



2007

# Energy Regulation

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## Recommended Citation

Gaye White, *Energy Regulation*, 60 SMU L. Rev. 971 (2007)  
<https://scholar.smu.edu/smulr/vol60/iss3/13>

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# ENERGY REGULATION

*Gaye White\**

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## I. INTRODUCTION

THIS survey focuses on the interpretation of, and changes relating to, various aspects of state-energy regulation. Since traditional oil and gas regulation matters are covered elsewhere in the Survey, this article is limited to developments affecting electric and natural gas utilities. The majority of the significant judicial developments during the Survey period concern the interpretation and implementation of the statutes and rules relating to the deregulation of the Texas electric industry.

## II. ELECTRIC UTILITY

### A. FUEL RECONCILIATION PROCEEDINGS

*CenterPoint Energy Houston Electric v. Public Utility Commission*<sup>1</sup> concerned the utility's request in a fuel reconciliation proceeding to recover purchased power costs under a Joint Operating Agreement ("JOA") arising out of litigation over the management of the South Texas Nuclear Project. CenterPoint Energy Houston Electric ("CenterPoint") appealed a decision of the Public Utility Commission of Texas ("PUC") to disallow recovery of these costs, arguing that the JOA allowed the utilities that were parties to the agreement to reduce their costs. The PUC

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1. 212 S.W.3d 389, 393 (Tex. App.—Austin, 2006 pet. granted, judgment vacated w.r.m.).

claimed that the benefits of the JOA were overstated and that the costs were not recoverable through CenterPoint's fuel factor.

Following the hearing on the fuel reconciliation proceeding, the administrative law judge recommended disallowing \$67.1 million of the \$160 million that CenterPoint paid to the other party to the JOA as their share of the JOA savings.<sup>2</sup> This recommendation was based on (1) a change and recalculation of the JOA's requirement of a 90/10 split, assigning ninety percent of the benefits to the other utility, to a 67/33 split of the savings, and (2) a \$46.8 million reduction in other savings recognized under the JOA. Although the PUC's final order included the administrative-law judge's finding that \$67.1 million of CenterPoint's claimed expenses were not reasonable and necessary, the PUC's basis for the disallowance was "that the parties to the JOA overstated the agreement's actual benefits and that CenterPoint paid more than it reasonably should have through the benefit-sharing payments."<sup>3</sup> The PUC also refused to recognize \$30.6 million of the \$67.1 million of savings based on a finding that the JOA overstated the joint benefits resulting from short-term sales, and \$16.2 million of the \$67.1 million of savings based on a finding that, at certain points in time, the costs of block-power purchases from ERCOT were less than the costs of operating CenterPoint's own gas-fired plants.<sup>4</sup> The district court affirmed the PUC's order disallowing the costs.<sup>5</sup>

CenterPoint challenged the PUC's order as arbitrary and capricious and as not reasonably supported by substantial evidence. The Austin Court of Appeals found that, although CenterPoint was not required to show that it could negotiate a more reasonable agreement, it was required to demonstrate that the 90/10 split of the JOA benefits was reasonable under the circumstances.<sup>6</sup> The court of appeals found evidence in the record that supported the PUC's determination that the split should be adjusted, and held that the PUC's disregard of the 90/10 split and adjustment to a 67/33 split of the shared savings was supported by substantial evidence and was not arbitrary and capricious.<sup>7</sup> The court of appeals also found that evidence was sufficient to support the PUC's decision that (1) the benefits of the JOA were overstated because CenterPoint's margins on short-term power sales to third parties were unreasonably included, and (2) the JOA benefits should also be reduced by \$16.2 million because the studies used by CenterPoint to define benefits attributed to the JOA did not account for short-term wholesale power purchases that CenterPoint would have made in a stand-alone case.<sup>8</sup> The

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2. *Id.* at 398.

3. *Id.*

4. *Id.*

5. *Id.* at 393.

6. *Id.* at 406.

7. *Id.* at 407.

8. *Id.* at 408-11.

court of appeals affirmed the PUC's order disallowing the expenses in its entirety.<sup>9</sup>

### B. ERCOT PROTOCOLS

*BP Chemicals, Inc. v. AEP Texas Central Co.*<sup>10</sup> involved a dispute between BP Chemicals, Inc. ("BP"), operator of a co-generation facility, and Central Power and Light Company, now AEP Texas Central Company ("AEP"). BP and AEP entered into a series of contracts that provided that AEP would take and pay for excess electricity generated at BP's plant. On January 1, 2002, AEP was required to "unbundle" its integrated services as a part of deregulation of the electricity market.<sup>11</sup> In preparation for deregulation, AEP provided notice to BP of the cancellation of the contract on November 29, 2001, effective December 21, 2001. AEP failed to pay BP for power transferred to AEP from August 2001 through September 2001. BP then registered with ERCOT to sell its excess power to third parties.<sup>12</sup> BP sued AEP for breach of contract, based on AEP's failure to pay for the August and September electricity deliveries, and BP's additional loss, incurred when BP was forced to seek third-party purchasers during the remainder of 2001. AEP asserted the affirmative defenses of failure of consideration and excuse from performance as a result of commercial impracticability, impossibility of performance, and/or frustration of purpose. After considering motions from both sides, the trial court agreed with AEP and granted its motion for summary judgment.<sup>13</sup>

