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"Deregulation of the Gas & Electric Industries & The `State - Action` Doctrine"

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I. INTRODUCTION

The state-action doctrine is an exemption to federal antitrust laws for actions taken by a state while operating in its sovereign capacity, or where the actions of private individuals are authorized, overseen or compelled by the state. The basic parameters of state-action immunity have been developed through a series of Supreme Court decisions which have relied upon principles of federalism and state sovereignty. See e.g., *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365 (1991); *Southern Motor Carriers Rate Conference, Inc. v. United States*, 471 U.S. 48 (1985); *Town of Hallie v. City of Eau Claire*, 471 U.S. 34 (1985); *Hoover v. Ronwin*, 466 U.S. 558 (1984).

The Supreme Court has expressed the view that because states have the ability to regulate their economies in many ways that are not inconsistent with the antitrust laws, the application of state-action immunity should be generally disfavored. See *FTC v. Ticor Title Insurance Co.*, 504 U.S. 621 (1992). Nevertheless, the state-action exemption has been found to apply to actions taken by city governments and other subdivisions of state governments when they carry out state policy. See e.g., *Town of Hallie v. City of Eau Claire*, supra; *Community Communications Co. v. City of Boulder*, 445 U.S. 40 (1982); *City of Lafayette v. Louisiana Power & Light Co.*, 435 U.S. 389 (1978).

State-action immunity will also be afforded to private parties when their actions are pursuant to a clearly-expressed state policy and are actively supervised by the state. Even where a state action is rescinded by state officials or is found to be inconsistent with state law, courts have found that private defendants have immunity from antitrust liability for conduct undertaken prior to the rescission or invalidation of the state law or regulation. See *Lease Lights, Inc. v. Public Service Co. of Oklahoma*, 849 F.2d 1330 (10th Cir. 1988), cert. denied, 488 U.S. 1019 (1989); *Llewellyn v. Crothers*, 765 F.2d 769, 774 (9th Cir. 1985); *Yeager's Fuel, Inc. v. Pennsylvania Power & Light Co.*, 22 F.3d 1260, 1269 (3d Cir. 1994).

The state-action doctrine plays a particularly significant role in the natural gas and electric industries. For public utilities, higher levels of state regulation have traditionally meant that the state-action doctrine could be more easily invoked as a defense against federal antitrust challenges. Thus, state-authorized monopolies and pervasive state regulation have, in past years, held the number of successful federal antitrust challenges against public utilities to a relative minimum. This, however, may no longer be the case in the future.

The natural gas and electric industries are undergoing deregulation or light-handed regulation in which regulators promote competition and leave some decisions to market forces, yet retain control over some crucial elements such as price or access to transportation, storage and distribution. Determining whether the state-action doctrine will apply in these situations is problematic for two reasons. First, changes in the scope and extent of state regulation has made state policy in some areas of utility operations increasingly ambiguous, and determining what is a state's "clearly articulated and affirmatively expressed" policy is often subject to a wide range of interpretation. Second, even where the state has mandated conduct, state regulators may not provide enough supervision over such conduct to satisfy the active supervision requirement of the state-action doctrine. Furthermore, the degree to which regulation has been replaced with competition in the natural gas industry varies substantially from state to state.

Conduct that may easily qualify for state-action immunity in one state might not be shielded from antitrust liability in another. As a result, the range of utility operations which qualify for state-action immunity from federal antitrust law has narrowed, and the number of federal antitrust actions against public utilities has risen considerably. Yet, all is not lost for utilities that seek state-action immunity, and as several recent cases have demonstrated, the applicability of the state-action doctrine has narrowed but has by no means disappeared.

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This article first presents an analysis of the current state of the state-action doctrine and the extent to which it continues to shield public utilities from federal antitrust liability. After examining the origin, purpose, and development of the state-action doctrine in a public utility context, the article then discusses the process by which courts determine whether or not to extend state-action immunity in cases against public utilities. Lastly, this article examines the current application of the state-action doctrine in the three areas of public utility operations that are most frequently the subject of antitrust litigation: pricing, market allocation, and anticompetitive agreements.

