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## Energy Regulation

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# ENERGY REGULATION

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## I. INTRODUCTION

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

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## II. ELECTRIC REGULATION

### A. CHALLENGES TO PUC RULES

#### 1. *True-up Rule*

The Public Utility Regulatory Act (“PURA”) provides that appeals of the validity of electric competition rules be filed in the Third Court of Appeals. In *Gulf Coast Coalition of Cities v. Public Utility Commission*, ratepayers filed a direct appeal in the Third Court of Appeals challenging the validity of an amendment to the Public Utility Commission’s (“PUC”) true-up rule.<sup>1</sup> In 2004, the PUC amended its true-up-proceeding rule to remove an express conflict-of-interest provision that defined who qualified as an independent financial expert in the valuation of generation assets. As a part of the transition to a competitive electric market, the Texas Legislature included in PURA a mechanism for an electric utility to recover its stranded costs. PURA specifically provides that after January 10, 2004, each transmission and distribution utility, along with its affiliated retail electric provider and generation company, must file with the PUC to finalize any stranded costs it has incurred through a true-up proceeding.<sup>2</sup> Each affiliated power-generation company must calculate its stranded costs using one of four specific methods designated in PURA. One method, the Partial Stock Valuation (“PSV”) method, “applies when an electric utility or its affiliated power generation company has transferred generation assets to separate affiliated or nonaffiliated corporations, but only if a certain percentage of the common stock of each such corporation is spun off and sold to public investors through a national stock exchange and is traded for one year or more.”<sup>3</sup> The PUC may either “accept the market value or convene a valuation panel of three independent financial experts to determine the valuation of common stock in each transferee corporation.”<sup>4</sup> The experts are selected from proposals submitted in response to a PUC request. In this case, the PUC sent out a Request for Proposals to the top ten investment banks as required by PURA. The PUC received no responses to this request.<sup>5</sup>

Subsequently, the PUC proposed an amendment to its true-up-proceeding rule that was designed to draw “a broader group of persons who would be eligible to serve on the valuation panel.”<sup>6</sup> The proposed amendment deleted the conflict-of-interest provision of the true-up-proceeding rule, which read:

None of the financial experts chosen for the panel shall have participated, or be employed by an investment house or brokerage house

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1. See TEX. UTIL. CODE ANN. § 39.001(e) (Vernon 2005).

2. 161 S.W.3d 706, 710 (Tex. App.—Austin 2005, no pet. h.); TEX. UTIL. CODE ANN. § 39.262(c) (Vernon 2005).

3. *Gulf Coast*, 161 S.W.3d at 710.

4. *Id.*

5. *Id.*

6. *Id.* (quoting 29 Tex. Reg. 5338 (May 28, 2004) (to be codified at 16 TEX. ADMIN. CODE § 25.263) (proposed May 13, 2004) (Pub. Util. Comm’n)).

which has participated, in the business of separation, securitization, or other activities related to the implementation of PURA Chapter 39 on behalf of the utility for which the market valuation is being determined.<sup>7</sup>

The PUC held a public hearing on the proposed amendment, the ratepayers filed written comments and objections to the amendment, and the PUC summarized and responded to the ratepayers' comments in its final order. Although it acknowledged the ratepayers' concern that the new rule did not guarantee the independence of the experts responding to the PUC's request for panelists, the PUC declined to alter the amendment and adopted the revised rule.<sup>8</sup>

The ratepayers first argued that the amended rule was facially invalid because it did not comply with the PURA requirement that panelists chosen to serve on a PSV panel be independent of the utility. In order to challenge the facial invalidity of an agency rule, a party must show that the rule: "(1) contravenes specific statutory language; (2) runs counter to the general objectives of the statute; or (3) imposes burdens, conditions, or restrictions in excess of or inconsistent with the relevant statutory provisions."<sup>9</sup> The ratepayers argued that, by removing the conflict-of-interest provision in the true-up proceeding rule, the PUC contravened the specific statutory mandate that the panelists be independent.<sup>10</sup> The court disagreed, concluding that, unlike other sections of the statute, there was no express provision in section 39.262(h)(3) of PURA designating the manner in which the PUC may establish the independence of panel candidates. PURA requires only that panelists are independent and leaves the establishment of their independence within the PUC's discretion. Thus, both the original inclusion of the express conflict-of-interest provision and the later deletion of the provision in order to attract a larger pool of possible panelists were actions within the PUC's discretion.<sup>11</sup>

The ratepayers' second argument was that the PUC did not substantially comply with the reasoned justification requirement of the Administrative Procedures Act ("APA"), so the rule is voidable.<sup>12</sup> The PUC's final order adopting the amended rule must explain how and why it reached its conclusion in order to satisfy the reasoned justification requirement.<sup>13</sup> Specifically, a reasoned justification must include summaries of (1) the comments that the agency received from interested parties; (2) the factual basis of the rule; and (3) the agency's reasons for disagree-

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7. *Id.* at 711 (quoting 26 Tex. Reg. 10498 (2001), amended in part by 29 Tex. Reg. 5338 (2004) (former 16 TEX. ADMIN. CODE § 25.262(f)(1)(C)(iv)) (Pub. Util. Comm'n)).

8. *Id.*

9. *Id.* at 712 (citing State Office of Pub. Util. Counsel v. Pub. Util. Comm'n, 131 S.W.3d 314, 321 (Tex. App.—Austin 2004, pet. denied)).

10. *Id.*

11. *Id.* at 712-13.

12. See TEX. GOV'T CODE ANN. § 2001.035(a) (Vernon 2000).

13. *Gulf Coast*, 161 S.W.3d at 713 (citing *State Office of Pub. Util. Counsel*, 131 S.W.3d at 327).

ing with a party's written comments.<sup>14</sup> The ratepayers contended that the PUC's final order adopting the amended true-up-proceeding rule did not include the requisite summary of the factual basis for the rule. They further argued that the court's review of the final order should be limited to the final paragraph. Rejecting their arguments, the court found that the review of the final order in its entirety showed that the PUC included a summary of the factual basis for the amended rule in its summary of the written comments. The factual basis provided by the PUC was that (1) it attempted to convene a PSV-panel but there were no responses to its Request for Proposals; and (2) it made a policy decision to consider on a case-by-case basis the independence of potential panelists rather than using an express conflict-of-interest prohibition.<sup>15</sup> The court concluded that the final order contained a satisfactory summary of the factual basis for the rule.<sup>16</sup>

The ratepayers also complained that the final order did not adequately state the reasons why the PUC disagreed with the submitted comments on the proposed rule. These comments included the ratepayers' concerns that (1) the amended rule would not ensure that the PSV panel was independent, and (2) removing the conflict-of-interest provision would result in an increase in the number of qualified persons interested in serving on the panel. In its final order, the PUC explained that, in order to comply with the PURA requirement that panelists be independent, it would "consider appropriate conflict-of-interest standards in selecting persons to serve on the valuation panel" on a case-by-base basis.<sup>17</sup> The PUC also stated that the ratepayers' concern that the new rule would not attract a sufficient number of qualified candidates to serve on the PSV panel was premature and speculative. The court found that the PUC's explanations of why it disagreed with the ratepayers' concerns satisfied the reasoned-justification requirement. It also concluded that additional comments filed by the ratepayers, such as requesting the PUC to include "appropriate conflict-of-interest standards" in the rule, were not comments on the proposed rule, but merely comments urging the PUC not to change the existing rule.<sup>18</sup> Likewise, the court determined that the ratepayers' comments suggesting that the PUC issue requests for panelists to groups beyond the top ten nationally recognized investment banks, were not only beyond the PUC's statutory authority, but were also comments on the drafting of the PUC's Request for Proposals and not on the proposed rule.<sup>19</sup>

Holding that the amended true-up-proceeding rule was not facially invalid and that the PUC's final order contained a sufficient reasoned justi-

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14. TEX. GOV'T CODE ANN. § 2001.033(a)(1) (Vernon 2005).

15. *Gulf Coast*, 161 S.W.3d at 714 (citing 29 Tex. Reg. 5338 (May 28, 2004) (to be codified at TEX. ADMIN. CODE § 25.263) (proposed May 13, 2004) (Pub. Util. Comm'n)).

16. *Id.* at 714.

17. *Id.* at 715 (quoting 29 Tex. Reg. 5338).

18. *Id.* (quoting 29 Tex. Reg. 5338).

