

**CASE LAW UPDATE**

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**STATE BAR PUBLIC UTILITY LAW SECTION SEMINAR**  
**August 27, 2010**  
**Austin, Texas**

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## CASE LAW UPDATE

### INTRODUCTION

This paper provides a brief summary of important cases involving utilities law decided in the past 12 months. This update is limited to cases, if any, from state and federal courts in Texas, the United States Courts of Appeals for the Fifth and District of Columbia Circuits, and the United States Supreme Court. Decisions from other federal circuits are not included. These summaries reflect only my interpretation of the facts and holdings in these cases and do not necessarily express the official position of the Office of the Attorney General or any state agency represented by the Office.

### I. U.S. SUPREME COURT

*NRG Power Mktg., LLC v. Maine Pub. Utils. Comm'n*, 130 S.Ct. 693 (2010)

Review on certiorari to consider whether the *Mobile-Sierra* test, which presumes contracted wholesale-energy rates to be just and reasonable, applies to challenges brought by non-contracting parties.

#### Facts

The Federal Energy Regulatory Commission (FERC) approved a comprehensive settlement designed to restructure New England's electric capacity market. The settlement established, among other things, rate-setting mechanisms for capacity, and provided for review under the *Mobile-Sierra* public interest test.

This test, which is a version of FERC's statutory mandate to ensure that all wholesale rates be "just and reasonable," includes a presumption that a "freely negotiated wholesale-energy contract" meets this requirement—a presumption that may be overcome only if FERC concludes the contract "seriously harms the public interest."

The D.C. Circuit broadly upheld the settlement but rejected the *Mobile-Sierra* test, finding that no presumption of justness and reasonableness should attach to rates that are challenged by parties who had not negotiated them.

#### Holding and Analysis

The Supreme Court reversed the D.C. Circuit's judgment to the extent that it rejected the application of the *Mobile-Sierra* doctrine to non-contracting parties.

The Court explained that *Mobile-Sierra* was not an exception to FERC's "just and reasonable" review, but merely an application of that standard to contractually set rates.

In this 5-4 decision, the Court emphasized the need for stability in contracts, opined that sophisticated parties can "generally be expected to negotiate just and reasonable rates," and noted that non-contracting parties are still protected by *Mobile-Sierra*'s provision allowing FERC to reject a contracted rate if it "seriously harms the consuming public."

### II. FEDERAL COURTS OF APPEALS

*UTEX Commc'ns Corp. v. Public Util. Comm'n*, Slip Copy, 2010 WL 3007615 (5th Cir. Aug. 2, 2010)

Appeal of PUC order declining to consider proposed amendments to the interconnection agreement between UTEX and AT&T Texas as part of a particular PUC docket.

#### Facts

The Telecommunications Act of 1996 required incumbent telecom providers to allow new entrants access to certain equipment: Unbundled Network Elements, or "UNEs." A local carrier can obtain these UNEs either by negotiating an agreement itself or by opting into

an existing agreement already obtained by another local carrier and approved by the PUC.

UTEX chose this second option, adopting a contract that, like most such contracts, contained a change of law provision. However, the next years saw the law change frequently, with the FCC issuing orders, courts rejecting them, and the issuance of new orders that did not address certain issues.

Ultimately, the PUC, with the guidance contained in the FTA, FCC rules, a complex body of case law, and the Triennial Review Order and Triennial Review Remand Order (TRO and TRRO), initiated a change-of-law docket that comprised UTEX and 27 other local carriers who had opted into the same agreement.

However, in addition to modifying the agreement to reflect changes in law, UTEX also sought to amend the pricing provisions and other terms. The PUC determined that such a request was beyond the scope of the TRO/TRRO change-of-law docket. (UTEX also had a new-agreement arbitration pending, which was later abated to await the FCC's VOIP decisions.)

UTEX additionally claimed it needed changes to access UNEs to which it was entitled according to the FCC. When the PUC declined to address these issues in the change-of-law docket, UTEX appealed to federal district court, which upheld the PUC's decision, and this appeal followed.

#### Holdings and Analysis

The Fifth Circuit's opinion affirmed the PUC's broad discretion to limit the scope of its own proceedings.

The Court also held that any deficiencies in UTEX's agreement were not created by a change in law. Thus, nothing in the FTA, FCC rules, or the TRO and TRRO required consideration of UTEX's issues in this change-of-law docket. Nor, the Court held, was the Commission or a court required to review the full agreement, as amended in the change-of-law docket, for compliance with the FTA.

