# EXHIBIT 1

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**UNITED STATES DISTRICT COURT**
**WESTERN DISTRICT OF TEXAS**
**AUSTIN DIVISION**

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| NEXTERA ENERGY CAPITAL HOLDINGS, INC., et al.,<br><br>*Plaintiffs*,<br><br>v.<br><br>DEANN T. WALKER, Chairman, Public Utility Commission of Texas, ARTHUR C. D'ANDREA, Commissioner, Public Utility Commission of Texas, and SHELLY BOTKIN, Commissioner, Public Utility Commission of Texas, each in his or her official capacity,<br><br>*Defendants*. | ) | CIVIL ACTION NO. 1:19-cv-00626-LY<br><br>Hon. Judge Lee Yeakel |

**SOUTHWESTERN PUBLIC SERVICE COMPANY'S**
**MOTION TO DISMISS FOR FAILURE TO STATE A CLAIM**

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Intervenor Southwestern Public Service Company ("SPS") respectfully moves to dismiss under Fed. R. Civ. P. 12(b)(6) for failure to state a claim.

## INTRODUCTION

This case concerns longstanding Texas policy, recently codified by the Legislature in Senate Bill 1938 ("S.B. 1938"), that largely limits the development of new transmission lines to the franchised utilities responsible for providing universal transmission and distribution service within defined service territories. In the part of Texas served by Southwestern Public Service Co. ("SPS"), a regulated utility has the responsibility to generate, transmit, and distribute electricity to everyone in its service territory. In the "ERCOT" region, Texas has allowed competition in power generation, but—aside from one limited experiment—has continued to combine transmission and distribution in a regulated utility responsible for serving all customers in a defined territory.

Plaintiffs are transmission-only companies, who believe they have a constitutional right to submit competitive bids to build new transmission lines in the State. But Texas has determined that the public interest is best served by maintaining the traditional regulated model, under which new transmission lines are built by utilities with universal service obligations. The Commerce Clause respects that policy choice. "[R]egulation of utilities is one of the most important of the functions traditionally associated with the police power of the States." *Ark. Elec. Co-op Corp. v. Ark. Pub. Serv. Comm'n*, 461 U.S. 375, 377 (1983). It ensures that utilities provide universal service on fair terms, and have the financial and technical wherewithal to do so. Indeed, Congress and the Federal Energy Regulatory Commission ("FERC") have consistently recognized that States have authority to regulate in this way.

Plaintiffs nevertheless contend that Texas's longstanding policy choice is unlawful because it discriminates in favor of in-state businesses and against out-of-state competitors. This claim fails

as a matter of law. Texas law does not discriminate against interstate commerce or interstate firms. It favors one business form (transmission-distribution utilities) over another (transmission-only companies like Plaintiffs). Plaintiffs' complaint alleges as much. Compl. ¶¶ 23, 72, 74. The Fifth Circuit has thrice held that States may draw distinctions based on "business form" without running afoul of the Commerce Clause. *Wal-Mart Stores, Inc. v. Tex. Alcoholic Beverage Comm'n*, No. 18-50299, __ F.3d __, 2019 WL 3822150, at *7-10 (5th Cir. Aug. 15, 2019); *Allstate Ins. Co. v. Abbott*, 495 F.3d 151, 161 (5th Cir. 2007); *Ford Motor Co. v. Tex. Dep't of Transp.*, 264 F.3d 493, 500, 502 (5th Cir. 2001). Nothing stops Plaintiffs (or any out-of-state entity) from acquiring one of Texas's franchised electric utilities, and thereby partaking of the burdens and benefits of Texas's regulatory compact. Indeed, many of the regulated utilities benefiting from the laws at issue are *out-of-state* entities. And the law disfavors transmission-only companies regardless whether they are in-state or out-of-state entities. Indeed, one of the Plaintiffs (Lone Star Transmission) and a putative Intervenor in support of Plaintiffs (East Texas Electric Cooperative, Inc.) are *in-state* entities who claim to be disadvantaged. Texas has not discriminated based on geography.

Moreover, the Supreme Court has specifically held that when States draw lines designed to protect utilities with exclusive franchises and universal service obligations, the Commerce Clause is not implicated. *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 289 & n.7 (1997). Nothing in the Commerce Clause requires Texas to allow transmission-only companies to compete with traditional transmission-distribution utilities that have universal service obligations.