19. *Id.* at 716.

fiction, the Third Court of Appeals overruled the ratepayers' challenges and sustained the validity of the amended rule as enacted by the PUC.<sup>20</sup>

## 2. Wholesale Market Oversight Rule

In *TXU Generation Co. v. Public Utility Commission*, electric utilities and other market participants challenged the validity of the PUC's Wholesale Market Oversight Rule ("WMO Rule"). This rule applies to the wholesale electricity market and allows retail electric providers to purchase power and capacity through bilateral agreements and the balancing energy services ("BES") market. It specifies the duties of wholesale market participants and prohibits certain anticompetitive practices. However, the WMO Rule "provides a defense to a market participant who engages in a prohibited activity if the participant demonstrates that the otherwise prohibited activity served a legitimate business purpose and that its adverse effects were not foreseeable."<sup>21</sup> In addition, the rule provides that the Electric Reliability Council of Texas ("ERCOT") enforces operating standards for market participants and sets forth a process for market participants to elucidate ERCOT protocols to ensure compliance. The rule also includes a PUC investigation procedure and record-keeping requirements for both market participants and ERCOT.<sup>22</sup>

The market participants brought a direct appeal challenging the portions of the WMO Rule relating to the duties of market participants and the prohibition of anticompetitive practices. Under the direct-appeal provision of PURA, a challenger of an agency rule may only question the validity of the rule.<sup>23</sup> In order to establish that a rule is facially invalid, a challenger must demonstrate that the rule: (1) breaches specific statutory language; (2) is contrary to the general objectives of the statute; or "(3) imposes additional burdens, conditions, or restrictions in excess of or inconsistent with the relevant statutory provisions."<sup>24</sup>

The market participants contended that the WMO Rule was void because the PUC did not have the required statutory authority from the Texas Legislature to enact the rule.<sup>25</sup> Specifically, several market participants argued that the WMO Rule was invalid because it usurps the legislative authority of ERCOT to regulate the wholesale market. They contended that the Texas Legislature limited the PUC's role to "oversight and review" and that the WMO Rule's provisions regulating the conduct of market participants exceeded this limited authority and contravened the powers allocated to ERCOT.<sup>26</sup> The Third Court of Appeals found that this argument was based only on a partial reading of PURA. The

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20. *Id.*

21. 165 S.W.3d 821, 829 (Tex. App.—Austin 2005, pet. filed).

22. *Id.* at 828-29.

23. See TEX. UTIL. CODE ANN. § 39.001(f) (Vernon 2005).

24. See *TXU Generation*, 165 S.W.3d at 830 (citing *City of Corpus Christi v. Pub. Util. Comm'n.*, 51 S.W.3d 231, 236 (Tex. 2001)).

25. *Id.*

26. TEX. UTIL. CODE ANN. § 39.151(d) (Vernon 2005).

PURA provision designating the PUC's oversight and review role also states: "An independent organization certified by the commission for a power region shall establish and enforce procedures *consistent with this title and the commission's rules* relating to the reliability of the regional electric network and accounting for the production and delivery of electricity among generators and all other market participants."<sup>27</sup> Acknowledging that PURA provides overlapping procedures relating to reliability and accounting, the court held that the plain language of the statute indicates that the PUC has the authority to create rules regulating market conduct because the independent system operator must have procedures consistent with those rules. The market participants also argued that the PUC did not have the necessary "statutory authority to prohibit market power abuses in the wholesale bilateral contracts market;" however, the court found that PURA gives the PUC "broad authority to monitor and remedy market power abuses."<sup>28</sup>

A number of market participants claimed that the WMO Rule lacked an intent element in describing prohibited conduct. They argued that the PUC lacked the necessary "statutory authority to prohibit conduct that is not intentional and that the prohibition's inclusion of unintentional conduct" contravened the statutory objective to create a rule "favoring competition rather than regulation."<sup>29</sup> The Third Court of Appeals rejected this argument, finding that the market participants' argument depended on an erroneous assumption that the only statutory authority for prohibiting activities was the section of PURA providing the PUC with the authority to monitor and remedy market-power abuse.<sup>30</sup> Rather, the court found that the PUC also had the requisite authority under PURA to protect retail customers and that issues relating to reliability or price in the wholesale market inevitably would be reflected in the retail market. Therefore, the court found that the Texas Legislature delegated to the PUC the power to regulate conduct in the wholesale market for consumer-protection purposes and to ensure reasonably priced power for ancillary services. The court also determined that the WMO Rule's prohibition of unintentional activities is not inconsistent with the statute because it allows "normal market forces" to set the price of power.<sup>31</sup>

The market participants also brought several other claims questioning whether portions of the WMO Rule were within the PUC's statutory authority. The Third Court of Appeals denied all these claims, including contentions relating to the burden-of-proof requirements and scope-of-remedy language included in the WMO Rule. The court also overruled arguments that the rule impermissibly regulated electric prices by forcing market participants to charge marginal cost prices and that the PUC adopted a market-power concept that conflicted with statutory and case

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27. *Id.* (emphasis added).

28. *TXU Generation*, 165 S.W.3d at 832.

29. *Id.*

30. *Id.*

31. *Id.* at 834-35.

law defining that term.<sup>32</sup>

The market participants challenged the WMO Rule on two constitutional bases. The market participants first contended that a number of definitions and other provisions of the WMO Rule were unconstitutionally vague. They were particularly concerned with the rule's general definition of prohibited activities and its definition of market power, as well as several other miscellaneous requirements. An agency rule is unconstitutionally vague if it (1) does not give fair notice of prohibited conduct, and (2) does not contain sufficient guidance for enforcing authorities, which allows for arbitrary and discriminatory enforcement.<sup>33</sup> Applying this standard, the Third Court of Appeals held that the WMO Rule, read in its entirety and in conjunction with PUC regulations on enforcement, provided sufficient notice and enforcement guidance and was not unconstitutionally vague.<sup>34</sup>

Second, the market participants claimed that the WMO rule resulted in unconstitutional takings without just compensation. They argued that the preamble to the rule required that capacity be offered at "marginal cost" under certain conditions.<sup>35</sup> Because marginal cost does not include the entire cost of producing power, the market participants asserted an unconstitutional taking.<sup>36</sup> The Third Court of Appeals dismissed this argument based on its earlier finding that the WMO Rule does not require market participants to sell power at marginal cost.<sup>37</sup>

One market participant raised two issues relating to the rulemaking standards of the APA: (1) the PUC did not provide adequate notice of the WMO Rule, and (2) the PUC did not substantially comply with the requirement that it supply a concise statement of the statutory authority for the rule.<sup>38</sup> As to the first issue, the challenger argued that it was not allowed the opportunity for "meaningful" comment on the PUC defining a "market power."<sup>39</sup> The Third Court of Appeals disagreed, adding that the challenger's own comments in the rulemaking record indicated that it was aware of how it might be affected by the proposed rule.<sup>40</sup>

As to the second claim, the challenger argued that the PUC's only stated purpose for the rule was to ensure reliability of electric power and that the WMO Rule exceeded the agency's authority to do so.<sup>41</sup> The Third Court of Appeals also rejected this argument based on its earlier holding in the opinion that the purpose of the WMO Rule also includes

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32. *Id.* at 834-38.

33. *Id.* at 838 (citing *Rooms with a View, Inc. v. Private Nat. Mortgage Ass'n, Inc.*, 7 S.W.3d 840, 845 (Tex. App.—Austin 1999, pet. denied)).

34. *Id.* at 844.

35. *Id.* at 845.

36. *Id.*

37. *Id.*

38. *Id.*; TEX. GOV'T CODE ANN. §§ 2001.024, .029, .033(c) (Vernon 2005).

39. *TXU Generation*, 167 S.W.3d at 845.

40. *Id.* at 846.

41. *Id.*



protecting consumers and preventing market-power abuses.<sup>42</sup>

### 3. *Quarterly Wholesale Electric Transaction Reports*

In *City of Garland v. Public Utility Commission*, municipal electric utilities challenged several provisions of Rule 25.93 of the Texas Administrative Code as it existed before the 2004 amendments, which required electric utilities to file Quarterly Wholesale Electricity Transaction Reports with the PUC “regarding all wholesale electricity transactions with a point of delivery or point of receipt in Texas.”<sup>43</sup> The appeal concerned the validity of subsections (g)(3) and (c)(2) of Rule 25.93, which define and set forth procedures for obtaining “Protected Information.” Protected information is defined as “[i]nformation contained in a [quarterly report] that comports with the requirements from exception for disclosure under the Texas Public Information Act (“TPIA”).”<sup>44</sup> Subsection (g)(3) allows the PUC to release protected information voluntarily and without a request for information from third parties after the PUC determines that that information is not protected in a contested-case proceeding.<sup>45</sup> The utilities contended that the procedure in Rule 25.93 is invalid for two reasons: (1) It conflicts with the TPIA because it potentially allows the PUC to voluntarily disclose “public power utility competitive matter,” which is excepted from disclosure under section 552.133(b) of the Government Code; and (2) it violates the PUC’s duty to protect their “competitively sensitive information” under section 39.155 of the Utilities Code.<sup>46</sup>

The Third Court of Appeals agreed with the utilities and declared subsections (c)(2) and (g)(3) of Rule 25.93 invalid. The court reasoned that such provisions would permit the PUC “to determine the validity of a claim of confidentiality in contravention of the exception to disclosure added to the TPIA for competitive matters of a public utility and of the procedure set forth to defeat such a claimed exception.”<sup>47</sup> Government Code section 552.133 grants the governing board of a municipal utility the power to except information designated as a “competitive matter” from the TPIA’s open-records requirements.<sup>48</sup> The exception to disclosure can only be defeated if there is a request for disclosure and the attorney general or a court determines that (1) the governing board did not exercise good faith; and (2) “the information is not reasonably related to a com-

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42. *Id.* at 847.

