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COMMENTS

FPC MUST CONSIDER ALLEGATIONS OF A RETAIL PRICE SQUEEZE IN SETTING WHOLESALE RATES *FPC v. Conway Corp.*, 426 U.S. 271 (1976)

In *FPC v. Conway Corp.*,¹ the Supreme Court directed the Federal Power Commission (FPC) to consider the impact of wholesale energy rates upon the retail energy market.² This decision provides the Commission with the authority to prevent large vertically integrated³ interstate utilities from discriminating against smaller municipally owned intrastate utilities.

Arkansas Power and Light Company (AP&L), a vertically integrated utility, sells electricity in the wholesale and retail markets.⁴ While serving as the only energy supplier for its wholesale customers, AP&L competed with these utilities for industrial retail sales.⁵ When AP&L applied to the FPC for a wholesale rate increase,⁶ Conway Corporation (Conway), representing nine of AP&L's wholesale customers, attempted to intervene. Conway claimed that by the proposed rate increase, AP&L was attempting to "price squeeze" Conway out of the retail sales market.⁷ If approved by the FPC, the higher wholesale rates would force Conway to increase its retail prices so that it could no longer compete with AP&L for industrial retail sales.⁸ The FPC refused to hear Conway's claim because it would require an investigation of AP&L's retail rates, which was outside the Commission's statutory jurisdiction.⁹ The Court of Appeals for the District of Co-

1. 426 U.S. 271 (1976).

2. *Id.* at 273.

3. Vertically integrated utilities perform more than one of the three functions of power production: generation, transmission, and distribution. See Meeks, *Concentration in the Electric Power Industry: The Impact of Antitrust Policy*, 72 COLUM. L. REV. 64, 67 (1972).

4. 426 U.S. at 273.

5. *Id.*

6. *Id.* at 274.

7. *Id.*

8. *Id.* at 274-75.

9. *Id.*

lumbia¹⁰ reversed; the Supreme Court affirmed the reversal, and *held*: In reviewing a request for an increase in wholesale electricity rates, the FPC has jurisdiction to consider the anticompetitive effects of the applicant's intrastate retail rates in order to set a just, reasonable, and not unduly discriminatory wholesale rate.¹¹

The FPC was created by the Federal Water Power Act of 1920 (FWPA).¹² The purpose of this statute was to replace the unhealthy competition between utilities¹³ with regulation—either by state commissions or the FPC—in the public interest.¹⁴ Under the FWPA, the FPC could regulate only the intrastate and interstate rates of utilities operating in states that had no regulatory agencies of their own;¹⁵ if a state commission existed, the utility's rate structure was subject to its exclusive jurisdiction.¹⁶ In 1927, however, the Supreme Court rendered these jurisdictional provisions inadequate. In *Public Utilities Commis-*

10. *Conway Corp. v. FPC*, 510 F.2d 1264 (D.C. Cir. 1975), *aff'd*, 426 U.S. 271 (1976).

11. 426 U.S. at 272-73.

12. Federal Water Power Act, ch. 285, § 30, 41 Stat. 1077 (1920) (current version at 16 U.S.C. § 791 (1970)). See generally M. CONOVER, *THE FEDERAL POWER COMMISSION* (1923).

13. Under the Federal Water Power Act, ch. 285, § 20, 41 Stat. 1073 (1920), the FPC could only regulate the rates of hydro-electric utilities. Congress subsequently enacted the Federal Power Act of 1935, ch. 687, § 213, 49 Stat. 52 (codified at 16 U.S.C. § 824e(a) (1970)) and the Natural Gas Act of 1938, ch. 556, § 5, 52 Stat. 823 (codified at 15 U.S.C. § 717d(a) (1970)), and thus gave the FPC jurisdiction over all gas transmission and electric utilities.

14. *Pennsylvania Water & Power Co. v. FPC*, 193 F.2d 230, 234 (D.C. Cir.) (Congress relied on regulatory agency rather than competition to control prices), *aff'd*, 343 U.S. 414, 417 (1951) (major purpose of Act is to protect consumers against excessive prices); see Meeks, *supra* note 3; cf. *Munn v. Illinois*, 94 U.S. 113, 126-30 (1876) (states may protect public interest by regulating property devoted to public use).

15. Federal Water Power Act, ch. 285, § 20, 41 Stat. 1073 (1920) provides:

[W]hen said power or any part thereof shall enter into interstate . . . commerce the rates charged . . . shall be reasonable, nondiscriminatory, and just . . . ; and whenever any of the States directly concerned has not provided a commission or other authority to enforce the requirements of this section within such State . . . jurisdiction is hereby conferred upon the commission

Id. at 1073-74.