Plaintiffs' remaining claims—a dormant Commerce Clause claim under *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), and a Contract Clause claim—likewise should be dismissed.

## BACKGROUND

### A. States Have Broad Authority to Grant Electric Utilities Exclusive Franchises.

The electric system includes three components. First, electricity is generated. Second, electricity is transmitted over long distances via high-voltage transmission lines. Third, electricity is delivered to end-users like homes and businesses, largely over lower voltage distribution lines.

To ensure that electricity is efficiently, reliably, safely, and widely available to consumers, States like Texas have long used their "police power" to closely regulate electric utilities—an exercise of one of the State's "most important" functions. *Ark. Elec. Co-op*, 461 U.S. at 377; *see generally Tracy*, 519 U.S. at 288-97 (similar history for gas utilities). "The nature of government regulation of private utilities is such that a utility may frequently be required by the state regulatory scheme to obtain approval for practices a business regulated in less detail would be free to institute without any approval from a regulatory body." *Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev't Comm'n*, 461 U.S. 190, 205 (1983) (quotation marks omitted).

To that end, Texas has enacted a "comprehensive and adequate regulatory system for electric utilities," to "protect the public interest inherent" in electric utility rates and services. Tex. Util. Code § 31.001(a). The Public Utility Commission of Texas ("PUCT") oversees this system. It has "exclusive original jurisdiction over the rates, operations, and services" of investor-owned electric utilities. *Id.* § 32.001. An electric utility cannot "directly or indirectly provide service to the public … unless the utility first obtains from the [PUCT] a certificate that states that the public convenience and necessity requires or will require the installation, operation, or extension of the service." Tex. Util. Code § 37.051(a). The PUCT can grant a Certificate of Convenience and Necessity ("CCN") if "necessary for the service, accommodation, convenience, or safety of the public." *Id.* § 37.056(a). Once certificated to operate in the State, an electric utility must comply

with a number of regulations: it must "serve every consumer in the utility's certificated area," and "provide continuous and adequate service in that area," *id.* § 37.151; must provide "safe, adequate, efficient, and reasonable" service, *id.* § 38.001; is largely restricted from withholding service, *id.* § 37.152; and can be ordered to construct or enlarge transmission facilities, *id.* § 35.005(b).

Texas's regulatory compact, which imposes significant regulatory burdens and oversight on utilities in exchange for an exclusive franchise in their certificated areas, reflects a policy choice that many States have made since electricity's invention. Some States initially adopted a laissez-fair, open-market approach to electricity distribution—but this approach soon gave way to the "predictable and disastrous" results of "wasteful competition … massive consolidation and the threat of monopolistic pricing." *Tracy*, 519 U.S. at 289. States "learned from [this] chastening experience" that it was "virtually an economic necessity for States to provide a single, local franchise with a business opportunity free of competition from any source," balanced "by regulation and the imposition of obligations to the consuming public." *Id.* at 290. Thus, utilities traditionally have been vertically integrated companies responsible for generating electricity, transmitting it over high-voltage lines, and distributing it to end-use customers.

### B. Texas Has Chosen a Regulatory, Rather than Competitive, Approach for Transmission Line Construction.

At various times, FERC and some States have experimented with opening aspects of the electric industry to competition. For example, Texas decided to allow competition in electric generation in the ERCOT region. In 2005, Texas also decided to allow competitive bidding for new transmission lines to serve new renewable energy projects located in "Competitive Renewable Energy Zones" ("CREZ") in the ERCOT region, *see* Tex. Util. Code § 39.904(g). But otherwise, Texas has maintained the traditional regulatory model—giving a single regulated utility an exclusive franchise to serve all transmission and distribution functions within a service territory.

*See Lamb Cty. Elec. Co-op., Inc. v. Pub. Util. Comm'n*, 269 S.W.3d 260, 265 (Tex. App-Austin. 2008, pet. denied).