43. 165 S.W.3d 814, 817 (Tex. App.—Austin 2005, pet. denied); 16 TEX. ADMIN. CODE § 25.93(d)(1) (2005).

44. 16 TEX. ADMIN. CODE § 25.93(c)(2) (2003) (amended 2004) (Pub. Util. Comm’n, Econ. Regulation).

45. 16 TEX. ADMIN. CODE § 25.93(g)(3) (2005) (Pub. Util. Comm’n, Econ. Regulation).

46. *City of Garland*, 165 S.W.3d at 820; TEX. GOV’T CODE ANN. § 552.133(b) (Vernon 2005); TEX. UTIL. CODE ANN., § 39.155 (Vernon 2005).

47. *City of Garland*, 165 S.W.3d at 821.

48. *Id.*

petitive matter.”<sup>49</sup>

The court acknowledged that the PUC “expressly limited its review in [R]ule 25.93 to a consideration of whether information in the quarterly reports ‘comports with the requirements for exception from disclosure under the’ TPIA.”<sup>50</sup> But the court explained that Rule 25.93 “is clearly calculated to allow the [PUC] to adjudicate for itself the validity of such a claim of confidentiality” under Government Code section 552.133.<sup>51</sup> Relying on legislative intent, the court also explained that the PUC’s duty under section 39.155 of the Utilities Code “to protect ‘competitively sensitive’ information would require it to protect ‘competitive matter’ so designated by a public power utility’s governing board under . . . section 552.133.”<sup>52</sup> Accordingly, the court held that PUC decisions under Rule 25.94 regarding section 552.133 confidentiality claims would violate its duties under section 39.155.<sup>53</sup> The court declined to rule on whether the procedure promulgated by the PUC in Rule 25.93 lacked statutory support.<sup>54</sup>

#### 4. *Qualified Facilities*

At the Fifth Circuit, Power Resource Group, Inc. (“PRG”) challenged Texas’ interpretation and implementation of the Public Utility Regulatory Policies Act (“PURPA”). PRG proposed construction of a natural-gas-fired generation facility in Lewisville, Texas and began negotiations to provide power to Texas-New Mexico Power Company (“TNMP”).<sup>55</sup> The proposed facility was certified as a “qualifying facility” (“QF”) under PURPA, and PRG commenced pre-construction activities. On February 13, 1998, PRG made a final written commitment to provide TNMP with power from the Lewisville QF. PRG considered this commitment a “legally enforceable obligation.” TNMP refused to execute an agreement with PRG and denied the existence of any legally enforceable obligation.<sup>56</sup>

PRG petitioned the PUC to compel TNMP to purchase power from the Lewisville QF. The PUC dismissed PRG’s application on the basis that Rule 25.242(f)(1)(B) of the Texas Administrative Code did not require TNMP to purchase power from the Lewisville QF unless the facility could deliver power within 90 days of notifying TNMP that energy would be available.<sup>57</sup> The PUC determined that a legally enforceable obligation was not created because the Lewisville QF was not completed and could

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49. *Id.* at 820; see TEX. GOV’T CODE ANN. § 552.133(c) (Vernon 2005).

50. *City of Garland*, 165 S.W.3d at 820.

51. *Id.* at 820-21.

52. *Id.* at 821.

53. *Id.*

54. *Id.*

55. *Power Res. Group, Inc. v. Pub. Util. Comm’n*, 422 F.3d 231, 233 (5th Cir. 2005).

56. *Id.* at 233-34.

57. See 16 TEX. ADMIN. CODE § 25.242(f)(1)(B) (2005) (Pub. Util. Comm’n, Econ. Regulation).

not produce power for delivery within 90 days.<sup>58</sup>

PRG first appealed the PUC's decision to the Third Court of Appeals, which affirmed the PUC's order. PRG then filed a petition for review at the Texas Supreme Court, but it was denied. PRG next petitioned the Federal Energy Regulatory Commission ("FERC"), requesting that the agency initiate an enforcement action against the PUC for failing to properly implement PURPA's regulatory scheme. FERC did not act on PRG's petition within 60 days, prompting PRG to file a complaint in the United States District Court for the Western District of Texas. The district court held that the PUC fully implemented the regulations promulgated by FERC under PURPA and entered summary judgment in favor of the PUC and intervenor, TNMP. PRG appealed the district court's rulings (1) that the 90-day rule did not violate PURPA; and (2) that the district court lacked jurisdiction to grant relief for PRG's "as-applied" claims.<sup>59</sup>

The issue before the Fifth Circuit was "whether the PUC's rule that a legally enforceable obligation arises only when a [QF] can deliver power within 90 days [complies] with PURPA and its associated federal regulations."<sup>60</sup> PURPA requires the FERC to promulgate regulations to effectuate its "goal of encouraging the development of cogeneration and small power production facilities."<sup>61</sup> The FERC, in turn, requires state agencies to implement the FERC regulations.<sup>62</sup>

After analyzing the FERC's regulations relating to QFs, the Fifth Circuit found that PRG failed to show that PURPA and the FERC regulations mandate that all QFs must be able to create a legally enforceable obligation at any time, including before completion of the QF.<sup>63</sup> The Fifth Circuit opined that "states must provide for legally enforceable obligations as distinct from contractual obligations, but 'it is up to the States, not [FERC], to determine the specific parameters of individual QF power purchase agreements, including the date at which a legally enforceable obligation is incurred under State law.'"<sup>64</sup> The Fifth Circuit held that the PUC's 90-day rule was within the discretion given to the states under PURPA and affirmed the district court decision upholding the rule.<sup>65</sup>

## B. OVER-RECOVERED STRANDED COSTS

*Cities of Corpus Christi v. Public Utility Commission* is an appeal of a PUC order requiring AEP Texas Central Company ("AEP") to refund excess mitigation credits to retail electronic providers ("REPs") for over-recovered stranded costs. On appeal, the district court agreed with the

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58. *Power Res. Group*, 422 F.3d at 234.

59. *Id.* at 235-36.

60. *Id.* at 237.

61. *Id.*

62. *Id.*

63. *Id.* at 238.

64. *Id.* (quoting *W. Penn Power Co.*, 71 F.E.R.C. P61,153, 61,495 (May 8, 1995)).

65. *Id.* at 240.

ratepayers and held that PURA requires that over-recovered stranded costs be paid directly to customers instead of REPs. In this appeal, AEP raised three issues: (1) whether the PUC had the statutory authority to order AEP to refund over-recovered stranded costs before the 2004 stranded cost true-up proceeding; (2) whether excess mitigation credits should be refunded to REPs or directly to customers; and (3) whether the PUC's decision to not allow AEP to recover interest on any over-refunded costs was a violation of PURA. The court found that, although PURA unquestionably prohibited the over-recovery of stranded costs, a literal interpretation of the statute did not allow the PUC to implement a refund of any over-recovered costs until the true-up phase was completed.<sup>66</sup> In its decision, the court emphasized that the Texas Legislature only mentions the concept of over-recovered stranded costs in the portion of PURA dealing with the stranded cost true-up proceeding and does not provide any role for the PUC during the second stranded-cost mitigation phase except to impose a composition transition charge ("CTC") that allows additional stranded-cost recovery based on the 1998 excess cost over market ("ECOM") estimates.<sup>67</sup> The court therefore upheld AEP's first issue regarding whether the PUC had the authority to order refunds of over-recovered stranded costs before the 2004 true-up proceeding, but did not reach the second and third issues relating to payment directly to customers and interest on overpayment of refunds.<sup>68</sup>

Ratepayers also raised issues in the appeal relating to the PUC's decision to characterize AEP's Nuclear Electric Insurance Limited ("NEIL") member account balance as generation-related instead of as a transmission and distribution-related asset.<sup>69</sup> NEIL is a mutual insurance company operated by utilities owning nuclear power plants. It retains portions of the premiums paid by its members sufficient to cover potential losses incurred by two nuclear power accidents.<sup>70</sup> These retained premiums are known as "member account balances." In AEP's proposed rates for the 2002 test year, it allocated "the generation portion of its NEIL premiums to its affiliated power generation company."<sup>71</sup> The ratepayers claimed that this asset should instead be credited to the REPs. The PUC issued a decision that the NEIL assets were generation-related, and the district court affirmed that ruling. Applying the substantial-evidence rule, the Third Court of Appeals affirmed as well. Although there was conflicting testimony in the record regarding the proper classification of the NEIL member account balances, the court found that the PUC's decision was reasoned and that substantial evidence existed in the record to provide a basis for its decision.<sup>72</sup>

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66. 188 S.W.3d 681, 670-893 (Tex. App.—Austin 2005, pet. filed).

