

***Fundamentals of Utility Law
Market Structure, Pricing, Mergers, Jurisdiction***

Scott Hempling
shempling@scotthemplinglaw.com

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Overview:

Injecting Competition into Historically Monopolistic Markets

The U.S. energy and telecommunications industries both display contradictory trends. Originally monopolistic, they host ambitious entrants: in electricity, providers of renewable energy, storage, modular nuclear plants, and energy efficiency services; in telecommunications, cellular phones, broadband access and content and more. But juxtaposed with this energetic activity is a three-decade parade of mergers and acquisitions, with which the original monopoly companies consolidate and complicate their industries and markets. Your local electric company, independent for most the 20th century, is now likely to be one subsidiary of a multi-utility, multi-state, even multi-industry and multi-national holding company. AT&T's original vertically integrated monopoly, broken up by a 1984 antitrust settlement, has now reintegrated, while major communications incumbents are merging with major content providers.

What some euphemistically call a struggle is more accurately called a war: the incumbents, still advantaged by their historic monopoly status; versus the new entrants, seeking to inject diversity, innovation and competition. That war is the subject of this seminar.

For over a century, our nation has depended on regulated companies, often monopolies, for electricity, gas, telecommunications, transportation and water. Regardless of the industry or era, the regulatory process has had five common elements:

mission (to align utility performance with the public interest);

legal principles (ranging from the state law on exclusive monopoly franchise to federal constitutional protection of shareholder investment);

policy flexibility (accommodating multiple market structures—from monopolies to competition; and multiple public purposes—from reliability to environmental accountability);

reliance on multiple *professions* (law, economics, finance, accounting, management, engineering and politics); and

formal administrative procedures, such as adjudication and rulemaking.

While these common elements remain, new political challenges are causing policymakers to stretch regulation's core principles and processes. Three examples of these challenges are:

climate change (e.g., To what extent should we make utilities and their customers responsible for "greening" energy production and consumption?);

universal service (e.g., Should we bring broadband to every home, and at whose cost?); and *privacy* (e.g., How do regulators induce personal changes in energy consumption while protecting the related data from public exposure?).

And then there are two constants: *ideological debate* (e.g., private vs. public ownership, government intervention vs. "free market"); and *state-federal tension* (e.g., Which aspects of utility service are "national," requiring uniformity, and which are "local," warranting state experimentation?).

These traditional elements, new challenges and constants comprise the subjects of this seminar. In our weekly two-hour class will address substantive law—*market structure, pricing, corporate structure, and federal-state jurisdiction*.

What I Hope for You to Learn

On completing this course all students will be able to:

- Recognize and critique the *multiple and conflicting purposes of economic regulation*; then articulate your own law-based definition of the “public interest”—a phrase appearing in every regulatory statute.
- Develop a mental file cabinet that stores the legal principles regulators use to (a) *induce the performance of monopolies* and (b) *convert monopoly markets into effectively competitive markets*.
- Understand the *complementary and conflicting roles of competition and regulation*, not as ideological poles, or as weapons in a century-long struggle for market control, but as tools that can be combined, productively or counterproductively, to *induce market performance*.
- Understand that today’s regulated industries reflect both “*old world*” *policies* and “*new world*” *technologies*—the combination of which can either sustain or impede performance progress; and then, see why efforts to transform historically monopoly markets into competitive markets is exceedingly difficult legally, economically and politically.
- Evaluate the effectiveness of a regulatory policy, in terms of the multiple dimensions of performance; e.g., *costs, quality, competitiveness, innovation*.
- Understand how our *federal-state, dual-jurisdictional system* makes regulatory policymaking simultaneously rich and frustrating, requiring decision-makers to grasp and value the local and the national.
- See how the major forms of government decision-making—*legislation, rulemaking, adjudication and judicial review, at the state and federal levels*—work together (or in conflict) to produce or undermine policy.

- Understand the *multiple roles lawyers play* in this field (e.g., drafting legislation, planning and executing adjudication, advising decision-makers, drafting regulatory decisions, defending decisions on judicial review); and how those roles make use of experts and expertise from the disciplines of economics, accounting, finance, engineering, management and politics.