In making this choice, Texas has judged that competitive transmission and distribution markets are generally not in the public interest. *See* Tex. Util. Code § 39.001(a) (finding that "transmission and distribution services" remain a "monopoly warranting regulation," for which competition is not in the public interest). Because electric utilities provide a vital service by helping to interconnect the electric grid in Texas—often in places where doing so is difficult and expensive—Texas has judged that it has a strong interest in (1) ensuring that the companies that commit to building and operating transmission facilities are financially healthy; (2) preventing exploitation or profiteering in the provision of essential services; and (3) retaining the power to mandate service to all consumers in a service area and expansion, even into unprofitable areas, when doing so is necessary to serve the public. *See* Tex. Util. Code §§ 35.004-35.005, 36.001-36.004, 37.101(b), 37.151, 38.021, and 38.071.

For a brief period, a PUCT decision (and a state court decision affirming it) created confusion about Texas' policy. Those decisions mistook the CREZ program as a *reversal* of Texas' longstanding commitment to exclusive franchises for transmission-distribution utilities, rather than a limited exception. *See Sw. Pub. Serv. Co. v. Pub. Util. Comm'n*, No. D-1-GN-18-000208 (459th Dist. Ct., Travis County, Tex. Sept. 27, 2018), *vacated as moot, Entergy Texas, Inc. v. Pub. Util. Comm'n*, No. 03-18-00666, 2019 WL 3519051 (Tex. App.-Austin Aug. 2, 2019).

To clear up this confusion, the Legislature enacted Senate Bill 1938, codified at Tex. Util. Code §§ 37.051 et seq., which confirmed that the State had not abandoned its policy favoring regulated transmission-distribution utilities. *See* Senate Research Center, Bill Analysis: S.B. 1938 (May 29, 2019) (S.B. 1938 would "codify the existing process in Texas for determining the proper

party to construct" transmission lines, and clarify statutory "ambiguity"); House Committee Report, Bill Analysis: S.B. 1938 (S.B. 1938 would codify "the practices and procedures that govern transmission development on a statewide basis"). S.B. 1938 gives existing certificated electric utilities the right to obtain CCNs to build, own, or operate new transmission lines that will directly interconnect with their facilities. Tex. Util. Code § 37.056(e); Compl. ¶¶ 68-72.

### C. Congress and FERC Have Left the Policy Choice of Whether to Regulate Transmission Siting, Construction, and Operation to the States.

The questions of where lines are built and who is allowed to build them—which often requires using the State's power of eminent domain—are matters of intense local concern. Thus, even as Congress assigned to FERC the authority to regulate the interstate transmission of electricity, 16 U.S.C. § 824(b), it reserved to States the authority over the siting and construction of transmission lines. *See S.C. Pub. Serv. Auth. v. FERC*, 762 F.3d 41, 76 (D.C. Cir. 2014) ("States retain control over the siting and approval of transmission facilities."); FERC, Order No. 888, 61 Fed. Reg. 21,540, 21,626 n.543 (May 10, 1996) ("Among other things, Congress left to the States authority to regulate generation and transmission siting."); *Piedmont Envtl. Council v. FERC*, 558 F.3d 304, 310 (4th Cir. 2009) ("states have traditionally assumed all jurisdiction to approve or deny permits for the siting and construction of electric transmission facilities"); FERC, Order No. 1000, 136 FERC ¶ 61,051, P 107 (2011) ( "Order No. 1000") ("We acknowledge that there is longstanding state authority over certain matters that are relevant to transmission planning and expansion, such as matters relevant to siting, permitting, and construction.").

Congress and FERC have recognized the traditional state authority to adopt laws like S.B. 1938—and in exercising the federal government's Commerce Clause power to regulate interstate transmission, they have sought to accommodate it. In 1999, FERC began shifting responsibility for transmission-line planning and ratemaking to the regional level, allowing non-governmental,

non-profit entities, known as Regional Transmission Organizations ("RTOs") or Independent System Operations ("ISOs"), to oversee transmission functions and planning over large areas of the electricity grid. *See generally* Order No. 2000, 89 FERC ¶ 61,285 (1999); 18 C.F.R. § 35.34. For over a decade, FERC approved tariffs for these entities that included right-of-first-refusal ("ROFR") provisions giving the exclusive right to build and operate new transmission lines to the incumbent utility—*i.e.*, the utility already serving the area. These provisions embedded in federal law a mandate that already existed under state law in many States, including Texas.