II. THE BASIC PRINCIPLES UNDERLYING STATE ACTION IMMUNITY

The Supreme Court first articulated the state-action doctrine in *Parker v. Brown*, 317 U.S. 341 (1943), as a rule of immunity for acts of the state legislature in its sovereign capacity which ostensibly violate provisions of federal antitrust law. See also *Hoover v. Ronwin*, supra. In *Parker*, a California statute authorized state officials to establish a marketing program for the state's raisin crop, which effectively restricted competition and maintained higher prices. The state law was subsequently challenged as a violation of the Sherman Act. The dilemma faced by the Court in *Parker* arose from the tension between enforcement of antitrust policies by the federal government and the right of states to implement their own public policies regulating domestic commerce. The Court's solution was to make "state action"-- that is, anticompetitive policies mandated by state government -- immune from federal antitrust liability based upon the principle of state sovereignty. Relying on fundamental principles of federalism, the Supreme Court held that federal antitrust liability did not apply because the state "as sovereign, imposed the restraint as an act of government which the Sherman Act did not undertake to prohibit." Under *Parker*, actions by a state legislature in passing state statutes are automatically immune regardless of the motives of the state, the wisdom of the action or the anticompetitive impact that may result. See *Hoover v. Ronwin*, supra. The Court thus created a bulwark for the individual states against encroachments by federal antitrust laws inside the confines of their constitutionally defined borders.

The cases after *Parker*, among other things, expanded the doctrine by establishing that state-action immunity can stem from sources other than state legislatures. For instance, when a state supreme court performs a legislative function, it also acts as the state. *Id.*; *Bates v. State Bar of Arizona*, 433 U.S. 350 (1977). It is unclear, however, whether the governor of a state stands in the same position as a state legislature or state supreme court for purposes of the state-action doctrine. See *Hoover v. Ronwin*, supra. Moreover, courts have held that state governmental agencies qualify for state-action immunity only if their actions are expressly authorized by the state legislature.

The seminal case involving the application of the state-action doctrine to private parties is *California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980). In *Midcal*, the Supreme Court made clear that private party conduct pursuant to a state regulatory program shares state-action immunity only if the conduct meets both parts of a two-prong test. Under the *Midcal* test, the anticompetitive conduct of private parties will be afforded state-action immunity only to the extent that: (1) the conduct is undertaken pursuant to a "clearly articulated and affirmatively expressed" state policy reflecting an intent to replace competition with regulation, and (2) such conduct is "actively supervised by the state." Although courts generally weigh each prong of the *Midcal* test separately, both parts of the test are directed at ensuring that particular anticompetitive mechanisms operate because of a deliberate and intended state policy, rather than for private interests.

It is hard to overstate the significance of the *Midcal* test: it defines the process by which courts determine whether or not to impose antitrust liability when state-regulated entities raise the state-action doctrine in defense. As such, both prongs of the *Midcal* test are discussed in detail below.

A. Clearly Articulated and Affirmatively Expressed State Policy

Until recently, most courts have taken a broad view of what constitutes "clearly articulated and affirmatively expressed" state policy. Most notably, in *Southern Motor Carriers Rate Conference v. United States*, 471 U.S. 48 (1985), the Supreme Court held that, "[a] private party acting pursuant to an anticompetitive regulatory program need not point to a specific, detailed legislative authorization for its challenged conduct. As long as the state as sovereign clearly intends to displace competition

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in a particular field with a regulatory structure, the first prong of the Midcal test is satisfied." See also 324 Liquor Corp v. Duffy, 979 U.S. 335 (1987). The Supreme Court has indicated that "the requirement that the state articulate a clear policy shows that the state has not acted through inadvertence." FTC v. Ticor Insurance Co., 504 U.S. 621, 633 (1992).

