

**Supplemental Testimony of
Washington State Attorney
General Rob McKenna
Concerning Antitrust Enforcement and
Regulated Industries¹**

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¹ While these comments are solely those of the Washington State Attorney General, drafts of these comments have been widely circulated among the Attorneys General and antitrust attorneys within those offices for review and comment, and the authors thank many enforcers for their suggestions and insights.

Thank you for inviting me to submit these supplemental comments in response to two excellent questions posed by Commissioners Valentine and Yarowsky (TR 74).

Commissioner Yarowsky asked whether "Congress [should] readdress the balance" of authority between antitrust enforcement and regulatory oversight to clarify the sometimes shifting line between the two?² Commissioner Valentine asked for more specific comments on what particular changes to the law would achieve this goal.³

My answers to these questions are informed by Washington's recent experience with the western electrical energy crisis and are directed specifically toward the Federal Power Act and the Energy Policy Act, and to the balance of authority between antitrust enforcers and the Federal Energy Regulatory Commission ("FERC").

I. SUMMARY

Should Congress should readdress the balance between regulatory oversight and antitrust enforcement? My answer is yes, amendments to existing law that clarify that balance are necessary and important to the goal of bringing regulatory oversight and antitrust enforcement into harmony. As I explain in more detail in these comments, however, these amendments should be narrowly tailored to resolve specific problems exposed by recent experience.

What specific legislation do I recommend that would achieve this end? My answer to this question has two parts. First, the Energy Policy Act should be amended to clarify the boundary between antitrust enforcement and regulatory oversight. Second, Congress, by appropriate legislation, should clarify and circumscribe the expanding application of the "filed rate doctrine."

² Transcript of 12-05-2005 hearing before the Antitrust Modernization Commission, panel on Regulated Industries (hereafter simply "TR"), pg. 74, lines 4-12. Acknowledging that time was growing short at the time he posed his question, Commissioner Yarowsky added, "If we don't have enough time, you can supplement the record with your responses."

³ TR pg. 49-50, lines 21-9.

II. THE NEED FOR CONGRESSIONAL CLARIFICATION

In my original written comments⁴ and in my testimony before the Commission⁵ I emphasized the benefits of complementary enforcement by regulators and antitrust enforcers, and described some of the problems associated with jurisdictional disputes and battles over oversight and enforcement authority. I proposed two areas in which Congress could clarify matters: Saving clauses and amendments delineating the scope of the filed rate doctrine.

A. Saving Clauses

One area that will benefit from congressional clarification is the saving clause. The Federal Power Act (FPA)⁶ confers to FERC regulatory authority over interstate electricity sales. The FPA contains no saving clause delineating the boundary between antitrust enforcement and regulatory authority. This omission created significant problems during the western electrical energy crisis in 2000-2001, particularly in the context of market-based tariffs approved by FERC. As a result, the task of defining a boundary between FERC and antitrust authority has fallen to the courts, with somewhat troublesome results. As discussed more fully *infra*, the Ninth Circuit has effectively eliminated any meaningful antitrust enforcement in the electricity industry, even in the case of companies that FERC has determined are subject to market-based rates. Where the number of competitors is small and the only control on a company's rates is the market, there are increased opportunities for collusion, manipulation and abuse. Antitrust enforcers have been the historic guardians of those markets and are uniquely qualified to serve in that capacity. I believe that antitrust enforcers should have authority to police industries and companies where the market forces control prices.

In the Energy Policy Act of 2005⁷ Congress increased FERC's market oversight authority by granting additional powers to investigate and penalize manipulative conduct. Unfortunately, the new statute did not address the boundary between antitrust enforcement and regulatory authority, nor did it address market-based rate tariffs. Accordingly, the Energy Policy Act of

⁴ "Testimony of Washington State Attorney General Rob McKenna Concerning Antitrust Enforcement and Regulated Industries", http://www.amc.gov/commission_hearings/pdf/050715_McKenna-Wash._AG-Reg_Indust.pdf.

⁵ http://www.amc.gov/commission_hearings/pdf/051205_Transcript_Regulated_Industries.pdf

⁶ 16 U.S.C. 791a-828c

⁷ Pub.L. 109-58, Aug. 8, 2005, 119 Stat. 594

2005 fails to resolve certain problems that lie at the heart of the 2000-2001 crisis. This omission is easily remedied, however, by the addition of language suggested below.

