No. 06-1438

IN THE
SUPREME COURT OF THE UNITED STATES

PAUL HUDSON, ET AL.,
Petitioners,
v.
AEP TEXAS NORTH COMPANY, ET AL.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF OF THE CITIES OF ABILENE, BALLINGER, CISCO, SAN ANGELO AND VERNON, TEXAS AS RESPONDENTS IN SUPPORT OF PETITION

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QUESTION PRESENTED

This Petition raises the question reserved by the Court in *Entergy Louisiana, Inc. v. Louisiana Public Service Commission*, 539 U.S. 39 (2003). That question is:

When there is a dispute over the meaning of a federally-approved tariff in a state retail utility rate proceeding, are States preempted from ensuring that the filed rate is used?

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES

RULES

OTHER AUTHORITIES

Blank Page

BRIEF OF THE CITIES OF ABILENE, BALLINGER, CISCO, SAN ANGELO AND VERNON, TEXAS AS RESPONDENTS IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The Cities of Abilene, Ballinger, Cisco, San Angelo and Vernon, Texas (collectively "Cities") were parties in the court of appeals and are, therefore, technically Respondents in this Court. *See* Sup. Ct. R. 12.6 ("All parties other than the petitioner are considered respondents...."). The Cities participated in the underlying case at the Public Utility Commission of Texas ("PUC" or "Commission") (PUC Docket No. 26000), AEP Texas North Company's ("TNC's") appeal of the PUC's Order to the district court and at the Fifth Circuit. Cities support the PUC's position on the issue raised in the Petition. Therefore, the Cities ask this Court to grant the Petition. *See* Sup. Ct. R. 12.6 ("a response supporting the petition shall be filed within 20 days after the case is placed on the docket").

In the event this Court issues a writ of certiorari, the Cities will file a Brief on the Merits as Respondents supporting the Petitioner. *See* Sup. Ct. R. 25.1 ("Any respondent ... who supports the petitioner ... shall meet the petitioner's ... time schedule for filing documents.").

STATEMENT

The underlying issue in this case surrounds the PUC's ruling on TNC's calculation of electricity sales' profits to be shared with Texas retail electric customers under the terms of their Federal Energy Regulatory

Commission ("FERC") approved System Integration Agreement ("SIA"). Under the filed-rate doctrine, operating agreements, such as the SIA, filed with and approved by the FERC are binding upon state commissions. This Petition raises the unsettled federal question of whether States are preempted under the filed-rate doctrine from reviewing and applying the express terms of a FERC-approved tariff. As part of an overlapping regulatory scheme, States are routinely called upon to resolve disputes over the application of such tariffs. Consequently, this Petition addresses an important federal question with widespread implications.

The SIA is an agreement between the AEP operating companies on file with FERC, and governs the allocation of off-system sales margins between their East and West Zones.[1] In the underlying case, TNC asserted the off-system sales margins were calculated in accordance with the SIA and a merger settlement agreement previously approved by the PUC. The Company invited the Commission to review the FERC-approved SIA and sought a finding that its calculations were in compliance with the merger settlement agreement.

To ensure TNC's compliance with the SIA, it was necessary for the Commission to review and apply the

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[1] The SIA defines the East Zone as: the electric generation, transmission and distribution facilities of the AEP Operating Companies, in total, that constitute the AEP Control Area. The West Zone is comprised of the electric generation, transmission and distribution facilities of the CSW Operating Companies, in total, that constitute CSW's Control Areas in the Southwest Power Pool ("SPP") and Electric Reliability Council of Texas ("ERCOT").

FERC-approved tariff. The Commission followed the formula for allocating margins set out in the SIA to confirm whether TNC complied with its tariff. Specifically, the Commission found that TNC failed to comply with the plain language of the SIA in apportioning the profits to the East and West Zones.

Historically, the presumption has been that state regulatory action is not preempted.[2] Furthermore, this Court has recognized that not every provision and term of a FERC-approved contract drapes FERC with exclusive jurisdiction. Under the court of appeal's decision, however, FERC has sole jurisdiction over any matter related to a FERC-approved tariff. Expansion of the preemption doctrine to exclude States from all issues implicated by federally-approved tariffs is not necessary as the existing process has worked for decades. Under this process, when a utility files an application at the state commission it must, under the filed-rate doctrine, comply with any applicable federal contract, rule and/or tariff. The States, also bound by the FERC-approved contract, rule or tariff, construe the relevant provision and give it binding effect. If a state fails to give the federal tariff binding effect in a manner which results in "trapped costs," the utility is entitled to appeal the decision. Moreover, absent clarification by this Court as to the proper role of States in such situations, an unworkable regulatory paradigm will exist where States will be obligated to seek FERC direction whenever, during the fulfillment of their regulatory functions, a federally-approved tariff is implicated. In order to keep from

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[2] *See New Orleans Public Service, Inc. v. City of New Orleans*, 911 F.2d 993, 1002 (5th Cir. 1990).

disrupting the existing scheme by expanding the federal preemption doctrine to prohibit state commissions from reviewing federal tariffs this Court should grant the Petition.