The key issues before the Corpus Christi Court of Appeals were (1) whether ERCOT Protocols that required the registration of a qualifying facility, such as BP, became effective July 6, 2001, or January 1, 2002; (2) whether the transfer of electricity from BP's plant to AEP was considered "transmission" on the electric grid as defined in the deregulation legislation and statutes and the ERCOT Protocols; (3) whether BP's failure to comply with ERCOT Protocols rendered it impossible or commercially impracticable for AEP to either capture or resell BP's electricity so that AEP was excused from performance of its contractual obligations; and (4) whether AEP signaled that it would refuse delivery of BP's excess power after September 25, 2001, so that BP was justified in seeking alternative markets for its power.<sup>14</sup>

After reviewing the specific requirements of the ERCOT Protocols, the court of appeals determined that a provision expressly requiring registration by qualifying facilities that intended to "participate in any aspect of wholesale or pilot retail market sharing," was effective July 6, 2001.<sup>15</sup> BP

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9. *Id.* at 411.

10. 198 S.W.3d 449 (Tex. App.—Corpus Christi 2006, no pet.).

11. *Id.* at 452.

12. *Id.*

13. *Id.* at 453.

14. *Id.* at 453-54.

15. *Id.* at 455-56.

contended that it was not required to register with ERCOT because it only “transferred” excess power to AEP at the meter located at its co-generation plant and did not “transmit” power on the ERCOT grid, but the court disagreed.<sup>16</sup> After analyzing the definition of “transmission service” in the PUC’s substantive rules, the court of appeals concluded that any use of the system involving the transfer of power from one facility to another, whether to serve loads or for sale to a third party, and whether through transmission lines or a transfer at a meter located at the exit of a generating plant to the transmission lines, was use of the transmission portion of the grid and required compliance with the ERCOT Protocols.<sup>17</sup> The court of appeals held that BP was required to register with ERCOT for the transmission of power onto the ERCOT grid, and the transfer of excess power to AEP’s meter constituted transmission on the ERCOT grid.<sup>18</sup>

AEP’s affirmative defense of excuse of performance as a result of commercial impracticability, impossibility of performance, and/or frustration of purpose was based upon the deregulation legislation’s creation of new preconditions to the acceptance or delivery of power, and BP’s failure to register and designate a Qualified Scheduling Entity pursuant to the ERCOT Protocols. Based on summary judgment evidence submitted by AEP that, absent registration, it was not possible to either recognize, identify, or credit unscheduled power for the benefit of either BP or AEP, the court of appeals found that the trial court did not err in finding that AEP established its affirmative defense and granting AEP’s summary judgment motion as to the power transfers made during August and September 2001.<sup>19</sup>

AEP also asserted a similar affirmative defense of failure of consideration and commercial impracticability, impossibility of performance, and/or frustration of purpose related to BP’s sale of excess power to third parties during the period from September 26 to December 31, 2001. The only evidence offered by BP in support of its summary judgment motion addressed the amount of scheduled power deliveries to third parties during the disputed timeframe. It presented no evidence concerning either (1) an attempt to sell its excess power to AEP, or (2) AEP’s intent if AEP had been approached by BP about the sales. The court of appeals held that BP did not meet its burden of showing that it was entitled to mitigate its damages because AEP refused, or indicated its intent to refuse, to comply with the contracts between September 26 and December 31, 2001.<sup>20</sup> The court of appeals affirmed the trial court’s judgment in its entirety.

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16. *Id.* at 456-57.

17. *Id.* at 457.

18. *Id.* at 460.

19. *Id.* at 460.

20. *Id.* at 461.