67. *Id.*

68. *Id.* at 690-93.

69. *Id.*

70. *Id.* at 694.

71. *Id.*

72. *Id.* at 696.

Ratepayers also complained that the PUC should not have authorized demand charges in excess of those assessed under AEP's bundled rate. In the initial phase of unbundling, AEP proposed that a demand charge for large commercial customers be set at \$2.83/kW based on a demand ratchet of 100%. The ratepayers contended that the demand charge should remain at the bundled rate of \$2.74/kW in order to avoid a problem with headroom. The PUC found that the reduced demand charge would result in an arbitrary transfer of costs to "high-load-factor customers" and ultimately set the demand charge at \$3.27/kW.<sup>73</sup> The ratepayers appealed the order, arguing that AEP's evidence was not a sufficient basis for the PUC's decision to set the rate above the bundled rate. Upon consideration of AEP's expert testimony, the Third Court of Appeals upheld the PUC's order. The court held that reasonable minds could have reached the PUC's conclusion based upon the evidence in the record and that substantial evidence supported the decision to set the demand charge at a higher rate than that used by the bundled utility.<sup>74</sup>

### C. PRICE-TO-BEAT RULE

*Office of Public Utility Counsel v. Public Utility Commission* concerned the process used by the PUC for approving the fuel-factor component of the "price to beat" ("PTB"). The issue on appeal was whether the expenses sought by two retail electric providers ("REPs") "were 'reasonable' estimates of 'eligible' projected fuel expenses, and whether procedural irregularities tainted the fuel factor determinations."<sup>75</sup> The PUC approved the disputed expenses and included them in the fuel-factor component of the PTB.<sup>76</sup> On appeal, the district court affirmed the PUC's order in all respects, except for the approval of the capacity-auction expense and the allowance for the unaccounted-for energy expense ("UFE").<sup>77</sup>

As a part of the deregulation of the electric market, REPs in Texas "were required, beginning January 1, 2002, to sell electricity to residential and small commercial customers at a discounted rate" known as the PTB.<sup>78</sup> The PTB protects such customers from adverse impacts of competition during the transition to deregulation.<sup>79</sup> It "is the base rate of the utility as modified by a 'fixed fuel factor,' an adjustment accounting for changes in fuel prices."<sup>80</sup> Further, "the expenses recovered [by a utility] through the fuel factor are reasonable estimates of the electric utility's eligible fuel expenses during the period that the fuel factor is expected to

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73. *Id.* at 698.

74. *Id.* at 699.

75. 185 S.W.3d 555, 561 (Tex. App.—Austin 2006, pet. filed).

76. *Id.*

77. *Id.*

78. *Id.* at 560.

79. *Id.* at 561.

80. *Id.*

be in effect.”<sup>81</sup> The intervening parties in the REPs’ applications for a PTB “argued that the expenses [that the utilities] would incur under deregulation as a result of competition were ineligible for inclusion in the fuel factor.”<sup>82</sup> These expenses “included the capacity-auction expense, [UFE], the transmission-congestion-management expense (“TCM”), the qualified scheduling entity expense (“QSE”), and the single area/multi-area management expense.”<sup>83</sup> The intervening parties also challenged the utilities’ inclusion of coal, natural gas, and purchased-power costs.<sup>84</sup>

Based on its review of section 39.202(b) of PURA, the Third Court of Appeals held that the PUC acted “within its authority to determine that the capacity-auction, UFE, QSE, TCM, and single area/multi-area dispatch expenses were eligible fuel expenses to be used in setting the fuel factors.”<sup>85</sup> In determining such eligibility, the PUC reasoned that, under the fuel rule, it could not ignore “known and measurable events” that occur during the year in which the fuel factor is to be in effect. The appellate court found that such analysis was not arbitrary and capricious.<sup>86</sup>

The Third Court of Appeals further concluded that the PUC’s estimates of the amounts of the disputed expenses were supported by substantial evidence, except for the allowance of UFE requested by one utility. In that instance, the court reversed the PUC’s decision concerning UFE since the utility did not present evidence as to the proper amount of UFE allowance. The Third Court of Appeals also held that the PUC’s decisions relating to the requested coal, purchased power, and railcar depreciation costs were supported by substantial evidence and that the intervening parties failed to show any harmful procedural error.<sup>87</sup>

#### D. FUEL-RECONCILIATION PROCEEDINGS

*Entergy Gulf States, Inc. v. Public Utility Commission* is an appeal of a PUC order in a fuel-reconciliation proceeding conducted under PURA. Entergy sought approval from the PUC for reimbursement of additional expenses incurred when it purchased energy from its own River Bend Nuclear Generating Station (“River Bend”) and from purchased-power contracts. The PUC disallowed approximately \$4.2 million of non-fuel expenses related to energy purchased from River Bend and other imputed capacity charges related to energy purchases from external wholesalers.<sup>88</sup> On appeal, the district court affirmed the PUC’s order and denied Entergy’s request for declaratory judgment on similar subsequently purchased power contracts. Entergy then filed this appeal.<sup>89</sup>

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81. *Id.* at 562.

82. *Id.*

83. *Id.* at 562-63.

84. *Id.* at 563.

85. *Id.* at 567.

86. *Id.* at 566.

87. *Id.* at 579.

88. 173 S.W.3d 199, 203 (Tex. App.—Austin 2005, pet. filed).

89. *Id.*

In the summer of 1999, Entergy experienced unanticipated power shortages, and its retail customers suffered rolling blackouts.<sup>90</sup> Reacting to severe criticism and PUC fines, Entergy obtained additional power from River Bend and some unaffiliated wholesale energy providers under purchased power contracts in order to provide for the projected needs of its retail customers. Originally, seventy percent of the energy generated at the River Bend facility was designated for regulated service ("River Bend 70%"), while the remaining thirty percent was set aside by Entergy for sale in the unregulated wholesale market ("River Bend 30%").<sup>91</sup> After the 1999 blackout, Entergy decided to make the River Bend 30% available to retail customers for the summer of 2000. FERC approved a tariff filed by Entergy for the sale of the River Bend 30% ("FERC tariff"), to be effective June 1, 2000.<sup>92</sup>

Entergy filed an application at the PUC for a fuel-reconciliation proceeding, requesting reimbursement of approximately \$583 million in additional energy expenses for this period. The PUC did not permit Entergy to recover non-fuel costs related to the River Bend 30% or the capacity costs embedded in the purchased-power contracts. Entergy objected, and the PUC referred the matter to the State Office of Administrative Hearings ("SOAH") for a hearing. The administrative law judge ("ALJ") found that the purchase of the River Bend 30% was an affiliate transaction that violated the PUC's cost-of-service rules prohibiting additional recovery of profit from an affiliate sale. The ALJ also concluded that there may have been some impermissible embedded capacity costs in the purchased-power contracts but did not calculate the precise amount of ineligible costs.<sup>93</sup> The PUC rejected these findings and "remanded the case to SOAH to determine the portion of Entergy's claimed reimbursable expenses that was a profit Entergy realized on the sale of Entergy's River Bend 30% energy to itself, and to determine the capacity costs reflected in the claimed eligible fuel costs."<sup>94</sup> The ALJ concluded that the transaction was not an affiliate transaction and that all of the costs were reimbursable. The PUC again disagreed with the ALJ findings, stating: "[a]n internal corporate transfer between Entergy's unregulated and regulated business activities does not amount to a sale."<sup>95</sup> The PUC's position was that Entergy should not be allowed to recover both a profit and ineligible costs associated with the "purchase" of its own wholesale energy because Entergy merely used its own generation, even though that energy was designated as unregulated energy.<sup>96</sup> The PUC also concluded that the purchased power included capacity charges embedded in the contract price. Because capacity charges are ineligible for reimbursement

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90. *Id.* at 204.