B. The Filed Rate Doctrine

Another area in which there is a growing need for clarification from Congress is the "filed rate doctrine," also known as the "filed tariff doctrine." Under this judicially-created doctrine, the courts defer to regulators on matters involving rates that have been filed with, and approved by, the regulator. The filed rate doctrine was adopted and perpetuated in cases where specific rates were filed with regulators. In that system, anyone could look up the relevant tariff and immediately see the filed rate for a given product.

The filed rate doctrine had its genesis as a judicial innovation aimed at "regulat[ing] the ruthless exercise of monopoly power by the Nation's railroads."⁸ The "ruthless exercise of monopoly power" involved railroads making secret deals with favored customers and charging supracompetitive rates to competitors of their favored customers. Their control of the tracks gave them a monopoly over certain lines, and they were able to charge exorbitant prices over those routes, unfettered by competition.

These abuses led to enactment of the Interstate Commerce Act ("ICA") in 1887.⁹ The Supreme Court has described the purpose of the ICA as being to "regulate commerce, whilst seeking to prevent unjust and unreasonable rates, ... to secure equality of rates as to all, and to destroy favoritism, these last being accomplished by requiring the publication of tariffs, and by prohibiting secret departures from such tariffs, and forbidding rebates, preferences, and all other forms of undue discrimination."¹⁰ The ICA created the Interstate Commerce Commission ("ICC") and required that carriers file their rates publicly with the ICC. Once a rate was approved by the ICC, the carrier was prohibited from negotiating a different rate with shippers. This rule became known as the "filed rate doctrine." In effect, the rule ended the practice of privately negotiating contracts for different rates for different customers.

⁸ *Maislin Industries, U.S., Inc. v. Primary Steel, Inc.*, 497 U.S. 116, 138 (1990) (Stevens, J., dissenting).

⁹ See Interstate Commerce Act, ch. 104, 24 Stat. 379 (1887) (codified as amended at scattered sections of 49 U.S.C.)

¹⁰ *New York, N.H. & H.R. Co. v. ICC*, 200 U.S. 361, 391 (1906).

In 1951, the Supreme Court decided *Montana-Dakota Utils. Co. v. Northwestern Publ. Serv. Co.*,¹¹ applying the filed rate doctrine to the power industry. If the cause of action "arises from being charged rates in excess of those permitted by the [Federal] Power Act, [the litigant] is confronted with the exclusive powers of the Commission to determine what those rates are to be."¹² In *Arkansas Louisiana Gas Co., v. Hall*, the Court elaborated on this point, holding that once a rate has been accepted by FERC under §205 of the Federal Power Act, utilities are bound by that rate, absent a waiver.¹³ Applying the doctrine to the area of telecommunications regulation, the Court held that "[d]eviation from [the filed rate] is not permitted upon any pretext."¹⁴ The filed rate may only be challenged administratively before FERC, which is charged with determining whether they are "just and reasonable" and not "unduly discriminatory."¹⁵ Parties may appeal FERC's determination to a U.S. Circuit Court. Appellate review is deferential.¹⁶

Under the process laid out in the FPA, a FERC jurisdictional seller must file a discernible, fixed rate or a formula by which a specific rate could be readily calculated. If the rate is challenged and FERC determines it to be unjust and unreasonable, it can order refunds. Approximately a decade ago, however, FERC began accepting tariffs that did not contain fixed or discernible rates. These tariffs are known as market-based rate tariffs. In accepting market-based rate tariffs, FERC departed from this prior practice, and from the practice that I believe is contemplated by the FPA, of requiring rates to be linked to the reasonable cost of service, plus a fair return on invested capital.

In determining that a company is entitled to charge a rate based on whatever the market will bear, FERC first determines that the company is unable to exercise market power in the

¹¹ 341 U.S. 246 (1951)

¹² *Id.* at 250.

¹³ *Arkansas Louisiana Gas Co., v. Hall*, 453 U.S. 571, 577 (1981).

¹⁴ *AT&T v. Central Office Telephone, Inc.*, 524 U.S. 214, 222 (1986).

¹⁵ 16 U.S.C. §824e.

¹⁶ See *City of Seattle v. FERC*, 923 F.2d 713, 715 (9th Cir. 1991).

markets in which it participates.¹⁷ In contrast to the filed rates historically addressed by the courts, market-based rates cannot be determined simply by looking at the filed tariff. Thus, it is not possible to determine whether the tariff is being violated absent economic analysis of the market – in short, the same type of analysis routinely conducted by antitrust enforcers. The filed rate doctrine should not bar antitrust enforcement in cases where instead of an actual filed rate, a company is charging market-based rates.