## C. MARKET ABUSE

In *Utility Choice, L.P. v. TXU Corp.*,<sup>21</sup> the plaintiffs, two unaffiliated retail electric providers (“REPs”) in Texas, sued several power generation companies and REPs, alleging conspiracy and unlawful manipulation of the Texas electric market under the Racketeer Influenced and Corrupt Organizations Act (“RICO”) and the Sherman Act. The defendants filed a motion to dismiss for failure to state a claim and argued that all of the plaintiffs’ claims, except for one, were barred by the filed rate doctrine.<sup>22</sup> After reviewing *Texas Commercial Energy v. TXU Energy, Inc.* (“*TCE*”),<sup>23</sup> the United States District Court for the Southern District of Texas rejected plaintiffs’ contentions that the Fifth Circuit failed to address certain issues, which “left open certain avenues through which this Court can navigate to reach a determination that the filed rate doctrine does not bar Plaintiffs’ claims for damages.”<sup>24</sup> The plaintiffs’ first argument was that for the filed rate doctrine to bar their claims for damages, there must be a substitute mechanism for recovery for defendants’ wrongful conduct. Citing several prior decisions, the district court held that an alternative mechanism for recovery is not a requirement for applying the filed rate doctrine to the antitrust claims.<sup>25</sup>

The Fifth Circuit had previously held in *TCE* that most of the plaintiffs’ claims were barred by the filed rate doctrine.<sup>26</sup> The plaintiffs asserted that the Fifth Circuit did not address in *TCE* the question of whether the implication doctrine requires a judicial finding that the Texas Legislature intended for injured parties to be able to sue for damages for violations of the Public Utility Regulatory Act (“PURA”). The district court found that this argument was contrary to the holding in *TCE* that claims for damages are barred under federal antitrust statutes.<sup>27</sup> The plaintiffs also contended that the filed rate doctrine violated the Texas Constitution’s open courts requirement. This argument was based on the notion that the filed rate doctrine’s applicability is contingent on Texas law. The district court found that the plaintiffs’ position was contrary to the Fifth Circuit’s ruling in *TCE*, which examined the underlying statutory authority of the PUC to determine that the filed rate doctrine barred that case’s federal antitrust claims.<sup>28</sup> The plaintiffs also sought recovery under RICO for damages resulting from their payment of artificially high prices. The district court held that these claims were also barred by the filed rate doctrine.<sup>29</sup>

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21. No. Civ. A.H.-05-573, 2005 WL 3307524 at \*1 (S.D. Tex. Dec. 6, 2005).

22. *Util. Choice, C.P.*, 2005 WL 3307524, at \*3.

23. 413 F.3d 503 (5th Cir. 2005)

24. *Util. Choice, L.P.*, 2005 WL 3307524, at \*3.

25. *Id.*

26. *Id.* at \*3 (citing *Tex. Comm. Energy*, 413 F.3d at 510).

27. *Id.*

28. *Id.* at \*4.

29. *Id.*

The plaintiffs further complained that the defendants interfered with the plaintiffs' business relationships through their anticompetitive conduct. The defendants responded that such claims were barred by the *Noerr-Pennington* doctrine, which "allows individuals or businesses to petition the government, free of the threat of antitrust liability, for action that may have anticompetitive consequences."<sup>30</sup> The district court found that the defendants' activities did not fit within the sham exception of the *Noerr-Pennington* doctrine, which barred the federal claims.<sup>31</sup>

The plaintiffs also claimed equitable relief for the defendants' alleged anticompetitive practices. The defendants argued that these claims were also barred by the filed rate doctrine. The district court dismissed the claims for equitable relief because such relief would require the court to engage in continued oversight of the Texas market and unduly infringe upon the PUC's regulatory authority.<sup>32</sup> As to the state-law claims raised by the plaintiffs, the district court decided to exercise its supplemental jurisdiction and dismissed the claims without prejudice.<sup>33</sup>

In *Jenkins v. Entergy Corp.*,<sup>34</sup> retail electric customers alleged that Entergy Corporation had devised an improper price-gouging scheme to sell and deliver higher priced electrical power to them while selling less expensive power to its off-system utilities. Claiming breach of duty and breach of fiduciary duty, aiding and abetting, conspiracy, and violations of the Texas Theft Liability Act, the retail customers accused Entergy and Entergy Gulf States, Inc. ("EGSI"), the Entergy operating company that serves Texas customers, of working together to force excessive purchases of power by EGSI from within the Entergy system rather than using less expensive power available from non-Entergy entities. The trial court found that it lacked subject-matter jurisdiction and granted Entergy's motion to dismiss.<sup>35</sup>

The appeal did not concern the merits of the retail customers' claims, but rather whether the trial court erred in (1) dismissing for lack of subject-matter jurisdiction, and (2) allowing EGSI to intervene in the suit. In determining subject-matter jurisdiction, the Corpus Christi Court of Appeals first looked at whether the PUC had exclusive or primary jurisdiction. Although the court of appeals noted that the PUC's jurisdiction is "admittedly broad, extending to issues involving the rates, operations, and services of an electric utility," it concluded that this matter did not fall within the PUC's exclusive jurisdiction over retail rates.<sup>36</sup> The court of appeals also determined that the PUC did not have primary jurisdiction over this matter because the suit involved state law tort claims based on Entergy's interstate purchasing and allocation decisions which were

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30. *Id.*

31. *Id.*

32. *Id.* at \*6.

