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

## PETITIONERS' REPLY

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## PETITIONERS' REPLY

### I. The Decision Below Threatens the Established Regulatory Framework and Warrants Immediate Review.

Petitioners seek review because the court of appeals decided an important question of federal law that the Court has not yet resolved. *See* Sup. Ct. R. 10(c). Whether States may interpret Federal Energy Regulatory Commission tariffs when setting retail rates is the very question that the Court reserved in *Entergy Louisiana, Inc. v. Louisiana Public Service Commission*, 539 U.S. 39 (2003). Because this matter is of critical importance to the proper functioning of the national electric system, the Court should grant the petition to establish a clear rule.

That other circuits have not specifically considered whether a state commission may interpret a FERC tariff contrary to the utility's interpretation does not diminish the significance of the issue. As in *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988), and *Entergy*—cases in which this Court recognized no circuit split—the present dispute raises an important question of the proper role of state commissions in a dually regulated federal-state system. And like the lower court decisions reviewed in each of those cases, the Fifth Circuit's opinion in the case below introduces considerable uncertainty into the state rate-setting process.

Indeed, the confusion wrought by the Fifth Circuit's opinion prompted the National Association of Regulatory Utility Commissioners and a number of individual state commissions (including those of the other two most populous States—New York and California) to request clarification of the appropriate rule in this case. *See* NARUC Br. 1-5. Understandably, States

throughout the nation have grave concerns about a ruling that gives utilities the upper hand in their retail rate proceedings.

As with both *MP&L* and *Entergy*, the national import of the question presented is readily apparent because it concerns the proper construction of state authority to regulate subsidiaries of holding companies that operate in multiple States. The Solicitor General noted the prevalence of such interstate arrangements when he successfully urged the Court to grant the *Entergy* petition. Br. of Amicus Curiae United States at 17, 539 U.S. 39 (2003) (No. 02-299). Not only are the very same interstate concerns implicated here, but the underlying facts in this case are more common than those in *Entergy*. FERC prescribes a specific method of allocation much more often than it delegates allocation discretion to an agent.

AEP Texas North Company (TNC) incorrectly claims that other courts of appeals have "come out exactly the same way as the Fifth Circuit." TNC Resp't Br. at 21. The decisions that TNC cites do not stand for the principle that FERC has exclusive jurisdiction over *all* tariff matters; they recognize only that FERC's authority to *set rates* is exclusive.[1]

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1. *See also Appalachian Power v. Pub. Serv. Comm'n of W. Va.*, 812 F.2d 898 (4th Cir. 1987) (finding that whether the utility was prudent to enter into the wholesale power agreement was a question within FERC's exclusive jurisdiction); *Pub. Util. Comm'n of Cal. v. FERC*, 462 F.3d 1027 (9th Cir. 2006) (deciding whether FERC or the State had authority over a certain segment of pipe; unrelated to rate setting); *Cal. ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831, 853 n.25 (9th Cir. 2004) (finding that California sought "to alter the terms and conditions provided for in the tariff"); *Transmission Agency of N. Cal. v. Sierra Pac. Power Co.*, 295 F.3d 918, 930 (9th Cir. 2002) (finding the suit for damages preempted because it "assum[ed] a hypothetical rate different from that actually set by FERC").

FERC itself has confirmed this point: The agency has explicitly disclaimed exclusive authority to interpret its own tariffs. *See Constellation Energy Commodities Group, Inc.*, 119 FERC ¶ 61,292, 2007 WL 1791169, at *7 (June 21, 2007) (holding that "[c]onstruing contractual and settlement agreement provisions and inquiring into the parties' intent are straightforward matters of contract interpretation" that do not warrant FERC review); *City of Glendale, Cal. v. Portland General Elec. Co.*, 115 FERC ¶ 61,231, 61,847-48 (2006) (ruling that state court claim seeking only to enforce the filed rate, not to alter it, did not require exercise of FERC jurisdiction); *Kentucky Utils. Co.*, 110 FERC ¶ 61,285, 62,102-03 (2005) (holding that state court suit that "only seeks enforcement of an existing [FERC-filed] contract, and not the setting of a new just and reasonable rate . . . does not fall within the Commission's exclusive jurisdiction").