In 2011, as part of a foray into competition, FERC eliminated its federal mandate, freeing States to experiment with competition if they wished. Order No. 1000, 136 FERC ¶ 61,051, at PP 7, 253, 313. But simultaneously, FERC reaffirmed state authority to decide whether, where, and by whom transmission lines could be constructed and operated. *Id.* at PP 107, 227, 253 n.231, 287. FERC declared that it would not "limit, preempt, or otherwise affect state or local laws or regulations" regarding "construction of transmission facilities, including but not limited to authority over siting or permitting of transmission facilities." *Id.*; *see also MISO Transmission Owners v. FERC*, 819 F.3d 329, 333 (7th Cir. 2016). FERC thus preserved for States their right to continue their traditional regulatory model. *See S.C. Pub. Serv. Auth.*, 762 F.3d at 76 (in eliminating federal ROFR, FERC "t[ook] great pains to avoid intrusion on the traditional role of the States" as to siting and construction of transmission facilities).

Then, when FERC reviewed the federal tariffs for the RTOs/ISOs in charge of transmission planning in parts of Texas— Southwest Power Pool, Inc., which includes SPS's service territory, and Midcontinent Independent System Operator, which includes Entergy Texas, Inc.'s service territory—FERC approved tariffs that expressly acknowledge and accommodate state laws like the ones challenged here. *See Midwest Indep. Transmission Sys. Operator Inc.*, 147 FERC

¶ 61,127, PP 147-150 (2014); *Sw. Power Pool, Inc.*, 151 FERC ¶ 61,045, PP 28-35 (2015). As FERC explained, by accommodating state laws like Texas's, even as it removed the federal ROFR, FERC "struck an important balance between removing barriers to participation by potential transmission providers in the regional transmission planning process and ensuring" that its reforms "do not result in the regulation of matters reserved to the states." *Sw. Power Pool*, 151 FERC ¶ 61,045 at P 31. FERC's choice has withstood many challenges, including from Movant-Intervenor LSP Transmission Holdings ("LSP"). *See Midwest Indep. Transmission Sys. Operator, Inc.*, 150 FERC ¶ 61,037, PP 17-22 (2015) (rejecting arguments against tariff provisions accommodating Minnesota ROFR); *MISO Transmission*, 819 F.3d at 336 (same); *LSP Transmission Holdings, LLC v. Lange*, 329 F.Supp.3d 695, 707-08 (D. Minn. 2018) (upholding Minnesota ROFR against Commerce Clause challenge), *appeal docketed*, No. 18-2559 (8th Cir. July 24, 2018). The Seventh Circuit found that FERC's desire to preserve the States' traditional authority was a "proper goal." *MISO Transmission*, 819 F.3d at 336.

Congress, too, has recognized the existence of state laws, like the ones under challenge here, that prevent the issuance of "a permit or siting approval for [a] proposed [transmission] project in a State" to transmission companies that "do[] not serve end-use customers in the State." 16 U.S.C. § 824p(b)(1)(B). Congress chose to preempt that state authority only under very limited circumstances. *Id.* § 824p(a)(4), (b)(3)-(6).

Notwithstanding the balance that Congress and FERC have carefully struck in exercising their Commerce Clause powers, Plaintiffs contend that the dormant Commerce Clause and the Contract Clause require a different result that would overturn a century of regulation. Plaintiffs contend that Texas has discriminated against interstate commerce by "preserving the opportunity to invest in and provide service over new transmission facilities in the state solely to entities that

already own facilities and hold a certificate." Compl. ¶ 3. They also claim that Texas has impaired their contractual rights. *Id.* ¶¶ 106-111.

## ARGUMENT

"To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). Neither the Commerce Clause claim nor the Contract Clause claim can survive.

### I. TEXAS' EXERCISE OF ITS LONGSTANDING AUTHORITY TO REGULATE TRANSMISSION LINE SITING AND CONSTRUCTION DOES NOT VIOLATE THE DORMANT COMMERCE CLAUSE.

The Commerce Clause, which authorizes Congress "[t]o regulate Commerce . . . among the several states," U.S. Const., art. I, § 8, cl. 3, also has a "negative or dormant implication," which "prohibits state taxation or regulation that discriminates against or unduly burdens interstate commerce." *Tracy*, 519 U.S. at 287. A statute discriminates against interstate commerce when it provides for "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Ford*, 264 F.3d at 499. But not all differential treatment is prohibited—only discrimination "among similarly situated" entities. *Int'l Truck & Engine Corp. v. Bray*, 372 F.3d 717, 725 (5th Cir. 2004); *accord Tracy*, 519 U.S. at 298 (discrimination is differential treatment of "substantially similar entities").