91. *Id.*

92. *Id.* at 204.

93. *Id.* at 204-05.

94. *Id.* at 205.

95. *Id.*

96. *Id.*

in a fuel-reconciliation proceeding,<sup>97</sup> the PUC disallowed 24% of the contract price—Entergy's estimate of the proper capacity charge.<sup>98</sup>

Entergy appealed the district court's decision affirming the PUC's final order on several bases. Entergy first contended that the PUC should have approved the recovery of the non-fuel costs of the River Bend 30%, claiming that the filed-rate doctrine required the PUC to allow for full recovery of all related costs as provided in the FERC tariff and that federal law preempted the PUC from regulating the River Bend 30% expenses.<sup>99</sup> The Third Court of Appeals rejected this federal-preemption argument. The court found that the evidence in the record showed that Entergy's efforts to avoid a prohibited affiliate transaction actually resulted in *no* sale occurring under the FERC tariff. Under the FERC tariff, Entergy was supposed to sell the River Bend 30% to Entergy Services, Inc., which would then sell the energy back to Entergy for use in supplementing its native load. But Entergy did not execute the sale according to this structure—it “sold” the River Bend 30% not to Entergy Services, Inc., but directly to itself.<sup>100</sup> The Third Court of Appeals reasoned that, because the sale to Entergy Services, Inc. contemplated under the FERC tariff never took place, the filed-rate doctrine did not apply, and the PUC's actions were not preempted by federal law. Because these sales were not subject to the filed-rate doctrine, the court found that it was not necessary to address the declaratory-judgment issue.<sup>101</sup>

Entergy also argued that the PUC's decision not to allow Entergy to recover imputed capacity charges from energy that it purchased from outside energy wholesalers violated the fuel rule, which prohibits a utility from recovering such costs through the fuel factor as part of purchased power.<sup>102</sup> Entergy reasoned that, under the fuel rule, the PUC is only allowed to look at capacity charges that are expressly stated as separate items in the purchased-power contract. In other words, Entergy argued that the PUC may not take into account whether there are actually other capacity charges “embedded” elsewhere in the contract.<sup>103</sup> Relying on the plain language of the fuel rule, the Third Court of Appeals found that the rule does not differentiate between segregated capacity charges and embedded capacity charges, but refers to total capacity charges. As such, Entergy contended that the PUC illegally modified the fuel rule without engaging in the formal APA rule-making process, claiming that the PUC's subsequent request for comments on a proposed amendment to the fuel rule, which would allow it to impute capacity charges, was an admission by the agency that it is required to follow the formal rule-mak-

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97. 16 TEX. ADMIN. CODE § 25.236(a)(4) (2004). The proper proceeding to recover capacity costs is a rate-case proceeding. TEX. UTIL. CODE ANN. § 36.051 (Vernon 2005).

98. *Entergy Gulf States*, 173 S.W.3d at 205.

99. *Id.* at 207.

100. *Id.*

101. *Id.* at 209.

102. 16 TEX. ADMIN. CODE § 25.236(a)(4) (2004).

103. *Entergy Gulf States*, 173 S.W.3d at 211.



ing process in order to modify the fuel rule.<sup>104</sup> The Third Court of Appeals found (1) that the proposed modification to the rule was merely to facilitate the identification and quantification of embedded capacity charges, not to establish whether the PUC could impute charges; and (2) that the PUC could consider a matter in a contested case before adopting a subsequent rule in cases in which the agency did not have sufficient experience to warrant promulgating a formal rule.<sup>105</sup> The Third Court of Appeals held that there was substantial evidence to support the PUC's decision to disallow the imputed capacity charges and that it was not an improper ad hoc amendment to the fuel rule.<sup>106</sup>

#### E. PUC JURISDICTION OVER CERTAIN MUNICIPAL ORDINANCES

In *City of Allen v. Public Utility Commission*, several Texas cities appealed the PUC's order invalidating city ordinances. Under the ordinances, Oncor Electric Delivery Company had to place electric distribution lines underground, screen facilities from public view, and replace wooden poles with metal or concrete poles. However, before the PUC's order, the City of Allen had repealed parts of the ordinances requiring underground lines and replacement of wooden poles. The cities sought judicial review of the PUC's order in district court, which dismissed part of the appeal and affirmed the PUC's order regarding the non-repealed ordinance requirements. The district court did not address whether the PUC had appellate jurisdiction over the repealed portions of the ordinances and dismissed the issue as moot.<sup>107</sup>

On appeal from district court, the cities contested the PUC's appellate jurisdiction to review Allen's ordinances, arguing that the ordinances were enacted as an exercise of police power as a home-rule municipality "to protect the health, safety, and welfare of Allen's citizens," rather than to regulate the utility.<sup>108</sup> Additionally, the cities argued that: (1) an electric utility's right to construct and operate facilities on city streets and rights-of-way must be exercised "with the consent of and subject to the direction of the governing body of the municipality;"<sup>109</sup> (2) city ordinances may designate the location of and screening of utility facilities, as long as they are not unreasonable, arbitrary, or in violation of Texas laws; and (3) zoning ordinances are presumed valid unless there is a "clear abuse of municipal discretion."<sup>110</sup>

The Austin Court of Appeals denied the PUC's motion to dismiss the appeal, which asserted that the court must first address the district court's

104. *Id.* at 211-12.

105. *Id.* at 212 (quoting *City of El Paso v. Pub. Util. Comm'n*, 883 S.W.2d 179, 189 (Tex. 1994)).

106. *Id.* at 212.

107. 161 S.W.3d 195, 197-99 (Tex. App.—Austin 2005, no pet. h.).

108. *Id.* at 197, 199; see TEX. CONST. art. XI, § 5.

109. TEX. UTIL. CODE ANN. § 181.043 (Vernon 2005).

110. *Id.* at 202-03; see TEX. REV. CIV. STATS. ANN. art. 1175, § 1 (Vernon 2005); see also TEX. UTIL. CODE ANN. §§ 181.042-.043 (Vernon 2005).

refusal to rule on the repealed portions of the ordinances before it could address the PUC's jurisdiction over them. The court explained that "the question of jurisdiction is fundamental and can be raised at any time in the trial of a case or on appeal."<sup>111</sup> But the court agreed with the PUC's contentions that (1) the ordinances "were an exercise of Allen's original jurisdiction over Oncor's rates, operations, and services" under PURA section 33.001; (2) "Allen's regulatory authority cannot exceed that of the [PUC];" and (3) "Allen may not regulate in a manner different from the [PUC]" under PURA section 33.004(b).<sup>112</sup>

The court of appeals found that Allen's ordinances required installation of "non-standard electrical distribution facilities" because underground distribution lines, replacement of wooden poles, and screening facilities are "in excess of those normally required for service" and do not "minimize the cost of [facility] extension," as required by Oncor's tariff.<sup>113</sup> The court concluded that Allen's ordinances also conflicted with Oncor's tariff because Allen holds Oncor financially responsible for the costs of non-standard facilities. Because of this conflict, the court held that (1) Allen was regulating Oncor's "rates," "operations," and "services" as defined by PURA sections 31.002(15) and 11.003(19), and (2) the PUC had appellate jurisdiction to review the ordinances.<sup>114</sup>

The court found that the PUC also had jurisdiction because the ordinances conflicted with PURA's comprehensive regulatory scheme for utilities. The court relied on (1) the Texas Supreme Court's recognition of PURA's broad scope in *In re Entergy Corp.*; (2) the PUC's enumerated power of appellate review of ordinances regulating electric utility rates under PURA section 32.001(b); and (3) the goal of regulatory uniformity.<sup>115</sup> The court found additional support in *Trophy Club*, in which the PUC concluded that it had appellate jurisdiction over similar municipal ordinances that conflicted with state utility regulations.<sup>116</sup>

## F. FRANCHISE FEES

In *Nucor Steel v. Public Utility Commission*, Nucor, an industrial non-municipal TXU Electric Company customer, appealed a PUC order. The order concluded that TXU's franchise charges should be (1) allocated using the "direct" method, which is based on the volume of sales and measured in kilowatt hours (kWh); and (2) collected from municipal and non-

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111. *Id.* at 199 (citing Pub. Util. Comm'n v. J.M. Huber Corp., 650 S.W.2d 951, 955 (Tex. App.—Austin 1983, writ ref'd n.r.e.)).

112. *Id.* at 203; see TEX. UTIL. CODE ANN. §§ 33.0011(a), 33.004(b) (Vernon 2005).

113. *City of Allen*, 161 S.W.3d at 204-05 (quoting Tariff for Retail Delivery Serv. Oncor Elec. Delivery Co., §§ 6.1.2.2.1, 6.1.2.2.2).