TNC also reaches to recast the question presented as an issue about FERC's primary jurisdiction and then to argue waiver by the PUCT for not raising the ground below. The PUCT did not waive any primary-jurisdiction issue because there is no such issue. The petition discusses this doctrine only to show that, in those rare cases in which interpreting a FERC tariff requires referral to FERC, access to FERC is available as part of a court's review of a state agency's decision. The issue in this case is—and has always been—whether federal law preempts a State from interpreting a FERC tariff to insure that the filed rate is used to set retail rates.

## II. The Decision Below Jeopardizes the Ability of States to Make Timely and Impartial Adjustments to Retail Rates.

TNC claims that there will be no harm or delay if the PUCT sets retail rates subject to any subsequent FERC decision. But

when TNC erroneously interprets its tariff, TNC's ratepayers will have to pay unreasonable rates until and unless FERC decides the case. TNC's "solution" means that the utility always prevails, at least in the short term.

But with state interpretation of the FERC tariff, an independent agency makes the decision. TNC improperly assumes that States will abuse their discretion in deciding these issues. Instead, the PUCT is created "to assure rates, operations, and services that are just and reasonable to the consumers and to the utilities." Tex. Util. Code Ann. § 11.002(a) (Vernon 2007). And this Court has recognized that state agencies must be presumed to be evenhanded. *See Withrow v. Larkin*, 421 U.S. 35, 53 (1975) ("Without a showing to the contrary, state administrators 'are assumed to be men of conscience and intellectual discipline, capable of judging a particular controversy fairly on the basis of its own circumstances.'" (quoting *United States v. Morgan*, 313 U.S. 409, 421 (1941))). In contrast, the utility—a for-profit company—has no mandate to balance the competing claims of utilities and ratepayers. Instead, utilities have a natural incentive to interpret tariffs to their benefit. *See United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 568 (1972) ("[A]bsent special circumstances, [corporations] can be expected to follow courses of action most likely to maximize profits.").

According to TNC, *Entergy* means that the utility must prevail. But that assertion relies on a radical interpretation of this Court's opinion, reasoning that the mere fact that a utility is tasked with implementing a tariff (i.e., performing the required calculations) grants the utility discretion to interpret the tariff any way it sees fit. Resp't Br. at 16. That interpretation stands in stark contrast to the Court's decision. In *Entergy*, the FERC tariff had left one factor, whether certain mothballed generators were available for service, dependent on

the utility's discretion. 539 U.S. at 49. TNC unreasonably stretches this Court's recognition of FERC's express grant of discretion to the utility in *Entergy* into a rule of unlimited utility discretion to revise a tariff's meaning.

TNC's claim that, if the PUCT errs, the utility will be unable to recover the rates the PUCT should have set is groundless. Should a court reviewing the PUCT's order find error, it can be corrected by the PUCT on remand. *See Southwestern Bell Tel. Co. v. Pub. Util. Comm'n of Tex.*, 615 S.W.2d 947, 954 (Tex. App.—Austin 1981), *writ ref'd n.r.e.* 622 S.W.2d 82 (Tex. 1981) (per curiam).

## III. The PUCT Was Not Preempted, Because It Only Interpreted a Tariff; It Did Not Set Rates.

TNC ignores the qualitative differences between setting rates and interpreting a tariff. Courts recognize these differences by characterizing rate setting as legislative and tariff interpretation as judicial. *See Great Northern Ry. Co. v. Merchants' Elevator Co.*, 259 U.S. 285, 290-91 (1922). The legislative nature of rate setting means that neither state agencies nor courts can set interstate wholesale electric rates. The judicial nature of construing the tariffs that set rates means that both state agencies and courts can interpret tariffs.

"The rate-making power is a legislative power and necessarily implies a range of legislative discretion." *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 313 (1989) (citing *Simpson v. Shepard*, 230 U.S. 352, 433 (1913)). Courts, having no authority to choose one correct rate within the range of reasonable rates, cannot set rates. An agency authorized to set rates can choose within the range, and, once it sets the rate, that becomes the only legal rate. *Montana-Dakota Util. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246 (1951) (holding

courts can assume no right to a rate other than the one set by FERC).