Required Materials

Hempling, *Regulating Public Utility Performance: The Law of Market Structure, Pricing and Jurisdiction*, Second Edition (American Bar Association 2021).

Hempling, *Preside or Lead? The Attributes and Actions of Effective Regulators* (2d ed. 2013). Download for free in the NARUC [RTI Learning Management Site](#).

Other cases and materials are listed in the Course Outline. I assume that you can access most cases yourself via WestLaw or Lexis. Non-case materials (yellow highlighted here) will be available in the NARUC [RTI Learning Management Site](#).

Weekly Questions

After doing your weekly pre-session reading, you can email me written questions. Please put the questions into the email, unnumbered and unbulleted, rather than in a separate file. I will attempt work the answers into the live sessions. Send them to my email **by 5pm on the Saturday week before class**. Examples of types of questions:

A request for clarification or explanation of a complicated topic (Be sure the question describes what you don't understand or what is not clear; merely saying "Please explain return on equity" is not useful. Display your struggle. Everyone will learn.)

A question about how the week's readings applies to current structures or actions in a regulated utility industry. Provide the background to your question.

A question probing a case you read. Provide background on the case, so others understand the question.

But: In these questions, please don't ask me to opine on a disputed matter, other than to explain how the issue relates to the course. While I have written and testified about my views on many issues, when I teach I aim to be as objective as possible. Don't hesitate to contact me separately, though, to discuss my opinions.

On the [RTI Learning Management Site](#), there is a long document containing all the questions my Georgetown students have asked in the past, with my written answers, organized by topic. I recommend that you make this document part of your weekly reading.

Course Outline and Weekly Readings

Each week, students will read the assigned chapter from *Regulating Public Utility Performance* (read the text and the footnotes), plus several of the short, easy-to-read essays from *Preside or Lead*. Under each topic below I have also listed the major cases as optional reading. All fully educated professionals know all these cases. Read at least one case each week. While my book summarizes major cases, there is no pedagogical substitute for sweating through the cases on your own.

About *Preside or Lead*: Effective regulatory practitioners study not only the law; they also study their decision-makers. These essays address the positive and negative tendencies of regulatory decision-makers, hundreds of whom I have worked for or with, or appeared before— or challenged (or defended) in appellate courts.

Week 1: Regulation's Purposes, Dimensions, and Professions [Sept. 9]

This session introduces the purposes of utility regulation, the actions and actors that regulators regulate, the contributions made by seven professional disciplines, and the regulatory lawyer's multiple roles. ***For this week only, students should read all items.***

1. Read **Alberta Utility Commission Chair's brief remarks** on a century of regulation. His speech is a perfect summary of what regulation of monopolies and competition is about.
2. *Regulating Public Utility Performance*: Read Preface and Ch. 1.
3. Take note of the document called "**Hempling Legal Book: Table of Contents Diagrammed.**" This document presents in diagram form every topic we will address in the course; the first page shows all 12 chapters; then each subsequent page has the detail for each chapter. Consider printing it out for regular reference. Visualizing structure aids absorption.
4. *Preside or Lead?* Read Essays 1-4, 53.

Weeks 2-12

Substantive Law: The Rights and Obligations of Utilities and Their Regulators, Under Monopoly and Competitive Conditions

Most substantive regulatory law falls into three main categories: ***market structure*** (What types of entities are authorized to sell what products? How many sellers and buyers are in the market and what are their market shares? What entry barriers exist?); ***sales of goods and services*** (What standards apply to ensure that prices, and other terms and

conditions, are consistent with the public interest?); and *corporate structure* (What activities, conducted under what corporate arrangements, may exist within a utility's corporate family?) Complicating the substantive picture is our federal system, in which policies, statutes, rules and orders emanate from both the federal and state levels, whose jurisdictional interactions can be exclusive, concurrent, or preemptive. (In 2016 there were two U.S. Supreme Court decisions relating to federal-state relations under the Federal Power Act.)