33. *Id.*

34. 187 S.W.3d 785, 791 (Tex. App.—Corpus Christi 2006, pet. denied).

35. *Id.* at 793.

36. *Id.* at 798, 801.

“inherently judicial in nature.”<sup>37</sup>

The court of appeals also analyzed whether the Federal Energy Regulatory Commission (“FERC”) had exclusive jurisdiction over the suit. Courts may set aside an energy contract obtained unconscionably or by fraud without interfering with FERC’s rulemaking authority under the Federal Power Act, so long as the court’s decision is not based upon a theory that the filed rate was too high.<sup>38</sup> The court of appeals concluded that, although FERC jurisdiction could include this dispute, FERC did not have exclusive or preemptive jurisdiction over the claims.<sup>39</sup> The trial court’s decision dismissing the matter for lack of subject-matter jurisdiction was reversed and remanded for further proceedings.<sup>40</sup>

Also at issue was whether the trial court’s decision not to strike the intervention of EGSI was proper. Despite the arguments set forth by the retail customers, the court of appeals held that EGSI had a justiciable interest in the matter and EGSI’s participation in the suit would not unduly complicate the case by a multiplication of issues.<sup>41</sup> The court of appeals also determined that EGSI’s intervention was essential to effectively protect any rights and interests that would potentially be adversely affected by the litigation, in particular by a ruling in favor of EGSI’s retail customers.<sup>42</sup> The court of appeals concluded that the trial court did not abuse its discretion by allowing EGSI to intervene in the suit.<sup>43</sup>

#### D. CONSTRUCTION AND RELOCATION COSTS

In another case involving CenterPoint, the Fifth Circuit held that a utility may collect the costs of relocating their utility lines and facilities due to construction of a tollway along an existing roadway.<sup>44</sup> CenterPoint incurred costs of over \$10 million relocating gas and electric facilities in order for Harris County to construct a new tollway. After the county denied its requests for reimbursement, CenterPoint brought this suit for claims under both the United States and Texas Constitutions. The trial court granted summary judgment in favor of CenterPoint.<sup>45</sup>

Although under common-law principles a utility would be responsible for its own relocation costs, the Fifth Circuit concluded that sections 251.10–102 of the Texas Transportation Code controlled under these circumstances.<sup>46</sup> The relevant portions of that statute allow “an eligible util-

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37. *Id.* at 801.

38. *Id.* at 803.

39. *Id.* at 807.

40. *Id.*

41. *Id.* at 797.

42. *Id.*

43. *Id.* at 798.

44. *CenterPoint Energy Houston Elec., LLC v. Harris County Toll Rd. Auth.*, 436 F.3d 541, 551 (5th Cir. 2006).

45. *Id.* at 543.

46. *Id.* at 543-44.



ity facility” to recover relocation costs.<sup>47</sup> Based upon its interpretation of sections 251.101 and 251.102, and its review of the statutes that preceded their codification, the Fifth Circuit concluded that “an eligible utility facility” means a utility incurring relocation costs that are “eligible under the law” for reimbursement.<sup>48</sup> Finding that CenterPoint satisfied the requirement that it incurred costs as a result of the county’s acquisition of the rights-of-ways along the pre-existing roadway for construction of the tollway, and that it was “an eligible utility facility,” the Fifth Circuit affirmed the judgment in favor of the utility ordering payment of the relocation expenses.<sup>49</sup>

In *Double Diamond, Inc. v. Hilco Electric Cooperative, Inc.*,<sup>50</sup> the issue on appeal was whether the PUC’s substantive rule 25.28 prohibits an electric utility from recovering for construction services provided to a subdivision developer. In the electric utility’s suit for expenses related to electric-line extensions and other facilities that it constructed in the subdivision, the jury ruled in favor of the utility, and the trial court entered judgment for the construction charges, prejudgment interest, and attorneys’ fees.<sup>51</sup> The developer appealed, arguing that the utility was a regulated utility during only a portion of the construction time, and that rule 25.28 restricts a regulated utility from collecting charges that are more than six months past due. The developer contended that the utility could not collect any amounts incurred prior to March 1, 1999, which was six months prior to September 1, 1999, the date that the utility ceased to be regulated. The utility argued that rule 25.28 was intended to cover bills for electric services and was not applicable to construction services. After reviewing rule 25.28 in the context of the PUC’s substantive rules as a whole, the Waco Court of Appeals agreed with the utility’s interpretation and affirmed the judgment of the trial court.<sup>52</sup>

#### E. NEGLIGENCE

*RT Realty, L.P. v. Texas Utility Electric Co.*<sup>53</sup> involved claims by an electric utility’s customers for negligence, breach of implied warranties, breach of contract, and products liability for the utility’s alleged improper design and maintenance of an underground electrical vault. The customers were the owner and tenants of a fifty-story office building in downtown Dallas, which was provided electric service through an underground network supplying power to the entire Dallas central business district. During construction of the building in the 1960s, the customers’ utility, the architect, and the owner of the building collaborated to design an electrical vault necessary to house the equipment required to supply 480-

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47. *Id.* at 544.

