they urged, would sufficiently ensure that states retained the ability to properly regulate the areas of the industry that are left to their control.[10]

The plaintiffs argued that the NGA was not intended to 'dilute in any way' pre-existing state power, and stressed the importance of preserving robust state participation in the regulation of the industry, as states are given significant responsibility under the NGA.[11] They claimed that because California was only attempting to regulate the retail side of the industry through a generally applicable state antitrust law, the law should not be pre-empted simply because it also affects the rates charged by the pipelines to wholesalers.

The plaintiffs also cited *Northern Natural* to buttress their claim that as long as the state in question was not attempting to regulate the wholesale rate, the regulation was permissible even if it had the unintended effect of affecting the wholesale rate. They pressed that the NGA was only intended to fill the regulatory gap left by several Supreme Court decisions in the early 20th century that held the Commerce Clause prohibited states from regulating wholesale sales or interstate transportation of natural gas.[12] They concluded by arguing that if the court did not rule in their favour, then natural gas sellers would be allowed 'to insulate themselves from virtually any state law simply by pegging wholesale prices to that law.'[13]

Rationale of the Supreme Court

The Supreme Court affirmed the Ninth Circuit by a seven-to-two vote. Justice Breyer wrote the opinion for the court, which was joined in full by five other justices and in part by Justice Thomas. The court began by emphasising that the Natural Gas Act 'was drawn with meticulous regard for the continued exercise of state power, not to handicap or dilute it in any way.'[14] In light of that congressional purpose, the court explained that it 'must proceed cautiously, finding pre-emption only where detailed examination convinces [the Court] that a matter falls within the pre-empted field as defined by [the Court's] precedents.'[15]

Turning to those precedents, the court read its cases to 'emphasize the importance of considering the target at which the state law aims in determining whether that law is pre-empted.'[16] According to the court, 'the significant distinction for purposes of pre-emption in the natural-gas context is the distinction between measures aimed directly at interstate purchasers and wholesales for resale, and those aimed at subjects left to the States to regulate.'[17] In this case, the court concluded, 'the lawsuits are directed at practices affecting retail rates – which are firmly on the States' side of that dividing line.'

In support of that conclusion, the court pointed to a footnote in *Schneidewind v ANR Pipeline Company*,[18] which the court paraphrased as stating that 'the Natural Gas Act does not pre-empt 'traditional' state regulation, such as state blue sky laws.'[19] The court reasoned that '[a]ntitrust laws, like blue sky laws, are not aimed at natural-gas companies in particular, but rather all businesses in the marketplace.' In the court's view, '[t]his broad applicability of state antitrust law supports a finding of no pre-emption here.'

The court also distinguished two other cases – *Mississippi Power & Light Co v Mississippi ex rel Moore*[20] and *FPC v Louisiana Power & Light Co*.[21] According to the court, both of those cases are best read as resting on principles of conflict pre-emption, not field preemption.[22] And so in the court's view, those two cases did not aid petitioners' field-preemption argument. The court emphasised, however, that because 'the parties have not argued conflict pre-emption,' the court was 'leav[ing] conflict pre-emption questions for the lower courts to resolve in the first instance.'[23]

Finally, the court concluded that although 'FERC has promulgated detailed rules governing manipulation of price indices,' the defendants and the Solicitor General had 'not pointed to a specific FERC determination that state antitrust claims fall within the field pre-empted by the Natural Gas Act'. The court thus declined to 'consider what legal effect such a determination might have.' It also 'conclude[d] that the detailed federal regulations here do not offset the other considerations that weigh against a finding of pre-emption in this context.'[24]

Justice Thomas wrote separately to reiterate his reservations about 'implied pre-emption doctrines.'[25] In particular, Justice Thomas expressed 'doubts about the legitimacy of this Court's precedents concerning the pre-emptive scope of the Natural Gas Act.' Justice Thomas agreed, however, that 'even under these precedents, the challenged state antitrust laws fall outside the pre-empted field.' Accordingly, he concurred in the court's judgment and joined all but the part of the majority's opinion discussing general principles of implied pre-emption.

The consequences of the court's decision

The court's ruling in *Oneok* may make it more difficult for natural gas pipeline companies to comply with relevant law. As Justice Scalia pointed out in his dissenting opinion, the court 'smudges' what had previously been understood to be a bright line between state and federal fields of regulation.[26] This 'smudging' of a bright-line rule is particularly worrisome for pipeline companies that must now answer not only to the FERC, but also to additional state entities. The burden now falls on those companies to decide which state regulations 'target' the wholesale rate and which only affect that rate without targeting it. This uncertainty will force the industry to make difficult decisions when their operations fall within the grey area created by the court. The dissent was correct in its observation that '[t]he Court's all-things-considered test does not make for a stable background against which to carry on the natural gas trade.' The court's rejection of the bright line rule, which said that if the state law had a direct effect on wholesale rates, it was pre-empted, is an undesirable development because the pipeline industry's ability to accordingly plan business strategy has been compromised. This development means that more risk-averse pipeline companies may be less inclined to fully participate in the market.