A recent interesting case involving the issue of a clear state policy is United States v. Rochester Gas and Electric Corp., 1998-1 Trade Case (CCH) ¶72,070, 4 F. Supp. 2d 172 (W.D. N.Y. 1998). In Rochester Gas & Electric, the U.S. brought an antitrust action against RG&E based on its agreement with the University of Rochester, under which the University promised not to co-generate power in exchange for a discounted rate from the utility. The court rejected RG&E's state-action defense after concluding that there was no clearly expressed state policy favoring agreements not to compete. Although state law permitted utilities to negotiate discounted rates with qualified customers, and discounting rates is carefully supervised by the New York Public Service Commission, the court found that state law did not authorize utilities to offer discounted rates to potential competitors for the purpose of preventing those potential competitors from becoming actual competitors. Additionally, despite the fact that the Public Service Commission vigorously reviewed and accepted RG&E's contract with the University, the court held that the agency's review was not enough to satisfy the active supervision prong of the Midcal test. Rather, the court held that the Commission's review did not shield RG&E from antitrust liability because the Public Service Commission is not charged with enforcing federal antitrust law and did not review the contract to determine whether or not it violates that law.

Rochester Gas demonstrates that even when a challenged action is part of a general field that is regulated by the state, unless the specific action challenged is compelled by—or at least permitted and readily foreseeable under—state law, there will be no state-action immunity from federal antitrust action.

Three other recent cases found that the clearly articulated state policy prong was established and the antitrust exemption applied. In Four J's, Inc. v. Little Rock Mur Airport Comm'n., 108 F. 3d 909, 914-15 (8th Cir. 1997), the Court held that an Airport Commission was entitled to state-action immunity for imposition of concession fees because "suppression of competition was foreseeable as a consequence of the Commission's exercise of its unlimited authority to operate the airport." Taking an even broader view of the state policy prong, the court in Zimora v. Alamo Rent-A-Car Co., 111 F.3d 1495, 1499-1500 (10th Cir. 1997) held that state-action immunity applied to car rental companies where, despite absence of active supervision, city ordinance left car rental companies with no discretion as to amount and imposition of usage fee. Finally, in California CNG v. Southern California Gas Company, 96 F.3d 1193 (9th Cir. 1996) the court applied state action immunity to a policy to permit and promote competition among natural gas vehicle fuel stations even though the state law contains provisions that are inconsistent with competition. A state policy to have a regulator resolve conflicts between competition and other policies reflected in state law will satisfy the requirement of a "clearly articulated and affirmatively expressed policy."

B. Active State Supervision

The requirement of active state supervision is less easily satisfied than the state policy prong. For instance, it is clear that the mere presence of a state regulatory scheme is not enough for a court to find that active supervision exists. Courts have set out some clear minimum requirements that state regulatory programs must satisfy in order to confer federal antitrust immunity. Active supervision requires that state officials possess and have actually exercised the power to review anticompetitive actions by private parties that are ostensibly permitted by state law.

The Supreme Court clarified the scope and significance of the active supervision prong in Federal Trade Commission v. Ticor Title Insurance Co., 504 U.S. 621 (1992). The Federal Trade Commission (FTC) charged six title insurance companies with engaging in a horizontal price fixing scheme to collectively price title search, examination, and settlement service charges through rating bureaus in various states. The FTC conceded that there was a clearly articulated state policy in favor of the challenged actions, and the determining question before the Supreme Court was whether state regulatory review was adequate to provide immunity for the companies' actions. The Court made clear that active supervision must be established in fact, not only in principle, holding that the purpose of the active supervision requirement is "to determine whether the State has exercised sufficient independent judgment and control so that the details of the rates or prices have

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been established as a product of deliberate state intervention, not simply by agreement among private parties." *Id.*, at 634-635.

Ticor provides that state-action immunity will be afforded to otherwise private price fixing arrangements provided a state's regulatory review scheme is pursuant to a clearly articulated and affirmatively expressed state policy, and the state actively supervises the regulatory review scheme. The Court held that "where prices or rates are initially set by private parties, subject to veto only if the State chooses to exercise it, the party claiming the immunity must show that state officials have undertaken the necessary steps to determine the specifics of the price-fixing or rate-setting scheme. The mere potential for state supervision is not an adequate substitute for a decision by the State." *Id.*, at 638.

Thus, Ticor makes clear that, regardless of the clarity with which a state expresses a policy to permit anticompetitive behavior, state-action immunity will not be extended without actual, meaningful state supervision. See *Praxair Inc. v. Florida Power's Light Company*, 64 F.3d 609 (11th Cir. 1995) (finding sufficient state supervision to cloak a territorial allocation of customers with state-action immunity), cert denied, 517 U.S. 1190 (1996); and *TEC Cogeneration, Inc. v. Florida Power & Light Co.*, 76 F.3d 1560 (11th Cir.) (Finding state exercised sufficient independent judgment and control to satisfy the active state supervision prong), modified 86 F.3d 1028 (11th Cir. 1996).