Despite these facts, in a series of decisions issued in 2004, the Ninth Circuit expanded the filed rate doctrine to bar antitrust scrutiny of companies subject to market-based rate tariffs.¹⁸ I believe that this expansion has created more problems than it solved. A result of this expansion is that power companies are subject to oversight only by a single federal agency with limited resources and which has been criticized as subject to regulatory capture.¹⁹

I believe that Congress is best positioned to correct this problem with appropriate legislation limiting the scope of this doctrine to situations to where an identifiable rate is actually filed. Where that is not the case, and in any case where the market controls prices, antitrust enforcers must be allowed to play their well established and vital role.

III. PROPOSED AMENDMENT

Both of the problems that I have mentioned above – the lack of a clear saving clause and the expansion of the filed rate doctrine – can be easily corrected. In this section, I will focus on the provisions that should be included by amendment, deferring to this Commission and to Congress the task of where best to insert these provisions.

¹⁷ See e.g. *Enron Power Marketing, Inc.* 65 FERC ¶ 61,305 (1993); *Enron Energy Services Power, Inc.*, 81 FERC ¶ 61,267 (1997) (Orders granting Enron market based rate authority); 103 FERC ¶ 61,343 (2003) (Order revoking Enron's market based rate authority.)

¹⁸ *People of California ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831 (9th Cir. 2004); *Pub. Util. Dist. 1 of Grays Harbor County, Washington v. Idacorp, Inc.*, 379 F.3d 641 (9th Cir. 2004); *California ex rel. Lockyer v. FERC*, 383 F.3d 1006 (9th Cir. 2004); *Pub. Util. Dist. 1 of Snohomish County, Washington v. Dynegy Power Marketing, Inc.*, 384 F.3d 756 (9th Cir. 2004), cert. denied 125 S.Ct. 2957, 162 L.Ed.2d 905 (2005).

¹⁹ "The Federal Energy Regulatory Commission (FERC) is the primary remaining example of victimization, subversion, and incapacitation of a central regulatory institution. Symbolically, this incapacitation is indicated in FERC's "vision statement," where the mission of 'promoting competitive markets' is listed above 'protecting customers,' 'respecting the environment,' and 'serving and safeguarding the public.'" Peach, H. Gil, "Choice is Never Having to Say you are Sorry: How Deregulation is Working for Low-Income Programs," Paper presented to the 2003 National Low Income Energy Conference,

In light of FERC's acknowledgement that generating companies and other FERC jurisdictional entities are sufficiently competitive to be allowed to charge market-based rates, a clear saving clause conferring enforcement authority on antitrust enforcers is urgently needed. A saving clause should provide that:

- Where rates are submitted and approved pursuant to provisions of §205 of the Federal Power Act, FERC enjoys exclusive enforcement authority and the filed rate doctrine bars the courts from "second guessing" FERC's rate-making decisions.
- FERC also enjoys exclusive authority over the determination of whether and when a market is sufficiently competitive, whether a company possesses or lacks market power within that market, and whether a market-based tariff is appropriate. In making this determination, FERC should employ an open fact-finding procedure in which antitrust enforcers receive notice and an opportunity to participate.
- The grant of a market-based rate tariff makes the filed rate doctrine inapplicable and confers jurisdiction on the courts to hear issues arising from pricing and other market behavior, including the full range of antitrust issues. This should not be affected by FERC's decision to retain regulatory authority over non-rate aspects of a company's conduct.
- In any case where a market-based rate tariff has been approved for any market participant, violations of the FPA, FERC regulation or the tariff that cause anticompetitive effects can provide the basis for an antitrust cause of action. Administrative enforcement action by FERC and legal enforcement action by antitrust enforcers should be treated as complementary rather than as inconsistent.

IV. CONCLUSION

The balance between regulatory oversight and antitrust enforcement should be addressed and clarified by Congress. Congress is uniquely situated to resolve ambiguities and disagreements between regulators and antitrust enforcers, and to harmonize their work, ensuring complementary enforcement toward the twin goals of competition and protection of the public interest.

Existing law should be amended to clarify the scope of the filed rate doctrine, which has recently been expanded to include rates that are not filed, but which are set by the market.

Legislation should clarify that the filed rate doctrine applies only in circumstances where either the tariff contains specific rates, or a formula from which a specific rate can be derived. Where a regulator has determined that there is sufficient competition to allow market forces to take over from regulation, then the filed rate doctrine should not apply, and antitrust enforcers should have full authority to pursue violators of the nation's trade laws.

These changes will bring regulation and antitrust enforcement into harmony, will avoid costly and time consuming court battles over jurisdiction and what standard applies, and will allow regulators and antitrust enforcers to focus on the markets rather than one another.