REASONS FOR GRANTING THE WRIT

Certiorari should be granted for two reasons. First, this Court in *Entergy Louisiana, Inc. v. Louisiana Public Service Commission,* 539 U.S. 39 (2003) expressly reserved ruling upon the issue presented in this Petition: whether a State, in setting retail rates, may decide a dispute over the meaning of a tariff filed with the FERC. This is an important issue that has not been directly addressed in previous decisions. Second, the Fifth Circuit erred in determining that FERC is the exclusive venue to review and apply the express terms of a federally-approved tariff. This Court should clarify that, although States are clearly bound by the filed-rate doctrine, they are not preempted from construing a federally-approved tariff in order to determine whether a utility is in compliance with the tariff.

I. QUESTION PRESENTED BY PETITION RAISES IMPORTANT PREEMPTION ISSUE RESERVED BY THE COURT IN *ENTERGY LOUISIANA, INC. V. LOUISIANA PUBLIC SERVICE COMMISSION*

The Fifth Circuit relied on *Entergy Louisiana, Inc.*, and its precursors in ruling that States are precluded from having any role in reviewing a FERC-sanctioned tariff which affects retail rates. However, in *Entergy Louisiana, Inc.* this Court reserved ruling on the question of "the

exclusivity of FERC's jurisdiction to determine whether, and when a filed rate has been violated." 539 U.S. 51. The court of appeals held that the preemption doctrine prevents States from reviewing or interpreting a FERC tariff. However, the cases relied on by the Fifth Circuit require state commissions to give binding effect to FERC-approved tariffs.[3] Yet, the lower court did not explain how a State is to give "binding effect" to FERC rate schedules and tariffs without reading, evaluating and interpreting the schedules and tariffs.

The regulation of utilities is "...one of the most important of the functions traditionally associated with the police power of the states."[4] Like many states, the Texas PUC regulates several utilities that are also subject to the jurisdiction of FERC.[5] Accordingly, States are required to

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[3] *Entergy Louisiana, Inc. v. Louisiana Public Service Commission*, 539 U.S. 39, 47, 49-50 (2003) (second-guessing of classification of units pursuant to FERC tariff prohibited); *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953, 972 (1986) (FERC allocation must be respected by North Carolina Commission); *Mississippi Power and Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354, 371 (1988); *Appalachian Power Co. v. Pub. Serv. Comm'n*, 812 F.2d 898, 905 (4th Cir. 1987) ("state regulatory authorities must give effect in calculating retail rate to the costs and allocations reflected in the federally regulated transactions that precede final retail sale of energy").

[4] *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 376, 377 (1983).

[5] The Commission understood that it "...may not impinge upon FERC's jurisdiction by restructuring, elaborating upon or second-guessing the reasonableness of the SIA's terms, as approved by FERC." Proposal for Decision, Record on Appeal, Ex. 6, Tab B at 58 (March 25, 2003).

review FERC-authorized tariffs, contracts and operating agreements in many cases. In order to honor the filed-rate doctrine, States must examine and understand what the tariffs require. It is, therefore, unremarkable that States must routinely evaluate FERC-approved tariffs and contracts to accomplish their duty to regulate utilities.

It is true that "under the filed-rate doctrine, FERC-approved cost allocations between affiliated energy companies may not be subjected to reevaluation in state ratemaking proceedings." 539 U.S. 41-42. As such, it is undisputed that States must assiduously review the applicable federal tariff and carefully comply with its terms. In the underlying case the Texas PUC did not challenge, alter or reevaluate the FERC-ordered revenue allocation. Rather, the PUC complied with the plain language of the tariff and gave the SIA "binding effect" as it was required to do. This Court should clarify whether States are preempted from acting in such a manner or from having *any* role in the determination of whether a utility has violated a filed federal rate.