*Coastal Habitat Alliance v. Patterson*, Slip Copy, 2010 WL 2465032 (5th Cir. Jun. 17, 2010) (per curiam) (not designated for publication)

Petition for review by landowners and environmental groups seeking to halt construction of wind farms on Texas coast.

#### Facts

The Coastal Habitat Alliance (Alliance), an association of landowners and environmental groups, filed suit against the Land Commissioner, the PUC Commissioners, and two private developers in federal court seeking to enjoin the construction of two wind farms on private ranch land in Kenedy County.

The Alliance argued that, under a plan Texas filed with the Secretary of Commerce in 1995 pursuant to the Coastal Zone Management Act (CZMA), 16 U.S.C. § 1451 et seq., Texas was obligated to conduct a public proceeding to review all electric generation projects in the coastal zone.

Because Texas had not reviewed the siting of the wind farms at issue, plaintiffs argued that the project had to be enjoined until that review had taken place. The defendants' motions to dismiss under Federal Rules 12(b)(1) and 12(b)(6) were granted and this appeal followed.

#### Holdings and Analysis

The Fifth Circuit affirmed the district court's dismissal, finding that there was no state law in active conflict with federal law. The Court noted that in enacting the CZMA Congress had specifically disclaimed any preemptive effect. Rather, the Act is a voluntary program that, to the extent it places obligations on government, directs the Secretary of the Interior to ensure compliance in order for states to receive federal funding. And this—the withholding of federal dollars, not injunctive relief—was the remedy for any potential violation of a state's obligations under the CZMA.

Although it has been long established that

the CZMA provides no private right of action, the Alliance made an interesting argument: that its suit arose not under the CZMA, but under the Supremacy Clause, citing a recent Fifth Circuit opinion (*Planned Parenthood of Houston v. Sanchez*, 403 F.3d 324 (5th Cir. 2005)) that suggested that this Constitutional provision may provide an independent source of jurisdiction.

However, the Court distinguished *Sanchez* on the basis that there was no affirmative state law that was in active conflict with federal law, and thus there was nothing to preempt or be preempted by.<sup>1</sup>

In addition, the Court noted that the CZMA itself did not specify the particular type of public review sought by the Alliance. Therefore, as the CZMA did not bestow any potentially preemptive procedural rights on private parties, the Alliance lacked standing and the district court's dismissal was affirmed.

### III. FEDERAL DISTRICT COURTS

Surprisingly, little utility case law has issued from the federal district courts relevant to this update.

### IV. TEXAS SUPREME COURT

A quiet year from the Texas Supreme Court, but expect an eventful case law update in 2011 following, presumably, the issuance of the Court's true-up decisions.

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<sup>1</sup> As the Court explained: "In *Sanchez*, the plaintiffs sought access to the benefit of federal funding that was being dispensed through a state program. In the instant case, the federal benefit the Alliance seeks is the grant of 'procedural rights' to challenge construction of wind farms. In other words, the benefit the Alliance seeks in the instant case is the 'right' itself. However, no such 'right' exists under the [CZMA] that Texas law is impeding, and therefore the Alliance lacks standing to bring its claims." 2010 WL 2465032 \*3 n1.

### V. TEXAS COURTS OF APPEALS

*Office of Pub. Util. Counsel v. Public Util. Comm'n*, 303 S.W.3d 904 (Tex. App.—Austin 2010, no pet.).

Appeal from district court's decision affirming the Commission's order that statewide stranded costs exceeded \$5 billion, and its reallocation of the excess amount, and remanding for further consideration of environmental retrofit costs.

#### Facts

Texas Utilities Code section 39.253(f) mandates that, after deregulation, once total retail stranded costs exceed \$5 billion, the excess amount will be allocated among ratepayers based on certain factors.

Ultimately, the PUC found that these stranded costs totaled approximately \$6.029 billion, despite various objections to the calculation, including TIEC's argument that interest on stranded costs is itself a stranded cost and should be added to the tally. The Commission similarly denied TIEC's request to include the utility's up-front costs incurred in securitizing its stranded costs.

The PUC also declined, over OPC's objections, to reduce the total amount of stranded costs resulting from a tax benefit, known as ADFIT (Accumulated Deferred Federal Income Tax).

In addition, OPC requested that the amount be adjusted to reflect a potential refund for certain environmental retrofit costs that were currently the subject of another PUC proceeding, an argument that persuaded the district court to remand on that issue.