114. *Id.* at 207-08; see TEX. UTIL. CODE ANN. §§ 11.003(19), 31.002(15) (Vernon 2005).

115. *City of Allen*, 161 S.W.3d at 208-09; see *In re Entergy Corp.*, 142 S.W.3d 316, 323 (Tex. 2004); see also TEX. UTIL. CODE ANN. § 32.001(b) (Vernon 2005).

116. *City of Allen*, 161 S.W.3d at 210-11; see Application of Texas Utilities Electric Company to Obtain a CCN for the Trophy Club-Coppell-Euleess 138 KV Transmission Line, Docket Nos. 6117, 6170-72, 1986 Tex. PUC LEXIS 292, at \*64-65 (Feb. 6, 1986) (final order granting application).

municipal customers using the “spread” method. The PUC determined that the direct/spread methods complied with PURA sections 33.008 and 36.003 and satisfied its goal “to institute, to the extent possible, a generic rate design that would honor the principles of cost causation, simplicity, and equity to customers.”<sup>117</sup> The PUC also found that the methods honored equity principles because “the franchise arrangement serves the entirety of the transmission and distribution system [and] benefits all customers in the system.”<sup>118</sup> Nucor sought judicial review of the PUC’s order in district court, which affirmed the order.<sup>119</sup>

On appeal, Nucor argued unsuccessfully that direct allocation of franchise charges based on kWh sales conflicts with cost-causation principles, and instead, TXU should continue to use “the historical method of allocating franchise charges on the basis of gross revenues derived by TXU.”<sup>120</sup> Nucor also contended that the PUC’s order allocating the franchise charges was an abuse of discretion, arbitrary and capricious, and in violation of PURA.<sup>121</sup>

The Austin Court of Appeals upheld the PUC’s order based on substantial evidence, finding that the rate-design matters were within the PUC’s broad discretion because PURA is silent as to how TXU’s franchise charges should be allocated and collected.<sup>122</sup> The court of appeals focused on expert testimony at the SOAH hearing, which rebutted Nucor’s position and explained the benefits of basing allocation on kWh sales, including (1) maintenance of an existing rate structure; (2) consistency with metering facilities for transmission and distribution service; (3) elimination of cost shifting; and (4) fulfillment of the goal of cost-causation.<sup>123</sup> Based on the substantial-evidence rule, the court held that the record supported the PUC’s decision to base TXU’s franchise charges on kWh sales. In addition, by relying on the plain language of PURA section 33.008, the court concluded that the statute was silent as to the proper method of allocation and that TXU’s method mirrors the calculation set forth by the statute. The court emphasized that the PUC has broad discretion over rate-design matters and that a “process of discussion, careful consideration, and compromise” occurred in this case.<sup>124</sup>

The Austin Court of Appeals also rejected Nucor’s argument that the PUC order permitting the spread-collection method, whereby TXU collects franchise charges from both municipal and non-municipal customers, constitutes an abuse of discretion and a violation of PURA section

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117. 168 S.W.3d 260, 265-66 (Tex. App.—Austin 2005, no pet. h.); see TEX. UTIL. CODE ANN. §§ 33.008, 36.003 (Vernon 2005).

118. *Nucor Steel*, 168 S.W.3d at 266.

119. *Id.*

120. *Id.* at 269.

121. *Id.* at 263.

122. *Id.* at 269; see *Reliant Energy, Inc. v. Pub. Util. Comm’n*, 153 S.W.3d 174, 189 (Tex. App.—Austin 2004, pet. denied); TEX. UTIL. CODE ANN. § 33.008 (Vernon 2005) (specifying only the method of calculating charges).

123. *Nucor Steel*, 168 S.W.3d at 269.

124. *Id.* at 269.

33.006. Nucor reasoned that the method was inappropriate because municipal sales only generate franchise charges, and non-municipal customers receive no benefit from the purpose served by the charge. Instead, Nucor proposed a direct-collection method.<sup>125</sup>

The PUC responded, and the court of appeals agreed, that it was proper for TXU to use the spread-collection method to recover its franchise charges because municipal and non-municipal customers alike benefit from TXU's ability to locate its facilities on municipal property given the nature of transmission and distribution of electric service. Further, since TXU had recovered its franchise charges from all of its customers over the past twenty years, the court relied on the Texas Supreme Court's decision in *Texas Alarm & Signal Ass'n v. Public Utility Commission*, stating that "when a concept has historically been 'widely accepted as a proper pattern for rate design' it 'should not be discarded by the [PUC] without concrete cost data to support such change.'"<sup>126</sup> The court also upheld the PUC's finding that Nucor's proposal for direct collection would be problematic—rates would vary based on geography, and it would conflict with the historical precedent of collecting franchise charges from all of TXU's customers.<sup>127</sup>

Finally, the court found no merit in Nucor's contention that the franchise charge results in "taxation without representation" and that non-municipal customers should not be forced to subsidize municipal projects.<sup>128</sup> The court concluded that PURA's express language in section 33.008 that franchise charges are "operating expenses" evidences a "clear legislative expression that the nature of the franchise charge is a fee, not a tax."<sup>129</sup>

### G. FILED-RATE DOCTRINE

In an appeal to the Fifth Circuit, Texas Commercial Energy ("TCE"), a REP, sought to recover damages for alleged market manipulation. TCE obtained electricity for its customers by negotiating bilateral agreements with electricity generators and by purchasing electricity on the ancillary Balancing Energy Service ("BES") market.<sup>130</sup> As the court explained, "the BES market is a bid-based wholesale market for short-term electricity power" that is administered by ERCOT.<sup>131</sup> During early 2003, prices for electricity on the BES market dramatically increased as a result of severe winter weather. Consequently, TCE was forced to pay considerably higher prices for the energy it needed, and the resulting financial

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125. *Id.*

126. *Id.* at 271; see TEX. UTIL. CODE ANN. § 33.006 (Vernon 2005) (quoting *Tex. Alarm & Signal Ass'n v. Pub. Util. Comm'n*, 603 S.W.2d 766, 768 (Tex. 1980)).

127. *Id.* at 272.

128. *Id.* at 269-700.

129. *Id.* at 270; TEX. UTIL. CODE ANN. § 33.008(c) (Vernon 2005).

130. *Tex. Commercial Energy v. TXU Energy, Inc.*, 413 F.3d 503, 506 (5th Cir. 2005), *cert. denied*, No. 05-491, 2006 U.S. LEXIS 52 (2006).

131. *Id.*

losses eventually led to TCE filing for Chapter 11 bankruptcy.<sup>132</sup> TCE filed suit in federal district court against twenty-four market participants and ERCOT, alleging violations of the federal Sherman Antitrust Act and the Texas Free Enterprise and Antitrust Act (“TFEAA”), fraud, negligent misrepresentation, breach of contract, defamation, business disparagement, and civil conspiracy.<sup>133</sup> The district court dismissed the fraud, negligent-misrepresentation, and antitrust claims on the basis of the filed-rate doctrine, as well as some of the breach-of-contract and civil-conspiracy claims.<sup>134</sup> Motions to dismiss the defamation and business-disparagement claims were denied. Because the federal claims were dismissed and there was no basis for diversity jurisdiction on the remaining state-law claims, the district court dismissed the entire case.<sup>135</sup>

TCE challenged the district court’s decision to dismiss the antitrust claims based on the filed-rate doctrine. The district court determined that, even if the defendants participated in improper market manipulation, the filed-rate doctrine precluded recovery on the antitrust claims. Under the filed-rate doctrine, allegations that a regulated entity’s filed rates are too high, unfair, or unlawful is precluded because the filed rate has been approved by the governing regulatory agency and is thus considered *per se* reasonable.<sup>136</sup> TCE argued that the district court erred in applying the filed-rate doctrine because (1) the Texas Legislature intended for parties to bring private claims under PURA; (2) wholesale energy rates in the BES market are not filed with the PUC and are therefore not subject to the filed-rate doctrine; (3) antitrust exemptions should be narrowly construed; and (4) PURA does not create a substitute-damages mechanism.<sup>137</sup>

TCE asserted that the Texas Legislature intended to allow private antitrust claims to be brought under PURA, citing the savings clause in PURA that expressly states, “Nothing in this chapter shall be construed to confer immunity from state or federal antitrust laws.”<sup>138</sup> TCE argued that, by applying the filed-rate doctrine, the district court conferred immunity on the defendants and thus violated this provision of PURA. The Fifth Circuit disagreed with TCE’s position, stating that the Supreme Court had explicitly rejected this position.<sup>139</sup> Regulated entities that “engage in anticompetitive activities based on filed rates are still subject to scrutiny under the antitrust laws by the Government and to possible crim-

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132. *Id.* at 506-07.