48. *Id.* at 548.

49. *Id.* at 550.

50. 195 S.W.3d 336, 337 (Tex. App.—Waco 2006, pet. denied).

51. *Id.* at 337.

52. *Id.* at 338.

53. 181 S.W.3d 905, 910-11 (Tex. App.—Dallas 2006, no pet.).

volt electric service to the building. The utility provided specifications for the transformers to be placed in the vault, and the customers built the vault. The vault was located in the parking garage of the building under the street sidewalk. It was covered by ventilation grates at the sidewalk level, and there were four drains in the vault floor. The vault was mostly constructed of concrete, but it did have one brick wall.

In 1995, a storm in Dallas caused flooding throughout the downtown area. The vault in the parking garage flooded, and the brick wall collapsed from the pressure of the accumulated water. The customers sued the electric utility, asking for over \$41.5 million of property damage. The utility filed a summary-judgment motion, arguing that the customers had claimed economic damages for which the utility had limited liability under the terms of its tariff and that the utility had no duty to protect the building owner's equipment. The trial court granted the summary-judgment motion "in its entirety," reasoning that under the filed rate doctrine, the terms of the utility's tariff governed the claims and the utility was not liable pursuant to those terms.<sup>54</sup>

The filed rate doctrine provides a presumption of reasonableness to any PUC-approved tariff, and customers may not sue a utility in contract or in tort over issues governed by the terms of the tariff.<sup>55</sup> In this case, the utility's tariff limited its liability for economic damages but provided a remedy for damages caused by the utility's wanton or willful acts or omissions. Relying on Texas Supreme Court decisions that such tariff terms are reasonable as applied to economic damages resulting from ordinary negligence of the utility, the Dallas Court of Appeals held that the tariff was reasonable and that it applied to the customers' claims.<sup>56</sup>

The customers argued that the electric utility was liable for damages because the "wanton and willful" language in the tariff is included in the definition of gross negligence and because the tariff provides a remedy for gross negligence.<sup>57</sup> The utility contended that the tariff did not create a duty to protect the building-owned equipment or to maintain the vault. After examining the terms of the tariff and the summary-judgment evidence, the court of appeals concluded that the customers failed to show that the utility owed them a duty to protect the building-owned equipment and prevent the damages resulting from the flood.<sup>58</sup> The court of appeals affirmed the trial court's grant of summary judgment on the gross-negligence claims.<sup>59</sup>

The customers complained that the electric utility had exclusive control of the vault and repudiated the tariff by failing to allow the building owner access to the vault. Based upon its determination that the tariff

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54. *Id.* at 911.

55. *Id.* at 913; *see Sw. Elec. Power Co. v. Grant*, 73 S.W.3d 211, 216-17 (Tex. 2002).

56. *RT Realty, L.P.*, 181 S.W.3d at 913; *see also Grant*, 73 S.W.3d at 220; *Houston Lighting & Power Co. v. Auchan USA, Inc.*, 995 S.W.2d 668, 675 (Tex. 1999).

57. *RT Realty, L.P.*, 181 S.W.3d at 914.

58. *Id.* at 915.

59. *Id.* at 916.

did not deny the building owner access to the vault and that the evidence showed that the building owner could have accessed the vault with an escort from the utility, the court of appeals affirmed the trial court's decision to grant the summary judgment motion on this claim.<sup>60</sup>

The customers further claimed that the electric utility breached the UCC implied warranties of merchantability and fitness for a particular purpose. Based upon the Texas Supreme Court's holding that the Uniform Commercial Code ("UCC") is inapplicable to utility tariffs, the court of appeals found that the trial court correctly granted the utility's motion for summary judgment on these claims.<sup>61</sup> The court of appeals also rejected the customers' breach-of-contract and strict-liability claims.<sup>62</sup>

Finally, the customers argued that allowing the electric utility to "hide" behind its tariff was a violation of public policy and a violation of the open-courts provision of the Texas Constitution.<sup>63</sup> The court of appeals found that, because the customers failed to raise these arguments in the trial court, these issues were not preserved for review on appeal.<sup>64</sup> The court of appeals rejected all of the customers claims and affirmed the trial court's judgment in its entirety.<sup>65</sup>