The interplay between the federal and state regulatory functions is manifest in the facts of the underlying case. The Texas PUC is required by state law to establish rates allowing the utility to collect its reasonable costs necessary to provide electric service.[6] Off-system sales margins, under the Commission's rules, are used to

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[6] Public Utility Regulatory Act ("PURA") §§ 36.051; 36.203(e); 16 TEX. ADMIN. CODE 25.236(d)(1).

off-set fuel expense.[7] The margins to be shared with TNC's retail customers are not the subject of federal law. Likewise, the obligation to off-set fuel expense by off-system sales is a requirement imposed by PUC, not federal, rules. TNC's duty to share profits from sales in other states is attributed to AEP's concession in obtaining the Texas Commission's approval of the merger of AEP and CSW. The SIA approved by FERC distributes sales margins to the two zones -- not to individual operating companies. Accordingly, it is the Texas Commission that has the final say over TNC's agreement to share profits. The Commission's review of the SIA was essential to enforce the terms of the merger settlement agreement.

These facts demonstrate the interrelationship between a state-approved agreement and a federal-approved tariff. Notwithstanding this interaction, the court of appeals found that States must accept a utility's proposed allocation regardless of whether the allocation followed the approved tariffs or not. This view of the filed-rate doctrine is irrational as it severely restricts States from carrying out their portion of the broader regulatory scheme. A more logical application of the doctrine would allow the state body to construe the tariff in question and ensure compliance. That is, in fact, what the Commission did in this proceeding. This Court should reverse the court of appeal's decision and clarify the States' role in reviewing federally-approved tariffs when necessary to fulfill their statutory regulatory duties.

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[7] 16 TEX. ADMIN. CODE 25.236(7)(C).

II. THE FIFTH CIRCUIT'S RESOLUTION OF PETITIONER'S CLAIM IS ERRONEOUS

To effectuate TNC's agreement to share off-system sales margins from other states with its retail customers in Texas, the PUC evaluated TNC's revenue calculations to determine compliance with the FERC-approved SIA. The Commission gave binding effect to the plain terms and provisions of the federal tariff. The courts have repeatedly held that a state commission must give binding effect to the federally-approved tariff. Notwithstanding these facts, the court of appeals enlarged the federal preemption doctrine to prohibit the Texas Commission from considering the SIA. In so doing, the court misapplied the federal preemption doctrine and overlooked TNC's duty to comply with the SIA.

As noted, States are called on to review FERC-approved contracts and operating agreements to perform their duty to regulate utilities. Under the filed-rate doctrine, States have no choice but to comply with the express terms and definitions found in the federally-approved tariffs -- to do otherwise is prohibited. Utilities, similarly, are bound by their tariffs. The filed-rate doctrine not only protects multi-jurisdictional utilities from enduring trapped costs associated with conflicting state orders but also protects the public from a utility charging rates and implementing practices that have not been approved by the applicable regulatory authority.

Under the court of appeal's decision the filed-rate doctrine is a one-way street -- binding only on the States. But the filed-rate doctrine applies to utilities, as well.

Indeed, the doctrine was established in a case where one utility sued another to recover damages for allegedly excessive utility rates. In *Montana-Dakota Utilities Company v. Northwestern Public Service Company*, 341 U.S. 246, 251 (1951) the Court set out the rule that a utility "...can claim no rate as a legal right that is other than the filed rate whether fixed or merely accepted by the Commission...."[8] The Fifth Circuit itself has previously recognized that the public may rely on the filed-rate doctrine:

> [T]he FPA and the filed rate doctrine protect the public interest by imposing severe limitations upon a public utility's ability to alter the terms of those contracts after they are certified by FERC.[9]

Texas law follows the federal scheme -- filed tariffs "govern a utility's relationship with its customers and have the force and effect of law until suspended or set aside."[10] Regulated utilities cannot vary a tariff's terms with

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[8] *See also Nantahala Power and Light Company v. Thornburg*, 476 U.S. 953, 963-64 (1986) ("no rate other than the one on file may be charged"); *Arkansas Louisiana Gas Company v. Hall*, 453 U.S. 571, 577 (1981) (doctrine forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority).

[9] *Mirant Corp., et al. v. Potomac Electric Power Company, et al.*, 378 F.3d 511, 525 (5th Cir. 2004).