Week 2: Market Structure I: Rights, Obligations and Powers of the Traditional Utility Monopoly [Sept. 16]

For most of a century, the market structure for electricity, gas, telecommunications, and water utilities was a monopoly market, served by a local, vertically integrated utility holding a franchise granted by state government (or municipal government, acting under state-granted powers). The granting of a utility franchise, "far from affecting the public injuriously, has become one of the most important agencies of civilization for the promotion of the public convenience and the public safety." *New Orleans Gas Co. v. Louisiana Light Co.*, 115 U.S. 650, 669 (1885). Since the 1980s we have introduced competition in segments of all these industries (competition being the subject we'll cover in Weeks 3-5). But features of the monopoly structure remain present and pervasive in all markets in which these utilities exist.

This week we will study the *seven rights, obligations or powers* that characterize most utility monopolies: exclusive franchise, consent to regulation, obligation to serve, quality of service, power of eminent domain, limits on tort liability, and the right to charge just and reasonable rates.

Required: *Regulating Public Utility Performance, Ch. 2*
 Preside or Lead, Essays 6, 10, 11, 12, 49

Optional:

1. *Munn v. Illinois*, 94 U.S. 113 (1877) (consent to regulation)
2. *Application of Houston Lighting and Power*, 50 PUR4th 157 (1982) (quality of service)
3. *Narragansett Electric Company*, 65 PUR4th 198 (1985) (eminent domain)
4. *Consumers Power Co.*, 140 PUR4th 332 (1993) (eminent domain)
5. *Illinois Bell Switching Station*, 641 N.E.2d 440 (Ill. 1994) (limits on tort liability)

Week 3: Market Structure II: Authorizing Competition in Traditional Monopoly Markets [Sept. 23]

The "central, continuing responsibility of legislatures and regulatory commissions" is "finding the best possible mix of inevitably imperfect regulation and inevitably imperfect competition." Alfred Kahn, *The Economics of Regulation* Vol. I, Introduction at xxxvii; Vol. II at 114.

Beginning in the 1970s and continuing today, federal and state regulators have been introducing "competition" at various levels of the electricity, gas, and telecommunications industries. This forty-year experiment is complicated, controverted, and not always successful. *Authorizing* competition does not ensure *effective* competition, as a continuous flow of agency and court decisions reveals. In each regulated industry, the struggle over "Who should sell what?" continues today; most prominently in the area of "distributed energy resources" (distributed generation, renewable energy, storage, microgrids, community solar, energy efficiency and demand-side management).

The first step is to identify which products or services, among the many performed by a vertically integrated monopoly, should be subjected to competition. The next step is to modify each of seven legal features of the incumbent monopoly (discussed in Week 2), so that competition is legally permissible and possible. Then it is necessary to assess and adjust market features external to the incumbent, such as entry barriers, to make competition possible.

Policymakers also must address the problem of "stranded costs": investments made by the utility, before the competitive era, to carry out its obligation serve, which might decline in value now that customers, in the competitive era, can shop elsewhere.

Required: *Regulating Public Utility Performance, Ch. 3*
 Preside or Lead, Essays 18, 19, 23, 24

Optional:

1. New York Commission order on *Reforming the Energy Vision*, pages 1-4, 10-30, 31-35, 45-46
2. Pennsylvania statute on retail competition in electricity [highlighted provisions]
3. Hempling article on stranded cost

Week 4: Market Structure III: Making Competition Effective [Sept. 30]

Authorized competition is not the same as *effective* competition. The readings for this week describe how policymakers make competition effective. There are two main steps: first, eliminating the incumbent's control of strategic assets by "de-integrating" the vertically integrated utility; and second, monitoring market structure and seller behavior to prevent anticompetitive practices.

The goal here is to separate monopoly assets and activities from competitive assets and activities, so that the incumbent's control of monopoly assets does not distort competition in the newly competitive markets. There are two main steps: "unbundling" competitive functions from competitive functions, and granting nondiscriminatory access to "bottleneck facilities."