III. APPLICATION OF "STATE-ACTION" DOCTRINE TO PRICING VIOLATIONS

Price-fixing arrangements are the most frequently prosecuted of antitrust violations and result in some of the largest damages awards. Antitrust concerns are potentially raised whenever utilities enter into agreements that affect price levels. The United States Supreme Court has held that combinations of competitors formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity" are deemed inherently anticompetitive and are illegal per se. However, the unique circumstances surrounding utilities have generally caused courts to decide price-fixing antitrust challenges against utilities under the Rule of Reason analysis, which views the allegedly anticompetitive conduct in light of the "facts peculiar to the business, the history of the restraint, and the reasons why it was imposed." *Chicago Board of Trade v. United States*, 246 U.S. 231, 238 (1918); See, *National Society of Professional Engineers v. United States*, 435 U.S. 679, 692 (1988); *FTC v. Indiana Federation of Dentists*, 476 U.S. 447, 458 (1986). Rule of Reason analysis thus enables defendants to attempt to establish that, under the circumstances, their actions can properly be attributed to the state.

For natural gas companies to qualify for state-action immunity in the area of price-fixing, it is especially important that their rates are a product of the state's efforts to regulate the price of natural gas, not merely privately-set rates for which the state has given authorization or approval. Indeed, even where a state expressly approves of rates offered by utilities, state-action immunity for those rates will not be extended unless the rates were the product of a clearly expressed state policy to set, or at least closely regulate, the price. *Columbia Steel Casting Co., Inc. v. Portland General Electric Co.*, 111 F.3d 1427 (1997); *Phonetele, Inc. v. American Tel. & Tel. Co.*, 664 F.2d 716 (9th Cir. 1981); *Cantor v. Detroit Edison Co.*, 428 U.S. 579 (1976).

City of Vernon v. Southern California Gas Co., 1994 WL 896057 (C.D. Cal. 1994), is illustrative of this principle. In *City of Vernon*, a district court dismissed Vernon's antitrust suit against Southern California Gas ("SoCal") after finding that SoCal was shielded by the state-action doctrine. In an attempt to lower the cost of natural gas to its industrial and commercial residents, Vernon established a municipal utility and sought to purchase gas from SoCal at a wholesale rate. SoCal, however, refused to sell gas at a wholesale rate and instead charged Vernon at the retail rate, thus thwarting Vernon's attempts to lower natural gas prices for its residents. In response, Vernon sued SoCal, alleging anticompetitive pricing and illegal monopolization in violation of § 2 of the Sherman Act.

The court agreed with SoCal's argument that, because the California Public Utilities Commission (CPUC) approved its rate, the state-action doctrine barred Vernon's federal antitrust claim against it. The court applied the Midcal test to determine whether the CPUC's approval of SoCal's rates amounted to actual state involvement rather than mere deference to private price fixing arrangements.

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The court relied on two facts in finding that California had a clearly articulated state policy replacing competition with regulation in natural gas pricing. First, under the California Public Utilities Code, utilities must apply to the CPUC for initial approval of rates and cannot raise rates without CPUC approval. Second, the California legislature has empowered the CPUC to fix rates for public utilities when necessary. Given these regulations, SoCal was not free to independently establish its own rates but rather had to apply to, and receive approval from, the CPUC before its rates, such as the one extended to Vernon, could take effect.