### III. GAS UTILITY

#### A. RATE CASES

*CenterPoint Energy Entex v. Railroad Commission of Texas*<sup>66</sup> involved a question of first impression before the Austin Court of Appeals: whether the Railroad Commission of Texas ("RRC") may conduct a retroactive prudence review of charges flowed through a purchased gas adjustment ("PGA") clause and order refunds of charges that the RRC finds the gas utility imprudently incurred. CenterPoint Energy Entex ("Entex") provided gas to retail customers under tariffs approved by the City of Tyler. Since 1985, Entex's tariffs have included a PGA clause, which is an automatic escalator mechanism designed to address rapid fluctuations in the cost of natural gas. Entex notified the City of Tyler on a monthly basis of any gas cost changes flowing through to customers under the PGA clause. Entex acquired gas from two suppliers, and the contract price with one of the suppliers was significantly lower than the contract price with the other. In 2002, the City of Tyler informed Entex of its concern that Entex was improperly charging higher priced gas to residential and small commercial customers and reserving lower priced gas for large commercial customers. As a result of the alleged improper

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60. *Id.* at 917.

61. *Id.*; see also *Grant*, 73 S.W.3d at 218-19.

62. RT Realty, L.P., 181 S.W.3d at 918.

63. *Id.*

64. *Id.*

65. *Id.* at 918-19.

66. 208 S.W.3d 608, 612 (Tex. App.—Austin, 2006, pet. dismiss'd).

allocation of gas, the City of Tyler claimed that Entex had overcharged residential and small commercial customers by about \$39,000,000.

In an effort to resolve the dispute, Entex and the City of Tyler filed a joint petition for review of the charges with the RRC. However, the parties did not agree on the scope of the RRC's review of the matter. The City of Tyler argued that the RRC had the power to conduct a retroactive prudence review of Entex's gas purchases. Although it agreed that the RRC could determine whether it had properly charged residential and small commercial customers as authorized under its tariffs, Entex contended that the RRC did not have the authority to consider the prudence of Entex's gas purchases because that would constitute retroactive ratemaking. The hearing examiners in the RRC contested case proceeding determined that, "issues related to a consideration of the reasonableness and necessity of Entex's gas costs and gas purchase practices will be considered in this proceeding."<sup>67</sup> Entex filed suit in district court seeking a declaration that the RRC did not have the authority to conduct a retroactive prudence review of gas purchases. The district court ruled in favor of the RRC.<sup>68</sup>

After reviewing the Texas Legislature's policy goals in enacting the PURA and the nature and function of PGA clauses, the Austin Court of Appeals concluded that the RRC had the necessary authority to conduct retroactive reviews of Entex's gas purchases and to order refunds.<sup>69</sup> Because the proceeding concerned the alleged misapplication of Entex's approved rates rather than the setting of Entex's rates, the court of appeals rejected Entex's arguments that the power to conduct a retroactive prudence review violated the filed rate doctrine and the rule against retroactive ratemaking.<sup>70</sup>

The parties also disagreed over whether the City of Tyler was entitled to reimbursement for its expenses in the RRC proceeding. Under PURA, a gas utility is required to reimburse the governing body of a municipality for reasonable expenses incurred in a "ratemaking" proceeding.<sup>71</sup> Entex argued that the City of Tyler was not entitled to a reimbursement because a retroactive review of its gas purchases was not a ratemaking proceeding. Since the PGA clause was already a part of Entex's approved rate, the court of appeals concluded that the prudence review did not involve setting new rates for Entex's customers.<sup>72</sup> The court of appeals agreed that the prudence review was not a ratemaking proceeding, and it reversed the district court's judgment that the City of Tyler was entitled to recover its expenses incurred in the RRC proceeding.<sup>73</sup>

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67. *Id.*

68. *Id.*

69. *Id.* at 620.

70. *Id.* at 621-26.

71. *Id.* at 626.

72. *Id.*

73. *Id.* at 626-27.

In *City of Port Neches v. Railroad Commission of Texas*,<sup>74</sup> both the utility and the cities involved challenged the district court's affirmance of the RRC's final order in a rate case proceeding. After filing an initial request for an annual rate increase with the four cities in its service area, the utility was acquired, and the parties agreed that the utility would file an updated rate request that included the acquisition costs. The updated filing reflected that, although the utility could justify an increase over its initial filing, it would only seek an increase in the original amount requested. The cities denied the rate request in full, and the utility appealed the decision at the RRC, requesting the higher amount set forth in its updated filing with the cities. The RRC awarded the utility a rate increase in an amount equal to the lower amount initially requested by the utility plus approximately \$33,500.<sup>75</sup> The district court affirmed this order.<sup>76</sup>