Required: *Regulating Public Utility Performance, Ch. 4*
 Preside or Lead, Essays 26, 27, 28, 29, 30

Optional:

1. *Verizon v. Federal Communications Commission*, No. 11-1355 (Jan. 15, 2014) (discussing "common carrier" obligation in the context of broadband access) (read opening 5 paras. only)
2. <http://codes.ohio.gov/orc/4928.17> (Ohio statute on corporate separation)

Week 5: Market Structure IV: Monitoring Competition for Anticompetitive Conduct [Oct. 7]

Even after unbundling and nondiscriminatory access to bottleneck facilities, competition doesn't happen automatically. Other market structure features, plus profit-maximizing incumbent behavior, pose obstacles. The regulator must monitor and adjust.

Required: *Regulating Public Utility Performance, Ch. 5*
 Preside or Lead, Essays 33, 34, 35

Optional:

1. ["Reforming the Energy Vision": Did New York Get Everything Right?](#)
2. *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956) (market power)
3. Sherman and Clayton Acts, 15 U.S.C.A. secs. 1-7; 12-27
4. *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973) (state-created monopolies are subject to antitrust prohibition against "monopolizing")
5. *Cantor v. Detroit Edison Co.*, 428 U.S. 579 (1976) (same)
6. *Conway Corporation v. FPC*, 426 U.S. 271 (1976) (price squeeze under Federal Power Act Section 205; economic regulators must take antitrust principles into account when dealing with their jurisdictional transactions)
7. *Gulf States Utilities Co. v. FPC*, 411 U.S. 747 (1973) (utility financing under Federal Power Act Section 204; "public interest" phrase in regulatory statutes means that economic regulators must

- take antitrust principles into account when dealing with their jurisdictional transactions)
8. *Southern Pacific Communications Co. v. American Tel. & Tel. Co.*, 740 F. 2d 980, 1001 (D.C. Cir. 1984) (entry barriers)
 9. *Fed. Trade Comm'n v. Procter & Gamble*, 386 U.S. 568 (1967) (entry barriers)

Weeks 6-9: Sales of Goods and Services

Among the most controverted and time-consuming regulatory activities is setting prices for the goods and services that utilities sell. Five main legal principles guide and constrain regulators: the "just and reasonable" standard—which, absent statutory repeal, applies both in monopoly and non-monopoly (but still regulated) markets; the prohibition against undue discrimination; the filed rate doctrine; the prohibition against retroactive ratemaking; and the *Mobile-Sierra* doctrine (which applies only under the Federal Power Act).

Week 6: Sales of Goods and Services I: Ratemaking Under the "Statutory Just and Reasonable" Standard and the Constitution's Fifth Amendment [Oct. 14]

For a century, the standard method for setting utility rates for regulated monopolies has been "embedded cost" regulation (sometimes referred to as "rate of return" regulation or "cost- plus" regulation). The commission estimates what it will cost the utility annually to meet its public service obligations, then calculates rates that give the utility a fair opportunity to recover those costs plus earn a reasonable profit (sometimes called "return") on its capital investment. But as we learned in Chapter 3, since the 1980s, we have authorized competition in certain formerly monopoly markets. In one of those markets, wholesale electricity, we have added a new regulation option known as "market-based" rates. These rates are still subject to the statutory "just and reasonable" standard (that is, we have not "deregulated" in the sense of repealing the regulatory role in overseeing prices). But under market-based rates, the regulator does not set the rates. Rather, the seller sets its own rates, disciplined only by market forces (and regulatory intervention when market forces are insufficient). To gain permission to do so, the seller must prove that it is unable to exercise "market power."

Required: *Regulating Public Utility Performance, Ch. 6*
Preside or Lead, Essays 44, 45
Verizon Communications v. FCC, 535 U.S. 467 (2002) (containing a superb summary of the history and technique of cost-based ratemaking). Read Intro and Part I.A. only.