133. *Id.* at 507.

134. *Id.*

135. *Id.* at 507-08.

136. *Id.*; see generally *Square D Co. v. Niagara Frontier Tariff Bureau, Inc.*, 476 U.S. 409, 422 (1986); *Keogh v. Chi. & Nw. Ry. Co.*, 260 U.S. 156, 163 (1922); *Wegoland, Ltd. v. NYNEX Corp.*, 27 F.3d 17, 18 (2d Cir. 1994).

137. *Tex. Commercial Energy*, 413 F.3d at 508.

138. *Id.* (quoting TEX. UTIL. CODE ANN. § 39.158(b) (Vernon 2005)): “This chapter is intended to complement other state and federal antitrust provisions. Therefore, antitrust remedies may also be sought in state or federal court to remedy anticompetitive activities.”)

139. *Id.* (citing *Square D Co.*, 476 U.S. at 422).

inal sanctions or equitable relief.”<sup>140</sup> The Fifth Circuit determined that the filed-rate doctrine applied with equal force to both the federal and state antitrust claims, and the application of this defense gave effect to the Texas Legislature’s intent to have PURA complement federal and state antitrust statutes.<sup>141</sup>

TCE also took the position that the filed-rate doctrine was improperly applied because PURA does not require rates in the BES market to be filed with and approved by the PUC. The court disagreed. After reviewing similar decisions made by other circuits,<sup>142</sup> the Fifth Circuit concluded that the market-oversight responsibility given to the PUC in PURA to “ensure ‘safe, reliable, and reasonably priced electricity,’” as well as the PUC requirements that electricity generators file market-power information and market-power-mitigation plans, were sufficient to determine that the BES rates were “filed” within the meaning of the filed-rate doctrine.<sup>143</sup>

TCE further contended that its antitrust claims were exempt from the filed-rate doctrine under the “competitor exception.”<sup>144</sup> The competitor exception provides “that ‘an anticompetitive practice embodied in a [filed] tariff may [still] violate the antitrust laws if it . . . impacts upon competitors as opposed to customers.’”<sup>145</sup> This exception has never been recognized by either the Fifth Circuit or the Supreme Court. The Fifth Circuit concluded that, “[a]ssuming, without deciding, that such an exception exists,” TCE was not a competitor of the defendants in this case.<sup>146</sup> TCE is a REP, and its claims of market manipulation are based on the defendants’ actions as electric-generation companies. The Fifth Circuit held that the district court did not err in refusing to apply the competitor exception.<sup>147</sup>

Finally, TCE argued that the filed-rate doctrine is inapplicable because PURA did not create a “substitute mechanism for the recovery of damages.”<sup>148</sup> The Fifth Circuit held that TCE waived this argument on appeal because TCE failed to raise it before the district court. The Fifth Circuit therefore affirmed the district-court judgment dismissing TCE’s state and federal antitrust claims.<sup>149</sup>

*AEP Texas North Co. v. Hudson* involved an appeal of a PUC order in a fuel-reconciliation proceeding. In AEP Texas’ application to the PUC

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140. *Id.* (quoting *Square D. Co.*, 476 U.S. at 422).

141. *Id.* at 509.

142. See *Town of Norwood v. New Eng. Power Co.*, 202 F.3d 408, 409 (1st Cir. 2000); *Pub. Util. Dist. No. 1 of Snohomish County v. Dynegy Power Mktg., Inc.*, 384 F.3d 756, 760 (9th Cir. 2004).

143. *Tex. Commercial Energy*, 413 F.3d at 509-10 (quoting TEX. UTIL. CODE ANN. § 39.101(a)(1) (Vernon 2005)).

144. *Id.* at 510.

145. *Id.* (quoting *City of Groton v. Conn. Light and Power Co.*, 662 F.2d 921, 929 (2d Cir. 1981)).

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.*

to reconcile its fuel costs from July 1, 2000, through December 31, 2001, an issue arose over the amount of revenue the utility was required to share with its customers under two agreements: (1) the System Integration Agreement (“SIA”), a wholesale-rate schedule filed at FERC, and (2) the Integrated Stipulation and Agreement relating to the merger of AEP Texas’ parent company, American Electric Power Company (“AEPSC”), and another public-utility holding company.<sup>150</sup> The SIA provided that the Trading and Market Realizations (“TMRs”), profits from off-system sales and purchase of power, would be allocated between the AEP east and west zones, which correspond to the pre-merger systems of the two companies. The SIA also specified how AEP Texas was to share its revenue with its retail customers once a designated agent, American Electric Power Service Corporation (“AEPSC”), had allocated the revenue between the two zones.<sup>151</sup> AEPSC calculated the TMRs using “‘mark to market’ accounting in which the ‘open’ transactions, transactions that had yet to be completed, were recorded at market value, while ‘closed’ or completed transactions were recorded at the actual contract value.”<sup>152</sup> The PUC disagreed with the AEPSC’s inclusion of both the open and closed transactions in the “Base Year” allocation and ordered AEP Texas to recalculate the TMR allocation without including the open transactions. The PUC’s allocation methodology resulted in higher TMRs and equivalent revenue for the AEP Texas zone.<sup>153</sup>

Alleging violations of the Federal Power Act and the Supremacy Clause of the United States Constitution, AEP Texas filed suit in federal court, challenging the portion of the PUC’s order that required AEP Texas to reallocate the TMRs. The utility argued that the PUC was federally preempted from reviewing AEPSC’s allocation of the TMRs and that the PUC had to accept the AEPSC’s methodology as approved by the FERC. The agency, on the other hand, contended that its interpretation and application of the terms of the SIA was proper and that its rejection of the AEPSC allocation was justified. Under the Federal Power Act, the FERC is granted exclusive jurisdiction to regulate wholesale electric transmissions and sales in interstate commerce, and utilities are required to file tariffs with FERC showing their rates and charges for such transmissions and sales.<sup>154</sup> Further, in an opinion concerning the filed-rate doctrine, the United States Supreme Court held that the FERC has exclusive jurisdiction over transactions among affiliated utilities operating an interstate power pool.<sup>155</sup> After evaluating these legal principles, the court found that the SIA is a federally approved tariff and that the PUC did not have jurisdiction to review and reject the AEPSC’s allocation of TMRs. The PUC was obligated to accept the AEPSC allocation

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150. 389 F. Supp. 2d 759, 761 (W.D. Tex. 2005).

151. *Id.*

152. *Id.* at 762.

153. *Id.*

154. *Id.* at 763-64; 16 U.S.C. §§ 824, 824d(c) (2005).

155. *Id.* at 765; *Entergy La., Inc. v. La. Pub. Serv. Comm’n*, 539 U.S. 39, 49 (2003).

so long as it was approved by the FERC. The court noted that if the PUC felt that the AESPC's allocation of TMRs was improper, it had a remedy under the Federal Power Act allowing the PUC to seek a determination from the FERC that the SIA had been violated.<sup>156</sup>

### III. GAS UTILITY REGULATION

In *Pinnacle Gas Treating, Inc. v. Read*, the gas utility commenced eight condemnation proceedings in Leon County, which were distributed to three different judicial district courts serving the county. Although the district clerk assigned the case to Judge Sandel of the 278th Judicial District, Judge Bournias of the 87th Judicial District appointed special commissioners in all eight proceedings. In the case at hand, which involved an easement for a gas pipeline over the Reads' property, the commissioners found that the Reads were entitled to an award for the easement, and Judge Bournias granted the gas utility a writ of possession.<sup>157</sup> After filing an objection to the commissioners' award, the gas utility filed a motion for partial summary judgment with Judge Sandel. Judge Sandel dismissed the proceeding, and a jury awarded damages to the Reads. The gas utility then brought a second condemnation proceeding to establish its right to the easement over the Reads' property.<sup>158</sup>

The gas utility also appealed Judge Sandel's judgment on the Reads' claims for damages in the first condemnation proceeding. The court of appeals concluded that the second proceeding rendered the case moot and dismissed the appeal. The Texas Supreme Court reversed and remanded the case, holding that the gas utility had an interest in the outcome of the case because damages were at issue. On remand, the court of appeals upheld the trial court's decision, concluding that Judge Bournias lacked jurisdiction to appoint special commissioners because there was no agreement to exchange benches with Judge Sandel.<sup>159</sup>

In its opinion, the Texas Supreme Court reversed the judgment of the court of appeals and held that both Judge Sandel and Judge Bournias had concurrent jurisdiction over the case because the 278th and 87th Judicial Districts both include Leon County. The court disagreed with the Reads' view that a proper exchange of benches was necessary to establish Judge Bournias' jurisdiction over the case. The court relied on the Texas Constitution, explaining that (1) "[n]o formal order is needed for an exchange or transfer to take place," and (2) "the right of district judges to exchange benches assumes that they already have concurrent jurisdiction over the same cases in a common county."<sup>160</sup>

The court also emphasized section 21.013 of the Property Code, which governs district and county clerks' assignment of eminent-domain cases

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156. *AEP Tex.*, 389 F. Supp. 2d at 765; see 16 U.S.C. §§ 824d(e), 824e(a), 825e.