State agencies cannot set interstate wholesale electric rates. If they could, different States, choosing within the permissible range, could set different rates for the same interstate wholesale transaction.

Thus, regarding authority to set rates, a bright line indeed separates courts from federal agencies and state agencies from federal agencies.

But no bright line separates federal agencies from courts and state agencies when interpreting a federal tariff. The Federal Power Act expressly grants federal courts authority to enforce FERC tariffs. 16 U.S.C. § 825p (2000). State courts also have jurisdiction to interpret federal tariffs. *See, e.g.*, *Pan Am. Petroleum Corp. v. Superior Court of Del.*, 366 U.S. 656, 666 (1961).

TNC ignores the distinction between rate setting and tariff interpretation, claiming that FERC must have exclusive jurisdiction over *all* tariff-related matters. But this Court and circuit courts have repeatedly recognized that the authority to interpret tariffs is not limited to federal agencies. In *Great Northern Railway*, the Court recognized that a court's task in enforcing the filed rate "is to determine the meaning of words of the tariff which were used in their ordinary sense and to apply that meaning to the undisputed facts." 259 U.S. at 294. Therefore, preliminary resort to the federal agency was unnecessary. *Id.* This principle still applies. *See Brown v. MCI WorldCom Network Servs., Inc.*, 277 F.3d 1166, 1171-72 (9th Cir. 2002).

As its final order demonstrated, the PUCT only interpreted the filed rate. Findings of Fact 89-95 in that order reveal a step-

by-step analysis of the wording of the FERC tariff to determine which off-system sales were included in the FERC-tariff formula. Pet. App. 33-35. That is not rate setting, which would be preempted. Instead, it is the type of analysis courts use to interpret a contract or a tariff. Although the PUCT is a state agency rather than a court, the same principle applies. Because state courts can interpret federal tariffs, it cannot be argued that federal agencies have exclusive authority to interpret those tariffs. TNC has provided no other principle that would justify proscribing state agency application of federal tariffs.

The Court has recognized that judicial review ensures necessary uniformity of interpretation. *See Great Northern*, 259 U.S. at 290-91. That fact defeats TNC's argument that allowing state agencies to interpret FERC tariffs could lead to different interpretations of the same FERC tariff by different States. Only one rate is set by the tariff, and the agency's duty to comply with federal law, coupled with the protections of judicial review provide a sufficient safeguard against conflicting interpretations of the same tariff.

TNC also relies on a FERC decision quoted in a concurrence by Justice Scalia to claim that state agencies cannot interpret tariffs. *AEP Generating, Inc.*, 36 FERC ¶ 61,226 (1986), *quoted in MP&L*, 487 U.S. at 378 (Scalia, J., concurring). But neither the concurrence nor the agency order turned on state-agency authority to interpret tariffs. Justice Scalia's concurrence addressed FERC's authority to make a prudence decision about a utility's participation in a nuclear power plant and purchase of power from that generator. Likewise, *AEP Generating* concerns a utility entering into joint ownership of a generator and "the justness and reasonableness of the unit power sales arrangement . . . ." 36 FERC at ¶ 61,550.

Neither the *MP&L* concurrence nor the quoted FERC order decided that only FERC may interpret its tariffs. Nor do the other cases TNC cites concern the interpretation of a federal tariff. Contrary to TNC's claims, *Nantahala*, *MP&L*, and *Entergy* do not answer the question in this case. Instead, each recognizes that once FERC has set rates, States *must* comply with the FERC tariff. That is what the PUCT attempted to do here.

TNC also argues that state-agency review of FERC tariffs could trap TNC's costs. That misapprehends the nature of trapping, which occurs when a state commission prevents the utility from recovering its FERC-approved rate. *MP&L*, 487 U.S. at 372 (quoting *Nantahala*, 476 U.S. at 970) ("When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate . . . ."). By definition, when a State requires that the utility recover its FERC-approved rate, no trapping is involved. The utility is responsible to correctly follow the FERC-approved rate in all States. Its failure to charge the filed rate in one State does not allow the utility to overcharge in a different State, claiming trapping.

## CONCLUSION

The Court should grant the petition for writ of certiorari.

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