#### Holdings and Analysis

The Court of Appeals upheld the Commission's order in its entirety, reversing the portion of the district court's judgment that remanded to the PUC the environmental retrofit issue.

The Court found that although TIEC's

argument concerning interest could be supported by portions of Texas Supreme Court precedent when read in isolation, this ignored the broader import of those decisions, which recognized the legislature's clear intent that the utility be made whole following deregulation.

The Court relied on the plain language of PURA to find that the Commission's decision not to calculate interest on stranded costs as stranded costs was not erroneous. Applying a similar analysis, the Court found the PUC's treatment of the utility's up-front securitization costs consistent with PURA.

Likewise, the Court affirmed the PUC's treatment of ADFIT, or accumulated deferred income tax, and found substantial evidence to support its determination regarding interest on reconciled amounts. *See* 303 S.W.3d at 912-13.

Finally, the Court reversed the district court's remand for consideration of environmental retrofit costs, holding that deference was due the PUC's interpretation of its procedural rule to find that the matter was not timely raised.

*Creedmoor-Maha Water Supply Corp. v. Tex. Comm'n on Env'tl. Quality*, 307 S.W.3d 505 (Tex. App.—Austin 2010, no pet.)

Appeal of trial court's finding of no jurisdiction to review TCEQ decision to terminate a portion of water supply corporation's CCN.

#### Facts

This case involved the application of a Water Code statute, § 13.254(a-1)-(a-4), a 2005 provision that creates a process for "expedited release" of an area from a CCN and bars judicial review of the decision.

After TCEQ granted a developer's petition for expedited release from Creedmoor's CCN, Creedmoor sued both the agency and the developer under the Uniform Declaratory Judgments Act (UDJA) seeking injunctive relief and a declaration that TCEQ's order was invalid as a violation of Texas's Open Courts provision,

the Due Process Clause, and the Supremacy Clause. The district court dismissed the case for lack of jurisdiction.

#### Holdings and Analysis

The Court of Appeals upheld the trial court's dismissal for lack of jurisdiction, finding that absent a waiver of sovereign immunity from the legislature, there is no common law right of appeal from an agency order, and so rejected Creedmoor's Open Courts claim.

The Court found that the UDJA claim could not be used to collaterally attack the Commission's order, and rejected Creedmoor's Due Process claim, reaffirming that there is no vested property interest in a CCN that would require any additional process.

As in the *Coastal Habitat* case, Creedmoor argued that the agency had violated the Supremacy Clause. But unlike *Coastal Habitat*, there is indeed a federal statute that would allow a private party to assert a claim, provided certain criteria are met.

In this case, one element of the test was found lacking: that Creedmoor was actually capable of serving the subdivision when its CCN was amended. Moreover, TCEQ had put on evidence demonstrating that Creedmoor lacked the resources to serve the development, and thus Creedmoor had pled no justiciable claim.

*Public Util. Comm'n v. Cities of Harlingen*, 311 S.W.3d 610 (Tex. App.—Austin 2010, no pet.)

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Appeal from trial court's reversal and remand of PUC order transferring CCN to new, transmission-only utility, and denying Cities rate case expenses.

#### Facts

In connection with its acquisition of a piece of substation equipment, a new electric utility, Electric Transmission Texas, LLC, (ETT), applied with the PUC for approval of its formation documents, requested a CCN, and

asked to set its initial rates.

In a single docket, the PUC approved the formation documents, and set initial rates, but it determined that although ETT had originally requested a new CCN, it was more appropriate to treat the transaction as a transfer of an existing CCN, which it granted. Finally, the PUC denied Cities' requested rate case expenses, citing in its order the fact that this proceeding was wholesale in nature, and therefore municipalities had no particular interest that warranted recovery of expenses, and also noted that Cities had not apportioned the requested expenses among those portions of the docket that involved rates and those which did not.

The district court reversed the PUC on all grounds, finding it lacked authority to issue a CCN to a utility without a service area, had erred by transferring rather than granting a new CCN, and had improperly denied Cities their rate-case expenses.

#### Holdings and Analysis

The Third Court of Appeals affirmed the PUC's order on all but the rate-case expense issue. The Court held the PUC had statutory authority to issue a certificate to a transmission-only utility and to approve a transfer of CCN rights to ETT without requiring compliance with the statutory provisions relating to new certificates.