United States v. Public Util. Comm'n, 345 U.S. 295, 305 (1953) states: "So the language of § 20 required reasonable rates to consumers of electricity moving interstate and then added the provision that when no state commission was provided to enforce reasonable rates, or the states interested could not agree, the Federal Power Commission could act."

16. Federal Water Power Act, ch. 285, § 20, 41 Stat. 1075-76 (1921); *Hearings on H.R. 3184 Before the House Comm. on Water Power*, 65th Cong., 2d Sess. 62-66, 95-97 (1918) (statement of O. C. Merrill), cited in *United States v. Public Util. Comm'n*, 345 U.S. 295, 305 n.10 (1953).

sion v. *Attleboro Steam & Electric Co.*,¹⁷ the Court held that, even if interstate wholesale rates adversely affected intrastate retail rates, the commerce clause prohibited states from regulating interstate wholesale rates.¹⁸ As a result of the Court's decision, neither the state nor the FPC could regulate the interstate wholesale rates of utilities that operated in states with regulatory commissions.¹⁹ Prior to creating this gap in the regulation of utilities, however, the Supreme Court had decided *Houston, East & West Texas Railway v. United States (Shreveport)*.²⁰ In *Shreveport*, the Court held that the ICC had power under the commerce clause, even in the presence of state regulatory commissions, to set intrastate freight rates if those rates had a substantial impact on interstate commerce. By implication, the Court's holding in *Shreveport* gave the FPC the power to set intrastate retail rates even in states that operated regulatory commissions if the rates had a substantial impact on interstate commerce.²¹

The Court's interpretations of the commerce clause in *Shreveport* and *Attleboro*, together with the advent of the holding company, a new form of public utility ownership,²² prompted Congress in 1935

17. 273 U.S. 83 (1927).

18. *Id.* at 90: "[T]he paramount interest in the interstate business carried on between the two companies is not local to either State, but is essentially national in character. . . . [I]f such regulation is required it can only be attained by the exercise of the power vested in Congress." Compare *Pennsylvania Gas Co. v. Public Serv. Comm'n*, 252 U.S. 23 (1920) (state could regulate rates charged by utility that transmitted gas across state lines for sale in state's retail market), with *Missouri v. Kansas Natural Gas Co.*, 265 U.S. 298 (1924) (state could not regulate rates charged by utility that transmitted gas across state lines for sale in state's wholesale market).

19. *FPC v. Florida Power & Light Co.*, 404 U.S. 453, 458 (1972); *FPC v. Southern Cal. Edison Co.*, 376 U.S. 205, 220 (1964); *United States v. Public Util. Comm'n*, 345 U.S. 295, 303, 307-08 (1953); *Jersey Cent. Power & Light Co. v. FPC*, 319 U.S. 61, 68 (1943); *New England Power Co. v. FPC*, 349 F.2d 258, 262 (1st Cir. 1965); *Otter Tail Power Co.*, 2 F.P.C. 134, 137 (1940); 2 A. PRIEST, *PRINCIPLES OF PUBLIC UTILITY REGULATION* 523 (1969).

20. 234 U.S. 342 (1914).

21. *Id.* at 355:

It is for Congress to supply the needed correction where the relation between intrastate and interstate rates presents the evil to be corrected, and this it may do completely by reason of its control over the interstate carrier in all matters having such a close and substantial relation to interstate commerce that it is necessary or appropriate to exercise the control for the effective government of that commerce.

22. A holding company's major asset consists of controlling interests of stocks in other companies. See, e.g., *Gulf States Util. Co. v. FPC*, 411 U.S. 747, 758 (1973); *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 611 (1944); *Duke Power Co. v. FPC*, 401 F.2d 930, 934 (D.C. Cir. 1968).

to enact Part II of the Federal Power Act.²³ The Act grants the FPC *exclusive* ratemaking authority over "the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce;"²⁴ it specifically reserves the remaining regulatory power to the states.²⁵ The Commission must establish rates for utilities within its jurisdiction that are just, reasonable, and not unduly preferential or discriminatory.²⁶

In *Otter Tail Power Co.*,²⁷ the FPC relied upon its authority over discriminatory rates to block a wholesaler's attempted takeover of a small municipal purchaser of electricity.²⁸ The wholesaler sold energy at lower prices to its larger municipal customers in an attempt to force its smaller customers out of business. The Commission held that a wholesale energy supplier could not discriminate on the basis of the purchaser's bargaining power.²⁹ Following *Otter Tail*, utilities developed long-distance transmission lines which facilitated the growth

23. Federal Power Act, 16 U.S.C. § 791 (1970) (original version at ch. 285, § 30, 41 Stat. 1077 (1920)). The Federal Water Power Act became subchapter I of the Federal Power Act.