157. 160 S.W.3d 564, 565 (Tex. 2005) (per curiam).

158. *Id.* at 565-66.

159. *Id.* at 566.

160. *Id.*



“to each court with jurisdiction that the clerk serves.”<sup>161</sup> The court continued “[t]he statute does not purport to confer exclusive jurisdiction upon the court to which a case is assigned,” and recognizes that multiple courts can have jurisdiction.<sup>162</sup> Moreover, the court explained that section 21.014 of the Property Code, which requires a judge presiding over an eminent-domain case to appoint special commissioners, does not “suggest[ ] that it confers exclusive jurisdiction to appoint commissioners to the judge to which an eminent domain case is assigned.”<sup>163</sup>

The Texas Supreme Court therefore reversed the judgment of the court of appeals and rendered a take-nothing judgment against the Reads for their wrongful-entry action. The court remanded the condemnation proceeding to the trial court to resolve condemnation damages in the original and second condemnation proceedings.<sup>164</sup>

#### IV. LEGISLATION

##### A. ELECTRIC

###### 1. *House Bill 989: Recovery of certain electric utility transmission investments*<sup>165</sup>

This legislation amends Chapter 36 of the Utilities Code by allowing an electric utility operated outside of ERCOT to recover transmission infrastructure-improvement costs through a rate rider mechanism without a rate proceeding. The rate-rider mechanism is limited in applicability to non-ERCOT utilities in areas included in the Southwest Power Pool or the Western Electricity Coordinating Council that own or operate transmission facilities. The bill also authorizes the PUC to allow an electric utility to annually recover its reasonable and necessary expenditures for transmission infrastructure-improvement costs and changes in wholesale transmission to the electric utility under a tariff approved by a federal regulatory authority to the extent that the costs have not already been recovered. The legislature stipulated that the utility may recover only costs allowable to customers in the State of Texas and may not over-recover costs.<sup>166</sup>

###### 2. *House Bill 1567: Delay in the deregulation of certain utilities outside of ERCOT*<sup>167</sup>

House Bill 1567 amends Chapter 39 of the Utilities Code, which relates to the transition to electric deregulation in certain non-ERCOT areas. The legislature provided that the rates of an investor-owned electric utility that was operating as of January 1, 2005, solely outside of ERCOT in

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161. *Id.* (quoting TEX. PROP. CODE ANN. § 21.013(d) (Vernon 2005)).

162. *Id.*

163. *Id.* at 567; see TEX. PROP. CODE ANN. § 21.014 (Vernon 2005).

164. *Pinnacle Gas*, 160 S.W.3d at 567-68.

165. Tex. H.B. 989, 79th Leg., R.S., 2005 Tex. Gen. Laws 1024.

166. *Id.*

167. Tex. H.B. 1567, 79th Leg., R.S., 2005 Tex. Gen. Laws 1072.

areas of Texas included in the Southeastern Electric Liability Council, will continue to be regulated under the traditional cost-of-service regulation, that the utility may file for rate changes and/or approval of rate-rider mechanisms, and that the utility is subject to all applicable regulatory authority.<sup>168</sup>

The bill prohibits the utility from filing a rate proceeding or altering or revoking an offered rate charged by the utility before June 30, 2007. The rate change is to go into effect no earlier than June 30, 2008. The legislation requires the utility to establish two vertically-integrated utilities—one under the jurisdiction of the PUC and the other under the jurisdiction of the Louisiana Public Service Commission. The utility is also required to file a plan with the PUC by January 1, 2006, identifying the applicable power regions that they may enter to develop competition.<sup>169</sup>

A utility is also required to file a transition-to-competition plan with the PUC by the earlier of either January 1, 2007, or the ninetieth day after the applicable power region is certified, identifying how the utility intends to mitigate market power, achieve full customer choice, and achieve any other measure that is consistent with the public interest. The plan must include a provision to reinstate a customer-choice pilot project and a price to beat for residential and commercial customers having a peak load of 1000 kilowatts or less.<sup>170</sup>

### 3. *Senate Bill 408: Public Utility Commission sunset legislation*<sup>171</sup>

This legislation extends the PUC to September 1, 2011 and modifies a number of the agency's administrative procedures. First, the Utilities Code was amended to require the PUC to develop and implement negotiated rulemaking and alternative dispute-resolution procedures. Second, the bill increases the administrative penalty for violations of PURA or PUC rules from \$5,000 to \$25,000 and requires the PUC to establish a classification system for violations that includes a range of administrative penalties that may be assessed based on various factors, such as the seriousness of the violation. Third, section 39.151 of the Utilities Code was amended to specify that the PUC, rather than an "independent organization," establish and enforce procedures relating to the reliability of the regional electric network and the accounting for the production and delivery of electricity among generators and other market participants. The legislation also redefines an "independent organization" and outlines its structure, duties, membership qualifications, and public-meeting requirements. The independent organization is required to contract with and support a PUC-selected entity to act as the agency's wholesale electric-market monitor, which is required to immediately report to the PUC "any potential market manipulations and any discovered or potential vio-

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168. *Id.*

169. *Id.*

170. *Id.*

171. Tex. S.B. 408, 79th Leg., R.S., 2005 Tex. Gen. Laws 797.

lations of [PUC] rules or rules of the independent organization.”<sup>172</sup>

4. *Senate Bill 712: Energy efficiency goals and programs*<sup>173</sup>

The legislature included, as part of its energy-efficiency goals, the opportunity for each customer to reduce its peak demand for energy. The legislation requires each electric utility to provide System Benefit Fund funding for certain low-income energy-efficiency programs in an amount equal to or greater than funding for those programs in 2003 fiscal year. It also extends indefinitely the deadline for achievement of legislative energy-efficiency goals.<sup>174</sup>

5. *Senate Bill 1668: Affiliate burden of proof relative to charges for capital costs*<sup>175</sup>

This legislation provides that, in considering the reasonableness of an electric utility's payment to an affiliate for capital costs, the regulatory authority must find that the price to the electric utility is not higher than the prices that the supplying affiliate charge for the same item to its other affiliates or to a non-affiliated person within the same market area or having the same market conditions.<sup>176</sup> Upon a finding of unreasonableness, the regulatory authority is required to “determine the reasonable level of the expense, and include that expense in determining the utility's cost of service.”<sup>177</sup>

## B. GAS UTILITY

1. *House Bill 474: Reporting requirements for gas utilities*<sup>178</sup>

Amending Texas Utilities Code section 102.051(a), this legislation requires a gas utility to report to the Railroad Commission “(1) a sale, acquisition, or lease of a plant as an operating unit or system in this state for a total consideration of more than \$1 million; or (2) a merger or consolidation with another gas utility operating in this state.”<sup>179</sup> The legislature changed the requirement that gas utilities report such a transaction “within a reasonable time” to within sixty days following the effective date of the transaction.<sup>180</sup>

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172. *Id.*

173. Tex. S.B. 712, 79th Leg., R.S., 2005 Tex. Gen. Laws 328.

174. *Id.*

175. Tex. S.B. 1668, 79th Leg., R.S., 2005 Tex. Gen. Laws 413.

176. *Id.*

177. *Id.*

178. Tex. H.B. 474, 79th Leg., R.S., 2005 Tex. Gen. Laws 1000.

179. *Id.*

180. *Id.*

2. *House Bill 872: Pipeline safety, annual inspection fee, and suspension of interim rate implementation*<sup>181</sup>

This legislation amends sections 121.211(d), 121.211(g), and 104.301(a) of the Texas Utilities Code. It clarifies that the Railroad Commission is to collect from operators of natural-gas-distribution systems an annual inspection fee of up to fifty cents for each service line. The bill also provides that an interim tariff or rate-schedule adjustment to recover the cost of changes in the investment in gas-utilities service, filed by a gas utility with a regulatory authority at least sixty days before implementing the interim rate, may be suspended by the regulatory authority for up to forty-five days. The previous law allowed an indefinite suspension of the interim rate implementation.<sup>182</sup>

## V. CONCLUSION

The cases and legislation 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.

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181. Tex. H.B. 872, 79th Leg., R.S., 2005 Tex. Gen. Laws 948.

182. *Id.*