On appeal, the cities argued that the RRC awarded a rate increase that was in excess of the agency's jurisdictional limits because the RRC improperly considered the acquisition costs as a "known and measurable change," and the rate calculation should have included increased revenues that the utility would collect as part of a settlement agreement with one of the cities.<sup>77</sup> The utility contended that the rate calculation should not have included as "revenues" any "forfeited discount revenues," consisting of a five-percent penalty added to any bill not paid within 15 days of issuance, and that the RRC should have awarded the utility rate case expenses for the services of its rate case consultant.<sup>78</sup>

The Austin Court of Appeals determined that PURA authorizes the RRC to award a rate increase that is greater than the rate requested at the municipal level because the amount may be adjusted for "known changes that are calculable with reasonable accuracy," and that there was substantial evidence in the record to support the RRC's final order.<sup>79</sup> The court of appeals also disagreed with the cities argument that the RRC should have considered the settlement revenues in the rate calculation.<sup>80</sup> The court of appeals held that the RRC's decision not to include the settlement revenues as a known and measurable change was within the agency's discretion and was supported by substantial evidence.<sup>81</sup> The increased settlement revenues were speculative, and it would have been unreasonable for the RRC to include them in the rate calculation.<sup>82</sup>

The court of appeals also concluded that the RRC improperly treated the forfeited discounted revenues as a credit against the revenue requirement and that its decision was not supported by substantial evi-

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74. 212 S.W.3d 565, 568-69 (Tex. App.—Austin 2006, no pet.).

75. *Id.* at 570.

76. *Id.*

77. *Id.*

78. *Id.*

79. *Id.* at 575.

80. *Id.* at 577.

81. *Id.* at 576.

82. *Id.*

dence.<sup>83</sup> There was no testimony or documentary evidence in the record in support of crediting the forfeited discounted revenues against the revenue requirement, there was no testimony about how to perform such a calculation and there was no evidence concerning the legal basis for such a calculation. However, the court of appeals disagreed with the utility that the RRC improperly disallowed the expenses associated with the utility's rate case consultant.<sup>84</sup> The RRC decided not to include the consultant expenses in the utility's recoverable rate case expenses because the consultant's services were used primarily to clarify the proper allocation of acquisition costs and to clear up confusion brought on by the utility itself as a result of its multiple rate request filings. The court of appeals concluded that the RRC's decision that the consultant fees were not recoverable was within the agency's discretion.<sup>85</sup>

In another appeal of Entex rates in the Houston area, the Austin Court of Appeals reversed and remanded a RRC determination that Entex could not allocate franchise fees paid to cities among environs customers located outside of the boundaries of Houston-area municipalities.<sup>86</sup> At the rate case proceeding, Entex filed an unopposed request to collect a proportionate share of municipal franchise fees from environs customers. The RRC denied the request as unreasonable without further explanation, and the district court affirmed the RRC's order.<sup>87</sup>

The Austin Court of Appeals found nothing in the record to support the RRC's finding that it was unreasonable for Entex to recover a share of the franchise fees from the environs customers.<sup>88</sup> The court of appeals held that there was no evidence that conditions existed to make recoument of the fees from environs customers unreasonable, and that the RRC failed to explain its rejection of uncontroverted testimony or to provide a basis for adopting a contrary conclusion.<sup>89</sup> The court of appeals also found that the RRC's action could be viewed as an ad hoc rulemaking, and under the arbitrary and capricious standard, there was no evidence in the record to support the RRC's order.<sup>90</sup> The order was reversed, and the matter remanded to the RRC for further proceedings.<sup>91</sup>

#### B. MUNICIPAL STREET RENTAL FEES

*City of San Benito v. Kinder Morgan Tejas Pipeline, L.P.*<sup>92</sup> involved municipal authority to charge a natural gas pipeline a street rental fee for the sale of natural gas to a single industrial customer within city limits.

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83. *Id.* at 579.

84. *Id.* at 582.

85. *Id.* at 581-82.

86. *CenterPoint Energy Entex v. R.R. Comm'n of Tex.*, 213 S.W.3d 364, 367 (Tex. App.—Austin, 2006, pet. filed).

87. *Id.* at 367-68.

88. *Id.* at 374.

89. *Id.* at 373.

90. *Id.* at 373-74.

91. *Id.* at 374.

92. 411 F. Supp. 2d 683, 685-86 (S.D. Tex. 2006).