24. Federal Power Act, 16 U.S.C. § 824(b) (1970).

25. *Id.* See, e.g., FPC v. Florida Power & Light Co., 404 U.S. 453, 454-55 (1972); FPC v. Southern Cal. Edison Co., 376 U.S. 205, 210, 217 (1964); Connecticut Light & Power Co. v. FPC, 324 U.S. 515, 518 (1945); Jersey Cent. Power & Light Co. v. FPC, 319 U.S. 61, 76 (1943); FPC v. Arizona Edison Co., 194 F.2d 679, 681 (9th Cir. 1952); *Otter Tail Power Co.*, 2 F.P.C. 134, 139 (1940); Breyer & MacAvoy, *The FPC and the Coordination Problem in the Electric Power Industry*, 46 S. CAL. L. REV. 661, 697 (1973).

26. Federal Power Act, 16 U.S.C. § 824(b) (1970) provides:

No public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

See, e.g., *Southwestern Pub. Serv. Co.*, 33 F.P.C. 343, 347 (1965) (public utility may make separate classifications for different customers).

27. 2 F.P.C. 134 (1940).

28. *Id.* at 149.

29. The Commission reasoned:

It occurs to us that one rate in its relation to another rate may be discriminatory, although each rate *per se*, if considered independently, might fall within the zone of reasonableness. There is considerable latitude within the zone of reasonableness insofar as the level of a particular rate is concerned. The relationship of rates within such a zone, however, may result in an undue advantage in favor of one rate and be discriminatory insofar as another rate is concerned. When such a situation exists, the discrimination found to exist must be removed.

For the purpose of removing a discrimination we interpret the statute to mean that the reasonable wholesale rate for any class of customers be not higher than

of large, vertically integrated interstate utilities³⁰ engaged in selling energy in the wholesale and retail markets.³¹ Although the utility company in *Otter Tail* discriminated between interstate wholesale rates in an attempt to force small purchasers out of business,³² the vertically integrated utility is capable of effecting a retail price squeeze by discriminating between the rates it charges wholesale customers who also compete at the retail level and the rates it charges its own retail customers. By increasing wholesale rates without raising its retail rates, the vertically integrated utility can squeeze its smaller, frequently municipally owned, competitors out of the retail market.

In *Gulf States Utilities Co. v. FPC*,³³ the Supreme Court confronted the problem of unfair competition between utilities and directed the FPC to consider anticompetitive effects when approving wholesale rates.³⁴ The Commission, however, interpreted this directive narrowly; it would not consider the anticompetitive effects of a retail price squeeze³⁵ because this would require the Commission to examine the retail rate (structure), a factor outside its jurisdiction.³⁶ In *Northern California Power Agency v. FPC*,³⁷ the Court of Appeals for the District of Columbia endorsed the Commission's jurisdictional limitation for considering anticompetitive

the lowest rate charged by vendor utility to any customer for the same class of service under the same or substantially similar conditions.

Id.

30. See Meeks, *supra* note 3, at 68.

31. Weiss, *Antitrust and the Electric Power Industry*, in PROMOTING COMPETITION IN REGULATED MARKETS 165 (1975).

32. *Otter Tail Power Co.*, 2 F.P.C. 134, 135-36 (1940).

33. 411 U.S. 747 (1973).

34. *Id.* at 758-59 (after finding that the FPC must consider anticompetitive effects when approving new security issues, the Court stated that similar considerations would obtain when the FPC approved a rate structure); *accord*, *Denver & Rio Grande W.R.R. v. United States*, 387 U.S. 485, 492 (1967) (ICC must consider anticompetitive effects when deciding whether to approve new security issue).

35. See text following n. 32 *supra*.

36. *Florida Power and Light Co.*, 50 F.P.C. 1626, 1627 (1973) (FPC has no jurisdiction to fashion relief for price squeeze on basis of retail rates); *Southern Cal. Edison Co.*, 50 F.P.C. 836, 837 (1973) (relief for price squeeze relates not to wholesale costs but to retail rates which are under the state's sole jurisdiction). *But see* *Panhandle E. Pipe Line Co. v. FPC*, 324 U.S. 635, 646 (1945) (in determining the wholesale cost structure of a utility that sold power in both wholesale and retail markets, the FPC could examine the cost of the retail operation in order to calculate the cost of the wholesale operation).