Optional:

1. "Ratemaking in 30 minutes" outline (highly recommended; it's short and easy)
2. *Market St. Ry. Co. v. R.R. Comm'n of Calif.*, 324 U.S. 548 (1945)
3. *Missouri ex rel. Southwestern Bell Tel. Co. v. Pub. Serv. Comm'n*, 262 U.S. 276 (1923) (read only the Brandeis concurrence)
4. *Bluefield Water Works & Improvement Company v. Public Service Comm'n*, 262 U.S. 679 (1923)
5. *Federal Power Comm. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944)
6. *Covington & Lexington Turnpike Road Co. v. Sandford*, 164 U.S. 578 (1896)

Week 7: Sales of Goods and Services II: Market-Based Rates Under the Federal Power Act's "Just and Reasonable" Standard [Oct. 21]

Required: *Regulating Public Utility Performance, Ch. 7*

Optional:

Farmers Union Central Exchange, Inc. v. F.E.R.C. (Farmers Union), 734 F.2d 1486 (D.C. Cir. 1984).

Week 8: Sales of Goods and Services III: Undue Discrimination, Filed Rate Doctrine [Oct. 28]

1. **Prohibition against undue discrimination**

Required: *Regulating Public Utility Performance, Ch. 8*

Optional:

Citizens Utilities Company, 151 PUR4th 238 (1994)

2. **Filed rate doctrine**

Required: *Regulating Public Utility Performance, Ch.9*

Optional:

1. *State of Calif. ex rel. Lockyer v. Coral Power et al.*, 383 F.3d 1006 (9th Cir. 2004)
2. *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951)
3. *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 (1981)
4. *Nantahala Power & Light v. Thornburg*, 476 U.S. 953 (1986)
5. *Mississippi Power & Light v. State of Mississippi*, 487 U.S. 354 (1988)

Week 9: Sales of Goods and Services IV: Retroactive Ratemaking, Mobile- Sierra Doctrine [Nov. 4]

1. Prohibition against retroactive ratemaking

Required: *Regulating Public Utility Performance, Ch. 10*

Optional:

Narragansett Elec. Co. v. Burke, 119 R.I. 559, 381 A.2d 1358 (1977)

2. Mobile-Sierra doctrine

Required: *Regulating Public Utility Performance, Ch. 11*
Morgan Stanley Capital Group Inc. v. Public Utility District No. 1 of Snohomish County, 554 U.S. 527 (2008)

Optional:

1. *United Gas Pipe Line Co. v. Mobile Gas Service Corp. Federal Power Commission v. Sierra Pacific Power Company Permian Basin Area Rate Cases*, 390 U. S. 747 (1968)
2. *United Gas Pipe Line Company v. Memphis Light, Gas and Water Division*

Week 10: Corporate Structure, Mergers, and Acquisitions [Nov. 11]

Corporate structure involves the relationships among members and activities of a corporate family: holding companies, subsidiaries and affiliates, and their mix of utility and non-utility activities. The regulator has multiple concerns: Will the risks of non-utility businesses affect the cost of capital to the utility businesses? Will assets created with ratepayer dollars for utility purposes subsidize the utility's non-utility activities? Will

management be distracted from its core purpose of delivering essential services to the public?

Corporate-structure issues involve both static analysis (corporate forms and intercompany relationships) and dynamic analysis (mergers and acquisitions). In the mergers and acquisitions area, the concerns include effects on competition, quality of service, rates, business risk and management distraction. On the positive side is the potential to realize economies of scale and scope, to strengthen a company financially and competitively. There is inherent tension between the private interests of the merging companies and public interest as defined by statute. The regulatory question is always: Is this use of corporate resources an efficient contribution to customer welfare?

Required

1. Peter Bradford, "Gorillas in the Mist"
2. Corporate Structure Issues diagram and table
3. Exelon-Constellation corporate diagram
4. Montana Public Service Commission, *Statement of Factors re future acquisitions*

Optional:

5. *WICOR, Inc.*, 83 P.U.R.4th 639 (Wisc. Pub. Serv. Comm'n, May 21, 1987)
6. *Tucson Electric Power*, 167 P.U.R. 4th 211 (1996) (describing "diversification" failure)

Weeks 11-12: The Federal-State Jurisdictional Relationships

Our regulated industries live with two historical legacies: the Framers' 1789 decision to embed in our Constitution separate governmental structures at the federal and state levels; and Congress's 1930s decisions to create separate roles for federal and state regulators, for industries whose geographic and technological features were then very different. The introduction of competition and the growing interconnectedness (both commercial and physical) across state lines have injected multiple tensions and unpredictabilities into what used to be a calm, amicable, and unremarkable federal-state jurisdictional relationship. These two weeks describe the legal fundamentals of the federal-state regulatory relationship and discuss today's multiple jurisdictional awkwardnesses.