Finding that a clearly articulated state policy existed, the court then turned to the active state supervision prong of the Midcal test. The court stated that, to satisfy this prong, the CPUC must be vested with the power to review SoCal's rate-setting and to disapprove those rates that do not comply with state policy. Several factors supported the presence of active supervision. First, the CPUC may investigate a utility's rate schedule, and has broad powers to enforce its orders and to ensure that utilities charge the rates filed with the CPUC. Second, the California Public Utilities Code prevents utilities from charging or collecting a rate different from the one filed with the CPUC. Third, SoCal's rates to Vernon were the subject of extensive proceedings before the CPUC, during which the Commission made detailed findings of fact and law before concluding that "it would be unfair for Vernon to receive a wholesale rate if it was not willing or able to deliver gas to all customers in Vernon." In light of these factors, the court found that California's approval, through the CPUC, of SoCal's rates amounted to active state supervision as contemplated by the Supreme Court in Midcal. Interestingly, the court refused to entertain Vernon's arguments that the CPUC's decision was incorrect, noting that only the California supreme court has jurisdiction to review CPUC decisions.

Not all courts extend state-action immunity for pricing-related antitrust allegations leveled against utilities. For example, in *Aurora Gas Company v. Presque Isle Electric and Gas Co-op*, Util. L. Rep. ¶ 14,119 (E.D. Mich. 1996), a federal court refused to extend state-action immunity to Presque Isle Electric, despite several facts that appeared to support Presque Isle Electric's argument that its actions were a result of state regulation. Aurora and Presque Isle Electric competed for local residential distribution of natural gas in northeast Michigan by obtaining multi-year franchises or franchises of indefinite duration from various municipalities. After being outbid by Presque Isle Electric on several occasions, Aurora brought suit in federal court alleging that the rates offered Presque Isle Electric's franchise bids were "substantially below" their actual cost and thus a form of predatory pricing in violation of federal antitrust law.

Again, the court applied both prongs of the Midcal test independently to determine whether Presque Isle Electric would be protected by the state-action doctrine. Unlike the court in *City of Vernon*, however, the court narrowly interpreted the "disfavored" state-action doctrine, noting that "the court must look only at the challenged activity, not at a general regulatory scheme for the industry."

The court found that Michigan has a clear policy to permit municipalities to grant monopolies to firms providing electric or natural gas power and that the state established a public utilities commission charged with the duty of fixing the rates and charges of public utilities within the state. In support of its state-action immunity defense, Presque Isle Electric stressed that the municipalities in each instance approved its prices as included in its bids and that the grant of those franchises should be considered state action. To this the court noted that "[i]f the question presented to the court is whether the municipalities had the authority to grant franchises (monopolies) to distribute natural gas, the state-action doctrine would likely apply."

However, such was not the question at issue, according to the court. Rather, the court agreed with Aurora that the issue to be resolved was whether Presque Isle Electric's predatory pricing practices violate antitrust law. According to the court, "[i]n seeking and obtaining a permitted monopoly, the state-action doctrine does not protect against unlawful activity in pursuit of that monopoly." Thus, despite state statutes which clearly demonstrated pervasive regulation of public utilities, the court found that the Michigan Public Service Commission does not regulate the bidding process by which municipalities award franchises, and, therefore, there was no clearly articulated state policy in favor of the specific action challenged.

Turning to the second prong of the Midcal test, the court relied heavily on the Supreme Court's decision in *Ticor*, finding that Aurora failed to establish that Michigan actively supervised Presque Isle Electric's pricing. Although Michigan clearly had authority to supervise Aurora's pricing methods, the court found that state supervision was not exercised in fact because the

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state neither reviewed nor approved of the bids. The court rejected Aurora's argument that the municipalities' grant of franchises essentially set the rate charged to users and thus, the municipalities' actions suffice to fulfill the active supervision prong of the Midcal test. Rather, the court held that active municipal supervision cannot substitute for active state supervision, and because the bidding process was not actively supervised by the state, no state-action immunity could be extended.

The City of Vernon and Aurora Gas Company cases illustrate the importance of active state supervision. In City of Vernon, the challenged practice was specifically reviewed and approved by the state PUC. In Aurora Gas Company, the challenged practice was not specifically reviewed and was approved indirectly. Although recent cases have come out on all parts of the spectrum, modern courts typically adopt a narrow interpretation of the state-action doctrine, thus making it more difficult for utilities to satisfy the Midcal test.

IV. STATE-ACTION DOCTRINE APPLIED TO MARKET ALLOCATION - THE PORTLAND GENERAL CASES

Exclusive market allocations are a common characteristic in the natural gas and electric industries. The progressive trend towards increasing competition and deregulation in these industries has resulted in a growing number of antitrust challenges involving market allocation agreements, which, in many instances, have been in effect for a substantial period of time.