The Court found that substantial evidence supported the PUC's approval of the ETT formation transactions under the statutory "public interest" review provision. However, the Court affirmed the district court's remand for a determination of whether Cities should be reimbursed any rate-case expenses.

The Court held the PUC had incorrectly decided that it was precluded by law from ordering reimbursement to Cities in a wholesale proceeding, as the statute authorizing municipalities' rate-case expenses makes no distinction between wholesale and retail ratemaking.

Instead, the PUC should have allowed a "reasonable" reimbursement. The Court noted that the PUC has discretion to determine whether it is reasonable to reimburse expenses incurred in non-rate-case components of the docket or to allow only those expenses relating to ratesetting.

Only two justices joined in the opinion. Justice Patterson filed a dissent, complaining about the handling of Justice Pemberton's recusal from the panel after oral argument. Her dissent did not address the merits of the case.

*Cities of Allen v. Railroad Comm'n*, 309 S.W.3d 563 (Tex. App.—Austin 2010, pet. filed).

Challenge to Railroad Commission rule providing for gas utilities' interim rate adjustments between rate cases.

#### Facts

In 2003, the Texas Legislature amended GURA to allow gas utilities an opportunity to recover capital expenditures made between rate cases. *See* Tex. Util. Code § 104.301 (a.k.a. the "GRIP statute" for "Gas Reliability Infrastructure Program").

Pursuant to the statute, the RRC adopted Rule 7.7101, setting out the substantive and procedural requirements for a utility to obtain a GRIP adjustment.

Thereafter, applications were filed with several cities, who denied them, and appeals of those denials were taken to the RRC. The Commission overruled the cities and granted the applications after taking the position that the GRIP scheme did not provide for adjudicative hearings regarding such appeals.

Cities sued, and the trial denied their request to find the rule void to the extent it prohibited them from participating in appeals to the Commission; rather, the trial court found that the GRIP scheme did not allow for any appeals to the Commission, and that the Cities' ability to deny a GRIP request was limited to procedural defects in the application.

### Holdings and Analysis

After a lengthy discussion of the legislative history behind the GRIP statute, the Court upheld the Commission's rule.

Finding that the legislature had intended to create more incentive to invest in capital infrastructure at a time when potential investors were scarce, the Court also noted that these interim adjustments would be subject to review during the utility's next rate case, which could be filed by a city at any time.

*AEP Texas North Co. v. Public Util. Comm'n*, 297 S.W.3d 435 (Tex. App.—Austin 2009, pet. denied)

Appeal of PUC's decision in utility's final fuel reconciliation.

### Facts

As part of the transition to competition, the legislature required each newly unbundled generation company to file a "final fuel reconciliation" to true-up its fuel expenses "for the period ending the day before the date customer choice is introduced." Tex. Util. Code § 39.202(c). After a lengthy dispute at SOAH, the parties reached a stipulated agreement that the Commission adopted in its order on rehearing. Several parties appealed, the district court affirmed in all respects, and this appeal followed.

### Holdings and Analysis

The Austin Court of Appeals affirmed the Commission's order in all respects. The Court rejected the utility's argument that the PUC had improperly extended the reconciliation period, which should, according to TNC, have ended on January 1, 2002, the date proclaimed by the legislature that each retail customer in Texas shall have retail choice.

Instead, the Court found the PUC's interpretation that customer choice was in fact introduced at a later date reasonable, given the record evidence showing that many TNC

customers had no choice but to remain as such, even after January 1. Likewise, the Court was unpersuaded that the Commission had not followed prior reconciliation methodology, given that this was, after all a final fuel reconciliation proceeding, and therefore the regulatory lag that would have been picked up in a subsequent proceeding had to be accounted for in this docket.

TNC also challenged the Commission's application of a profit sharing agreement between TNC and its customers. The settlement that TNC's parent company (CSW) had entered into pursuant to a merger (the Integrated Settlement Agreement, or ISA) provided that off-system sales margins would be shared with ratepayers for the following five years. However, the final fuel reconciliation took place only three years after the merger.

Therefore, the PUC used a proxy to determine the amount of margins to be shared with customers for the final two years of the agreement, a method that the Court found to be a reasonable remedy necessary to effectuate the terms of the ISA.

In an extended discussion of the ISA, the Court held that, as the ISA was non-unanimous, the PUC had to make independent findings that the rates therein were just and reasonable and supported by substantial evidence. As such, the Court agreed with the Commission that the ISA assumed the character of an administrative order, rather than a private contract, and that "the rules of contract interpretation do not apply in construing the ISA." 297 S.W.3d at 447. Thus, the Commission was entitled to deference in its interpretation of the settlement's provisions and in its ability to fashion reasonable remedies to disputes arising thereunder.