[10] *Southwestern Electric Power Company v. Grant*, 73 S.W.3d 211, 216-17 (Tex. 2002) citing *Carter v. AT&T Co.*, 365 F.2d 486, 496 (5th Cir. 1966); *see also CenterPoint Energy Entex v. Railroad Commission of Texas*, 2006 WL 431722 at 8 (Tex. App.-Austin).

individual customers, discriminate between customers, or charge rates other than those properly filed with the appropriate regulatory authority.[11] As shown in the PUC's Order, TNC altered the plain terms of the SIA to direct more sales margins to AEP East where there is no obligation to share revenues with retail customers. Under the ruling of the court of appeals, the Texas PUC was powerless to apply the terms of the SIA and enforce the filed-rate doctrine regardless of whether the utility actually complied with the tariff. The decision improperly denies States from having any role in ensuring that utilities comply with their tariffs, while simultaneously giving utilities full discretion to resolve issues related to application of those same tariffs.

In holding that the Texas Commission is precluded from reviewing TNC's revenue allocation, the court of appeals found that the Commission has a remedy at FERC to resolve any disagreements with the utility's application of the federal tariff. Here, again, the lower court did not explain how States are to identify issues to bring to FERC if they lack jurisdiction to evaluate or interpret the federal tariff. Under this decision, even where a utility clearly violates the terms of its tariff, the only remedy a state commission would have would be to abate the proceeding and file a complaint at FERC to enforce the tariff. Such a procedure is unworkable and has never been the law.

When a federal contract or tariff impacts a retail rate determination, the historical practice has been to

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[11] *SWEPCO v. Grant* at 217, citing *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 579 (1981).

review and evaluate the contract or tariff and proceed to give effect to those documents. If the utility believes the Commission has intruded upon the FERC's jurisdiction, it retains the right to appeal the Commission's decision.[12] This system, in place in Texas for over two decades, has worked well. There is no need, using this procedure, to interfere with the processing of cases or to petition and wait on FERC for resolution.

As a practical matter, the state regulatory body has essentially three choices when confronted with a retail rate decision effected by a federal order, rule or tariff:

(1) It can simply accept without review the utility's application of the federal requirement;

(2) It can review and evaluate the utility's calculations and claims regarding the federal contract or tariff, and if it finds the utility has failed to comply with the filed-rate

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[12] *See Public Utility Commission of Texas v. Gulf States Utilities*, 809 S.W.2d 201 (Tex. 1991) (Commission reviews and applies FERC rules); *Entergy Gulf States v. Public Utility Commission, et al.*, 173 S.W.3d 199, 208-09 (Tex. App.-Austin 2005, pet. denied) (PUC reviews wholesale power contract and federally-approved System Agreement); *Gulf States Utilities Company v. Public Utility Commission of Texas*, 841 S.W.2d 459 (Tex. App.-Austin 1992, writ denied) (Commission reviews and applies FERC-approved wholesale power contract); *see also Jenkins v. Entergy Corporation*, 187 S.W.3d 785 (Tex. App.-Corpus Christi 2006, pet. filed) (trial court reviews System Agreement to determine jurisdiction).

doctrine, abate the proceeding and seek resolution from FERC; or

(3) It can review and give binding effect to the federal requirements in making its decisions and issue a final, appealable order. The utility can appeal if it is dissatisfied with the order.

The first option is not viable for most state regulators. It constitutes an abdication of the duty to regulate in a manner that is fair to utilities and customers. The second option assumes jurisdiction to review the tariff but creates procedural hardships. In most states, utility proceedings have directory and mandatory time limits. For example, in Texas a transmission and distribution rate case must be resolved in 185 days.[13] If it is not resolved, under law *the utilities' rate increase request goes into effect.*[14] Moreover, requiring states to affirmatively seek an order from FERC effectively shifts the burden of demonstrating compliance with a tariff from the utilities to the states. Lastly, this approach places a financial burden on many States that do not have the resources to pursue federal complaint actions. As such, it would be unworkable for States to abate a proceeding to obtain a resolution from FERC. The last option complies with the requirement that the agency give binding effect to the federal tariff and allows for efficient completion of the proceeding. In the instant case, TNC could have gone to FERC to complain

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[13] PURA § 36.108(c).

[14] *Id.*

that the allocation was unfair to its customers prior to filing its application at the Texas PUC. Instead, TNC filed its Application with the state commission that reviewed and applied the tariff. Unsatisfied with the result, the utility appealed to the district court. This long standing process preserves the rights of the participants and should be reaffirmed by this Court.

CONCLUSION

For the reasons stated above and in the Petition itself, the Petition for Writ of Certiorari should be **GRANTED**.

Respectfully submitted,

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May 22, 2007

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