In addition to creating confusion, the court also muddied the water on its precedents, which had held that if the FERC has jurisdiction to regulate a subject then the states do not. In dissent, Justice Scalia remarked that the court has, 'made a snarl of our precedents,' which he believes have never held that States were intended to share the ability to regulate practices affecting wholesale rates. The court's departure from precedent may create disagreements among the lower courts as they attempt to decide which state laws do and do not 'aim' at the wholesale rate. They also must decide if the state regulation comes from a 'traditional area of state regulation' or is of 'general applicability' and how those factors should weigh in the analysis, on which the court gives little guidance.[27]

The court has, in essence, replaced a bright-line rule with an ad-hoc analysis that weighs heavily in favour of state law occupying the field, so long as no conflict exists. This test is friendly to parties seeking to enforce state regulations as it appears that they now must only frame their suits to challenge the effect of the alleged misconduct at the retail level. Because the crux of the inquiry now focuses mainly on conflict pre-emption, there is no way to resolve differences between differing states' regulations because conflict pre-emption only applies when there is conflict between state and federal law.[28] This patchwork scenario is clearly not the intention of the writers of the NGA, who intended the Act to create 'uniformity of regulation.'[29]

Although the court made clear that state antitrust laws aimed at regulating retail rates are not pre-empted by the NGA, there is an open question as to what other types of state regulation may be on the table for future litigation. The dissent points out several scenarios that may foreseeably arise in the future following *Oneok*: 'May States aim at retail rates under laws that share none of the features of antitrust law advertised today? Under laws that share only some of those features? May States apply their antitrust laws to pipelines without aiming at retail rates?'[30] Of those concerns, the second

appears the most worrying for pipeline companies and lower courts as they attempt to develop a workable framework for evaluating the applicability of state laws. An important question remains regarding a state law aimed at retail rates, but not of general applicability.

There is little doubt that courts and businesses will struggle to answer some of the questions that *Oneok* leaves open. Justice Scalia's concern in his dissent regarding the applicability of state laws to pipelines without aiming at retail rates is also relevant, because the 'aim' of the law is, according to the court, the crux of the evaluation for a field pre-emption question. In *Oneok*, the state aimed to regulate the retail side of the process, but it is easy to imagine a state's attempting to regulate the sale from the drilling company to the pipeline company through a similar vehicle of generally applicable state law. While that sale could surely affect the wholesale rates, would it also not be pre-empted under *Oneok*?

Conclusion

The Supreme Court's decision in *Oneok* is not only a significant alteration of the court's field preemption and NGA precedent, but also a decision carrying large practical ramifications for the natural gas industry. Moving forward, courts will begin to define what constitutes the 'aim' of an action and whether that action is 'aimed' at a permissible area of state control. *Oneok* creates significant uncertainty, which state lawmakers, lower federal courts and most of all, natural gas pipeline companies will struggle to follow.

Notes

1 *Oneok v Learjet*, 135 S. Ct. 1591, 1601 (2015).
2 15 USC § 717 (1938).
3 *Learjet*, 135 S Ct. at 1604 (Scalia, J, dissenting).
4 Id 1603-04.
5 Id at 1594.
6 *Arizona v United States*, 132 S. Ct. 2492, 2502 (2012).
7 Id at 2496.
8 Id.
9 Brief For Petitioners at 41 *Oneok v Learjet,* 135 S. Ct. 1591 (2015) (No. 13-271).
10 Id at 43.
11 Brief For Respondents at 16 *Oneok v Learjet,* 135 S. Ct. 1599 (2015) (No. 13-271) (citing *Panhandle Eastern Pipe Line Co v Public Serv Comm'n of Ind*, 332 US 507, 517-518 (1947)).
12 *Oneok*, 135 S. Ct. 1595.
13 Brief For Respondents at 32 *Oneok*, 135 S. Ct. at 1591.
14 *Oneok*, 135 S. Ct. at 1601.
15 Id at 1599.
16 Id.
17 Id at 1600.
18 485 US 293 (1988).
19 *Oneok*, 135 S.Ct. at 1600.
20 487 US 354 (1988).
21 406 US 621 (1972).
22 Id at 1601-02.
23 Id at 1602.
24 Idat 1603.
25 Id (Thomas, J, concurring).
26 Id at 1603.
27 *Oneok*, 135 S. Ct. 1592.
28 The potential for differing standards under state law is not merely hypothetical. In a somewhat analogous situation, the Supreme Court held recently that pharmaceutical patent holders could be subject to antitrust claims challenging the terms of settlements of patent infringement suits that involve 'reverse payments' from the patent holder to the alleged infringer in exchange for an agreement to respect the terms of the patent. See *FTC v Actavis*, 133 S. Ct. 2223 (2013). In doing so, the court rejected the argument that the parties should be immune from antitrust claims so long as the settlement was within the scope of the patent that had been granted under federal law. Subsequent to *Actavis*, state courts have begun exploring the possibility that federal patent settlements could be scrutinised under state antitrust law as well. In a recent decision, the California Supreme Court held that states could regulate patent settlements under state antitrust law. In re *Cipro* Cases I and II, 348 P.3d 845 (2015). The court held that the scope of the patent test was inapplicable as a defence under state law, and explicitly recognised that state antitrust law could analyse these settlements under a different – and more restrictive – standard than federal antitrust law. The unfortunate implication of this line of reasoning is that pharmaceutical patent settlements may be regulated under divergent standards in each of the 50 states. The decision in *Oneok* likewise poses that risk for pipeline companies.
29 Id at 1608 (Scalia, J, dissenting) (citing *Northern Natural*, 83 S. Ct. 646).
30 Id.

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