Under a municipal ordinance that allowed it to charge rental fees to gas utilities for the use of municipal "streets, alleys, parks, and other public places," the City of San Benito sued numerous pipelines and other defendants claiming that they failed to pay for the use of these rights-of-ways.<sup>93</sup> The defendant operated a pipeline, portions of which lied beneath city streets, that served an electric generating plant located within city limits. The pipeline filed a motion for summary judgment, arguing that (1) the municipal ordinance did not apply here because the pipeline did not engage in "distribution" of natural gas, and (2) the statutes authorizing the street rental charge did not apply to the pipeline because it was not a public utility.<sup>94</sup>

The pipeline's first argument related to the express language of the municipal ordinance specifying that the ordinance applied to "all persons and corporations using and maintaining any main and auxiliary lines, appurtenances and fixtures for the sale and distribution of natural gas."<sup>95</sup> Relying on a 1939 Texas Supreme Court decision that also involved a pipeline's sale of gas to one customer within city limits, the pipeline contended that it did not "distribute" gas within the city because the definition of "distribution" does not include the sale of gas to one customer.<sup>96</sup> In *Utilities Natural Gas Co. v. State*, the Texas Supreme Court held that the term "distribution" included in a similar city ordinance means the "transfer of possession of gas to various individuals or concerns in the city," and that the Texas Legislature did not intend for the term to mean "the transfer of the possession of gas, by means of a pipeline, to a single purchaser where such purchaser is the only customer to whom the gas company sells gas in the city."<sup>97</sup> Although the facts were not completely identical, the district court found that the "key similarity" was that the "sale and distribution" language used in both of the disputed municipal ordinances was the same.<sup>98</sup> Because the City of San Benito's ordinance was passed after the publication of the Texas Supreme Court decision interpreting the term "distribution," and because the city could have chosen to omit the phrase "and distribution" from the ordinance, the district court held that the pipeline's sale and delivery of gas "to a single customer on a privately-negotiated basis" was not subject to the street rental charges authorized under the ordinance.<sup>99</sup>

The pipeline further argued that it was not a "public utility" and, thus, not subject to the City of San Benito's ordinance. The city was authorized to assess the street rental charge under two Texas statutes: (1) Article 1175 of the Texas Revised Civil Statutes, which states that a home-rule municipality has the power to "prohibit the use of any street, alley, high-

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93. *Id.* at 685.

94. *Id.*

95. *Id.* at 684.

96. *Id.* at 685; see *Utils. Natural Gas Co. v. State*, 128 S.W.2d 1153, 1155 (Tex. 1939).

97. *City of San Benito*, 411 F. Supp. 2d at 686.

98. *Id.*

99. *Id.*

way or grounds of the city by any telegraph, telephone, electric light, street railway, interurban railway, steam railway, gas company, or any other character of public utility,"<sup>100</sup> and (2) Article 7060 of the Texas Revised Civil Statutes, which is an omnibus tax law that imposed an occupation tax on "[e]ach individual, company, corporation, or association, owning, operating, managing, or controlling any gas, electric light, electric power or water works . . . used for local sale and distribution."<sup>101</sup> The pipeline defined a "public utility" as a business "impressed with the public interest, and those engaged in that business must hold themselves out as serving or ready to serve all members of the public to the extent of their capacity, and the nature of the service must be such that all members of the public have an enforceable right to demand it."<sup>102</sup> When the City of San Benito passed its street rental ordinance, Article 7060 did not include a definition of "public utility," and prior case law addressed the fact that no express definition of that term existed under Texas law at the time those decisions were issued.<sup>103</sup> After reviewing prior decisions that discussed the term, as well as the definition provided by *Black's Law Dictionary*, the district court determined that the "common thread" in all of the definitions of "public utility" was that the utility in dispute "must somehow serve the public."<sup>104</sup> The district court found that the pipeline's sole relationship with an electric generating plant did not confer public utility status on the pipeline.<sup>105</sup> The district court also referred in its opinion to the definition of "public utility" included in the current Texas Tax Code.<sup>106</sup> Section 182.025 of that statute defines a "public utility" as "a person who owns or operates a gas or water works or water plant used for local sale and distribution located within an incorporated city or town in this state . . ."<sup>107</sup> Because the pipeline had sold but not distributed gas within the city limits of San Benito, the district court held that it was not a public utility under the plain language of Section 182.025.<sup>108</sup>

#### IV. CONCLUSION

The cases included in this Survey should provide attorneys with a guide to significant developments in Texas law concerning electric and natural gas utilities. As most of the cases demonstrate, Texas courts are continuing to interpret and implement the statutes and regulations that facilitate the transition from a regulated electric market to a competitive Texas electric industry. There is also increased activity at the appellate level relating to gas utility rate regulation.

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100. TEX. REV. CIV. STATS. ANN. art. 1175 (Vernon 2006).

101. TEX. REV. CIV. STATS. ANN. art. 7060 (Vernon 2006), *repealed by* Acts 1959, 56th Leg., 3d C.S., ch. 1, § 7, 1956 Tex. Gen. Laws 187.

102. City of San Benito, 411 F. Supp. 2d at 687.

103. *Id.* at 687.

104. *Id.* at 688.

105. *Id.*

106. *Id.*

107. TEX. TAX CODE. ANN. § 182.025(e)(3)(A) (Vernon Supp. 2006).

108. City of San Benito, 411 F. Supp. 2d at 688.