Two recent federal court antitrust decisions involving market allocation agreements by utilities involve the same company, Portland General Electric, and similar facts. However, the two courts reached differing conclusions, upholding Portland's state-action doctrine defense in one case and rejecting it in the other. The reason for the difference in the courts' decisions lies in the courts' interpretation of Oregon's state policy, or, specifically, whether the challenged agreement could properly be said to have resulted from an affirmative state action to supplant competition.

In *Columbia Steel Casting Co., Inc. v. Portland General Electric Co.*, 111 F.3d 1427 (1997) (Portland I), the Ninth Circuit Court of Appeals denied Portland General Electric's (PGE) state-action doctrine defense in an antitrust challenge to its market allocation agreement with Pacific Power and Light (PP&L). Thwarted in their efforts twenty years ago to gain a state agency's approval of an exclusive territory agreement, these two electric companies had then settled for an agreement which divided the city of Portland into two separate and non-competing sections. The agreement, which the Oregon Public Utilities Commission ("OPUC") approved, provided that all electric utility customers in each section became the customers of the utility serving that section, but the agreement did not expressly refer to exclusive service territories. The case arose nearly twenty years after the agreement took effect, when one of PGE's customers, Columbia Steel, attempted to switch its electric service to PP&L. Claiming that Columbia Steel's move would violate its exclusive territory agreement with PP&L, PGE refused to wheel PP&L-generated electricity to Columbia Steel. Columbia Steel responded by suing PGE, PP&L, and the OPUC on the theory that the division of Portland into exclusive service territories violated the Sherman Act, 15 U.S.C. §§ 1-2.

The Court applied the Midcal test, finding that Oregon has a clearly articulated state policy of permitting exclusive service territory agreements but such agreements qualify for state-action immunity only after the OPUC approves them. Although the OPUC approved PGE's agreement with PP&L, the court found that the agreement was for a one-time exchange of customers and did not authorize or establish exclusive service areas. Furthermore, the court found that the OPUC's failure to cite to the state statutes which authorize the establishment of exclusive service territories in its order approving the agreement indicated that the OPUC did not intend to authorize exclusive service.

In response, PGE argued that it was entitled to state-action immunity because the division of the Portland market was a foreseeable result of the OPUC's order approving its agreement with PP&L. The court noted that, as a general rule, private conduct is immunized from antitrust liability if it is a foreseeable result of state agency action and if the circumstances justify an inference that the agency intended to authorize the conduct. And, although the district court initially upheld PGE's foreseeability argument, the district court reversed its decision on remand from the Ninth Circuit. According to the court, a finding of express authorization is a necessary predicate of the foreseeability test, and in no case can the foreseeability test serve as a substitute for a finding of clearly articulated state policy as required by Midcal.

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Less than two years after Portland General was denied state-action immunity in Portland I, the United States District Court for the District of Oregon granted Portland General's state-action doctrine defense in another exclusive territory case. *Columbia River People's Utility District v. Portland General Electric Co.*, 40 F. Supp.2d 1152 (D. Ore. March 23, 1999) ("Portland II").

Like Portland I, Portland II involved a challenge to a market allocation agreement that was said to violate the Sherman Act and a state-action doctrine argument in defense. Because of the strong similarity of the legal and factual issues between the two cases, the court discussed Portland I in detail. However, the district court distinguished Portland I from the immediate case by focusing on the clarity with which the state agency's order granted exclusive territorial rights. The court held that, unlike Portland I, "the OPUC Order allocating territory to [Portland General] speaks with clarity and clearly articulates the intent to allocate an exclusive territory." Consequently, the district court granted Portland General state-action immunity without any discussion of the active supervision part of the Midcal test.

V. APPLICATION OF STATE-ACTION DOCTRINE TO ANTICOMPETITIVE AGREEMENTS

Market allocation arrangements are certainly not the only type of agreements that raise antitrust concerns. Recent years have seen an increase in antitrust challenges to a wide variety of agreements among competitors in the natural gas and electric industries. Because courts are now examining state-action doctrine defenses with a heightened degree of scrutiny, in many cases it has become more difficult for utilities to establish that private agreements are actually the result of state action. However, as the case discussed below indicates, increased competition does not always mean that private agreements will not qualify for state-action immunity from antitrust challenges. Generally, anticompetitive agreements will be afforded state-action immunity where the parties thereto can point to a specific authorization for either the challenged agreement or for substantially similar agreements.