Week 11: Federal-State Jurisdictional Relationships I: Limits on Federal Action—Congress’s Commerce Authority, Tenth Amendment [Nov. 18]

1. **Does the federal government have the power to regulate; *i.e.*, is there an interstate-commerce basis? And is the federal agency acting within its authority?**

Required: *Regulating Public Utility Performance, Ch. 12.A
Preside or Lead, Essays 33-40*

Optional:

- a. *U.S. v. Lopez*, 514 U.S. 549 (1995)
 - b. *National Federation of Independent Businesses v. Sibelius* (U.S. 2012): Focus on the the Commerce Clause section of Chief Justice Roberts's opinion *and* the Commerce Clause section of Justice Ginsburg's dissent. It is hard to imagine a better way to master the Commerce Clause than to study this immensely erudite dialogue, in which each writer addresses the other over a dozen times.
 - c. *Federal Energy Regulatory Commission v. Electric Power Supply Assoc.*, No. 14-840 (2016).
2. **Does the federal statute violate the Tenth Amendment because it interferes with powers reserved to the states?**

Optional

- a. *New York v. U.S.*, 505 US 144 (1992)
- b. *FERC v. Mississippi*, 456 US 742 (1982)

Week 12: Federal-State Jurisdictional Relationships II: Limits on State Action: Dormant Commerce Clause, Supremacy Clause; Models for Federal-State Relationships [Nov. 25]

Required: *Regulating Public Utility Performance, Chap. 12.B, 12.C.*

3. Does the state program violate the dormant Commerce Clause by discriminating against interstate commerce?

a. Violations

Optional:

- (1) *New England Power Co. v. New Hampshire*, 455 US 331 (1982)
- (2) *Wyoming v. Oklahoma*, 502 U.S. 437 (1992)
- (3) *New Energy Co. of Indiana v. Limbaugh*, 486 U.S. 269 (1988)

b. Non-violations

- (1) *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970) [Caution: Court found violation but the case's criteria are often cited as support for non-violations]
- (2) *Alliant v. Bie*, 330 F.3d 904 (7th Cir. 2003) (upholding some provisions and rejecting another), *rehearing denied*, 336 F.3d 545 (7th Cir. 2003)
- (3) *Arkansas Electric Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375 (1983) (discussing state's interest in regulating utilities as a value to be balanced)
- (4) *General Motors Corp. v. Tracy*, 519 U.S. 278, 305-06 (1997) (same)
- (5) *Pacific Gas & Electric Co. v. Public Utilities Comm'n*, 475 U.S. 1, 19 (1986) (same)

4. Is the state action preempted by federal law?

Optional

- a. *Pacific Gas and Electric v. Energy Resources Conservation and Development Comm*, 461 U.S. 190 (1983) (not preempted)
- b. FCC's 2015 Open Internet Order (See Week 4), paras. 431-433
- c. *Kentucky West Virginia Gas Company v. Pennsylvania Public Utility Commission*, 837 F.2d 600 (3d Cir. 1988) (not preempted)
- d. *Pike County Light and Power Company v. Pennsylvania Public Utility Commission*, 77 Pa.

- Commw. 268; 465 A.2d 735 (1983) (not preempted)
- e. *Nantahala Power & Light v. Thornburg*, 476 U.S. 953 (1986) (preempted)
 - f. *Mississippi Power & Light v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988) (preempted)
 - g. *Hughes v. Talen*, No. 14-614 (2016) (preempted)

5. Current challenges in fed-state relationships

How do federal and state statutes assign jurisdiction over the activities that regulators regulate (market structure, sales of power and transmission, quality of service, corporate structure, financial structure)?

Optional

- a. **Table on electricity jurisdiction**
- b. ***Regulating Public Utility Performance, Ch. 13***