37. 514 F.2d 184 (D.C. Cir. 1975) (petitioner, wishing to purchase wholesale energy, claimed contract for construction of power plant was anticompetitive because it called for capacity sufficient only to supply the needs of petitioner's competitors).

effects.³⁸ The Commission was obligated to investigate charges of discrimination involving non-jurisdictional facts, the court held, only if the party claiming discrimination established a *nexus* between the anti-competitive effect and a remedy within the FPC's jurisdiction.³⁹

In *FPC v. Conway Corp.*,⁴⁰ the Supreme Court again directed the Commission to consider the anticompetitive effects of a wholesale rate increase and more clearly defined the FPC's jurisdiction.⁴¹ After acknowledging the state's power to regulate intrastate retail rates,⁴² the Court reminded the Commission of its statutory duty to consider anti-competitive effects in setting just, reasonable, and not unduly discriminatory wholesale rates.⁴³ The Act forbids the maintenance of any "unreasonable difference in rates . . . with respect to any sale . . . subject to the jurisdiction of the Commission."⁴⁴ In *Conway*, the anti-competitive effect was the unreasonable difference between the wholesale and retail rates.⁴⁵ The Court rejected the FPC's argument that it could not consider discrimination between wholesale and retail rates because it had no jurisdiction over retail sales.⁴⁶ As long as the anti-competitive effect is traceable to a sale over which the Commission has jurisdiction (wholesale rates), the Court held, the FPC can reduce the wholesale price to the lowest just and reasonable rate.⁴⁷ The Court concluded that by requiring the Commission to examine the entire

38. The court explained:

The Supreme Court and this court have held, time and again, that the Federal Power Commission, as other regulatory agencies, must consider the anticompetitive consequences of matters properly before it Of course, this is not to say that the doctrine is without limits or that the Commission must hold "hearings" on every complaint alleging anti-trust violations. 514 F.2d at 187. The court went on to quote the test from *City of Lafayette v. SEC*, 454 F.2d 941, 955 (D.C. Cir. 1971): "Where an agency has some regulatory jurisdiction over operations, it must consider whether there is a *reasonable nexus between the matters subject to its surveillance and those under attack on anticompetitive grounds.*" *Id.* at 187-88 (emphasis supplied by *Lafayette* court).

39. *Id.* at 189 (court upheld FPC's determination that the Commission had no jurisdiction to remedy the anticompetitive effect by increasing the plant's capacity and that petitioner had failed to establish a nexus between the anticompetitive effect and a jurisdictional remedy).

40. 426 U.S. 271 (1976).

41. *Id.* at 273.

42. *Id.* at 273, 275.

43. *Id.* at 273.

44. *Id.* at 273 n.1.

45. *Id.* at 275.

46. *Id.* at 277.

47. *Id.* at 277-78.

“factual context in which the proposed wholesale rate will function,” including retail rates in this case, it was merely reaffirming the FPC’s statutory responsibilities.⁴⁸

The Supreme Court correctly rejected the FPC’s contention that it could not consider anticompetitive effects in setting just, reasonable, and not unduly discriminatory rates unless the anticompetitive effect resulted entirely from sales within the Commission’s jurisdiction.⁴⁹ The Federal Power Act clearly authorizes the FPC to consider charges of rate discrimination as long as *one* sale is subject to its jurisdiction.⁵⁰ In addition, the Conway intervenors did not request that the Commission alter AP&L’s *retail* rates and thereby infringe the state’s regulatory authority.⁵¹ Rather, as required by *Northern California Power Agency v. FPC*,⁵² Conway sought to establish a nexus between the anticompetitive effect of the increase in wholesale rates and a remedy wholly within the Commission’s jurisdiction: a reduction in AP&L’s *wholesale* rates.⁵³ The Court’s decision in *Conway* that the FPC must examine and remedy the anticompetitive effects of an unreasonable difference between wholesale and retail rates by adjusting the wholesale rates has forced the Commission to confront and develop a regulatory policy on the issue of price squeezing.

Experts differ over whether the public ultimately benefits from anticompetitive activities of vertically integrated utilities.⁵⁴ Although small, municipally owned companies, are more responsive to consumer needs,⁵⁵ they are presumably less efficient.⁵⁶ Consumer energy costs would therefore be reduced, some suggest, if larger utilities forced these sellers out of the retail market.⁵⁷ Although there are no easy answers to these complex economic questions, the Court in *Conway* commendably instructed the FPC that it no longer can avoid these issues by hiding behind its “nonjurisdictional factors” defense.