For example, in *Destec Energy Inc. v. Southern California Gas Company*, 5 F. Supp. 2d 433 (S.D. Tex. 1997), a federal court in Texas extended state-action immunity for an anticompetitive agreement that would otherwise have been a per se violation of the Sherman Act. Destec was an antitrust action challenging the inclusion of transport-or-pay clauses in two long-term natural gas transportation contracts that were approved by the California Public Utilities Commission (CPUC). Destec, owner of cogeneration facilities in California, asserted that, by refusing to enter into long-term contracts without transport-or-pay clauses, SoCal monopolized or attempted to monopolize the natural gas transportation market in Kern County, California. In its prayer for relief, Destec sought a declaratory judgment that the transport-or-pay provisions of its contracts with SoCal were void and unenforceable. Destec also sought damages for violations of the antitrust laws, and an injunction against further antitrust violations. Destec was denied relief, however, when the court dismissed its case after finding that SoCal's contracts were sufficiently attributable to state-action under the Midcal test.

Turning first to the clearly articulated state policy requirement, the court noted that the first prong of the Midcal test raised two threshold questions: (1) whether the state deliberately displaced competition with regulation in the field of natural gas transportation; and more importantly, (2) whether the challenged restraint (i.e., the transport-or-pay clause) was part of the field which the state clearly intended to regulate or was a foreseeable consequence of such regulation. The court's findings as to California's policy concerning natural gas transportation mirrored those in *City of Vernon*, supra. The court found that the CPUC had extensive authority to regulate the rates, services, and facilities of California's public utilities.

With regard to the natural gas transportation market, the CPUC discouraged the use of take-or-pay clauses in standard contracts but did not specifically prohibit such clauses in the specific market in dispute. In response, Destec argued that the CPUC's decisions were part of an overall shift in California's policy from regulation of the natural gas market to free competition and, therefore, SoCal failed to establish that California intended utilities to take actions such as theirs. Unpersuaded, the court found that, while the CPUC was allowing the natural gas utility companies more flexibility to compete with interstate carriers, the CPUC did so as part of its policy of continuing to regulate the California natural gas transportation market. Hence, increased competition did not mean an absence of regulation, and SoCal's use of transport-or-pay provisions was held to be within the field regulated by the CPUC and a foreseeable consequence of such regulations.

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With regard to active state supervision, the court readily found that the CPUC's regulatory powers of supervision generally satisfy the second prong of the Midcal test and that the CPUC did in fact review and approve the contracts at issue. Destec conceded as much, but argued that SoCal could not satisfy the active supervision prong because the CPUC gave up its power to actively supervise by waiving its rights to unilaterally modify the contracts in a 1996 Order. The court found that the CPUC's 1996 Order did not negate its authority to supervise the contracts, and furthermore, that a regulatory agency need not retain unfettered authority to modify approved contracts in order to satisfy Midcal's active supervision requirement.

VI. CONCLUSION

The state action defense shields regulated firms from liability under the Sherman Act where the private conduct being challenged is authorized or compelled by state law and is actively supervised by the state. Several courts have held that private parties may invoke this defense even where the state eventually rescinds the operative rule. In these circumstances, the courts have typically held that a private party should not be subject to liability under the Sherman Act if it has "reasonably relied" upon a prior state action having the appearance of legality.

As the above cases indicate, there are perceptible themes among recent state-action doctrine decisions. Among these are a more narrow application of the state-action doctrine, a focus on the state's involvement in the specific conduct challenged rather than in a particular field, and an insistence by courts on actual, meaningful state supervision. As competition waxes and regulation wanes in the natural gas and electric industries, one development is the rising tide of antitrust cases. Whether state-action immunity will shield utilities in future antitrust challenges will likely depend on the nature of the specific action challenged, the expressed policy of the state, the extent of state review, and utilities' ability to favorably establish both of these aspects in court.