The Court also upheld the PUC's order against issues raised by cities, finding it supported by substantial evidence and neither arbitrary nor capricious.

*Pioneer Natural Resources USA, Inc. v. Public Util. Comm'n*, 303 S.W.3d 363 (Tex. App.—Austin 2009, no pet.)

Appeal of PUC rate order, affirmed by district court.

#### Facts

Electric utility Cap Rock and its customer, an intervenor in the utility's rate case, appealed the PUC's order.

#### Holdings and Analysis

The Austin Court of Appeals affirmed the PUC's order against a challenge by one of its customers, Pioneer Natural Resources USA, Inc., an intervenor before the Commission.

Pioneer asserted, *inter alia*, that the Commission erred by including a portion of the cost of a computer system that Pioneer believed to be unnecessarily expensive, and by approving a hypothetical capital structure of 75% debt and 25% equity.

With respect to the computer system, which Pioneer characterized as "massively oversized" for a utility like Cap Rock, the Court noted that the Commission heard ample, if conflicting, evidence on this issue, and reached a reasonable result by including only 35% of the system's cost in rates.

Again, the Court affirmed the "range of evidence" standard for determining whether a particular figure is supported by the record.

The Court also rejected Pioneer's complaint that the Commission should have used Cap Rock's actual capital structure. Relying on prior case law, the Court found no prohibition on the use of a hypothetical capital structure when substantial evidence supports its application.

Here, there was evidence that the actual capital structure (83/17) would have damaged Cap Rock with no resultant benefit to utility or ratepayer, while Cap Rock's proposed 60/40 structure would harm ratepayers. Once again, the Court found that a figure within the range of testimony was supported by substantial

evidence.

In the utility's sole point of error, Cap Rock complained that by imposing a discount for commercial customers who receive service at primary voltage, the PUC had erroneously interfered with its ability to earn a reasonable return. Deferring to the Commission's expertise, the Court affirmed the order.

*Cities of Corpus Christi v. Public Util. Comm'n*, 2010 WL 2330366 (Tex. App.—Austin June 11, 2010, no pet.)

Appeal challenging PUC's approval of AEP Texas Central Company's (TCC) application to increase its base rates and simultaneously terminate "merger savings" and "rate reduction" riders in TCC's tariff.

#### Facts

In 1999, the Commission approved a settlement, titled the "Integrated Stipulation and Agreement" (ISA), in connection with the merger of CSW with AEP. The ISA required each "Texas Operating Company" (i.e., TCC) to provide its customers certain rate credits during the six-year period following the closing of the merger, to be implemented through "merger savings" and "rate reduction" riders in TCC's tariff. Thereafter, some of the credits were to continue until "base rates for [TCC] are changed."

At the end of the six-year period following the merger, TCC filed a rate case with the PUC and, in the interim, implemented new, bonded rates. Considering these bonded rates to mean that "base rates [were] changed" under the ISA, TCC terminated the merger savings and rate reduction riders. Cities and OPC appealed, the district court affirmed, and this appeal followed.

#### Holdings and Analysis.

On appeal, OPC argued that the merger savings and rate reduction provisions were terminated prematurely on the basis that rates cannot be changed otherwise than in a final

order of the Commission. However, the Court noted the several instances in PURA that provide for changed rates without the need for final PUC approval (though such changes may be subject to PUC review). Moreover, the Court reasoned that to construe the ISA as OPC had argued would provide ratepayers with additional savings that had not been bargained for in the agreement.

In contrast to *AEP Texas North*, however, the Austin Court of Appeals treated the ISA as a contract rather than an administrative order. Compare *AEP Texas North Co.*, 297 S.W.3d at 447 (“We hold that the rules of contract interpretation do not apply in construing the ISA . . .”), with *Cities of Corpus Christi*, 2010 WL 2330366 at \*3 (“In interpreting the ISA . . . we are guided by principles of contract construction.”). Regardless, the Court again upheld the Commission’s interpretation as consistent with the ISA.

The Court also upheld the Order against challenges to the PUC’s treatment of unmet energy efficiency goals and consolidated tax savings, which could not be better expressed than by pinpoint reference to the opinion itself: 2010 WL 2330366 at \*10.