48. *Id.* at 280.

49. See notes 45 & 46 *supra* and accompanying text.

50. Federal Power Act, 16 U.S.C. § 824d(b) (1970). See text quoted *supra* note 26.

51. *FPC v. Conway Corp.*, 426 U.S. 271, 274-75 (1976).

52. 514 F.2d 184 (D.C. Cir. 1975).

53. See notes 23-26 *supra* and accompanying text; cf. *Houston E. & W. Tex. Ry. v. United States*, 234 U.S. 342 (1914) (discussed at text accompanying notes 20 & 21 *supra*).

54. See generally Meeks, *supra* note 3.

55. See Meeks, *supra* note 3, at 80.

56. Compare Breyer & MacAvoy, *supra* note 25, at 661, and Meeks, *supra* note 3,

at 71-75, with Brief Respondents at 28.

57. See, e.g., Meeks, *supra* note 3.

Unfortunately, the Court created an alternative means by which the Commission may continue to evade these difficult policy questions. Under *Conway*, if a nexus exists between the anticompetitive effect and a remedy within the Commission's jurisdiction—if the effect is traceable to the remedy—the FPC must consider and eliminate the anticompetitive effect.⁵⁶ Although the retail price squeeze in *Conway* meets this nexus test, the Court failed to imply from the Federal Power Act⁵⁷ any standards or formulae for the FPC to employ in determining when other instances meet the nexus test. The decision whether a nexus exists between the anticompetitive effects of variances in retail rates caused by differences in, for example, pollution control facilities or accounting practices⁵⁸ and a jurisdictional remedy is, therefore, within the FPC's discretion. By committing the decision to agency discretion, the Court has provided the Commission with a new way to avoid further anticompetitive effect questions: it can make the nexus test extremely difficult to meet. Because a ruling that is within the FPC's discretion will be reviewed on appeal only for abuse, it will rarely be overturned.⁵⁹ If the Court wanted the Commission to confront the problems of anticompetitive effects and price squeezes, it should have established some guidelines by which the FPC could determine whether a sufficient nexus between the effect and remedy exists.⁶⁰

56. See notes 40-47 *supra* and accompanying text.

57. Federal Power Act, 16 U.S.C. § 791 (1970) (original version at ch. 285, § 30, 41 Stat. 1077 (1920)).

58. There are only two of many factors which the FPC has the power to consider. Nevertheless, because case precedent indicates the FPC will attempt to limit its scope of review, it is doubtful that these or additional variables will play an active role in the FPC's ratemaking determinations. See, e.g., *NAACP v. FPC*, 520 F.2d 432 (D.C. Cir. 1975) (FPC has jurisdiction in ratemaking and licensing procedures to consider effect of employment discrimination on regulatee's operating costs).

59. See, e.g., *FPC v. Pacific Power & Light Co.*, 307 U.S. 156, 160 (1939); *Northern Cal. Power Agency v. FPC*, 514 F.2d 184, 189 (D.C. Cir. 1975).

60. Cf. *NLRB v. Longshoremen's & Warehousemen's Union Local 50*, 504 F.2d 1209 (9th Cir. 1974), *cert. denied*, 420 U.S. 973 (1975) (The court held that it could not determine whether the NLRB's legal conclusions following a § 10(k) hearing were arbitrary and capricious because the Board had in the past provided no explanation of how it reached its decision in a given case. After reviewing these prior cases, the court determined that, in fact, the Board had given considerable attention to two factors. It remanded the case to the Board for a new decision in view of these factors and directed it to explain why certain factors were given greater weight than others in its decision. The court could then meaningfully review for arbitrary and capricious actions. *Id.* at 1221-22),

The Court in *Conway* confronted the price squeeze problem and clarified the Federal Power Commission's authority over jurisdictional and nonjurisdictional factors. It directed the Commission to examine charges of anticompetitive effects in setting just, reasonable, and not unduly discriminatory wholesale rates whenever one of the sales causing the anticompetitive effect *and* the remedy sought are within the FPC's jurisdiction. Thus the Commission must consider nonjurisdictional retail rates and, by adjusting the jurisdictional wholesale rates, remedy the anticompetitive effects of an unreasonable difference between wholesale and retail rates. It cannot employ its nonjurisdictional factors defense to evade the price squeeze issue any longer. Nevertheless, because the Court declined to articulate standards by which the FPC may determine other cases in which there is a sufficient nexus between the anticompetitive effects and a remedy within the Commission's jurisdiction, the Commission can continue to avoid the difficult issues of discrimination and anticompetitive effects in reviewing wholesale rates.