This principle forecloses Plaintiffs' discrimination claims. The transmission-distribution utilities that S.B. 1938 favors are not similarly situated to the transmission-only companies it disfavors—as 100 years of Texas history testifies. Moreover, because many of the transmission-distribution utilities favored by the statute are *out-of-state* companies, S.B. 1938 does not even incidentally track state lines. Plaintiffs' claim of an "undue burden" under *Pike* also lacks merit.

### A. S.B. 1938 Does Not Discriminate Between Similarly-Situated Entities or Against Interstate Commerce.

This case is about Texas's choice to favor one business model over another. Continuing its century-long commitment to regulation of the electricity sector, Texas made the policy judgment to favor transmission-distribution utilities—*i.e.*, utilities that both transmit electricity from generators to service areas, and distribute that electricity to consumers in certificated service areas—to build new transmission lines within those service areas. *See* Compl. ¶¶ 23, 61 (alleging that S.B. 1983 resulted from an effort to "prevent[] the PUCT from approving anything but a traditional transmission and distribution utility … from owning [transmission] facilities"); *id.* ¶ 72 (alleging that the statute "limits the right to build and operate approved transmission lines in Texas to those entities that already have a Texas transmission and distribution footprint"); *id.* ¶ 74 (alleging that S.B. 1983 was intended to "benefit … a defined few utilities that already own transmission and distribution facilities in Texas"); Tex. Util. Code § 37.056(e) (providing that a CCN to build, own, or operate a transmission facility that directly interconnects with an existing electric utility facility can only be granted to owner of existing facility); *id.* § 37.056(g) (authorizing certificated electric utility to designate electric utility certificated within same electric power region to build transmission facility). Hence, businesses that have chosen to organize as transmission-only companies cannot build new transmission lines. Compl. ¶¶ 23, 97. [1]

[1] S.B. 1938 grandfathers in the few transmission-only utilities that built lines in the ERCOT region, including as part of the CREZ program. Under S.B. 1938, owners of these lines, just like transmission-distribution utilities, are permitted to build new lines interconnecting with their existing lines. Tex. Util. Code § 37.056(e). These lines, however, total only about 3,600 miles, *see* ERCOT, Competitive Renewable Energy Zones Process (Aug. 11, 2014), at 8, https://bit.ly/2KY0bt4—a sliver of ERCOT's 46,500 miles of lines, http://www.ercot.com/about; Compl. ¶ 31 ("the vast majority of lines in ERCOT" are owned by transmission-distribution utilities). There are no lines owned by transmission-only utilities in the non-ERCOT regions of the State. S.B. 1938 also provides special treatment for electric cooperatives, which typically

This case thus presents the question of whether the dormant Commerce Clause prohibits Texas from favoring one business form—transmission-distribution utilities—over others, and compels Texas to allow transmission-only companies to compete to build transmission lines.

The answer is no. Three times, the Fifth Circuit has recognized that laws that simply treat two different business forms differently do not run afoul of Commerce Clause. In *Allstate*, the court upheld a statute that distinguished between two business models for auto body shops. Any body shop will provide the same essential service—fixing that dent from the parking lot. But some are independent while others are owned by insurers. Texas chose to regulate those business models differently, restricting insurer-owned shops while leaving independent shops unaffected. The court rejected a Commerce Clause challenge contending that this choice impermissibly discriminated against insurers (who were out of state) and in favor of independent body shops (who were in-state), explaining that the legislation merely "treat[ed] differently two business forms . . . a distinction based not on domicile but on business form." 495 F.3d at 161.

In *Ford*, the court rejected a challenge to legislation that prohibited automobile manufacturers (who are largely out-of-state) from acting as dealers (thereby protecting incumbent dealers who were allegedly in-state). 264 F.3d at 498. This law, the court explained, "does not discriminate based on Ford's contacts with the State, but rather on the basis of [its] status as an automobile manufacturer." *Id.* at 502. Because the law "only prevent[ed] manufacturers, regardless of their domicile, from entering the retail market," it did "not protect dealers from out-of-state competition" but only "from competition with manufacturers." *Id.* Most recently, in *Wal-Mart*, the court reversed a ruling invalidating a law that barred public corporations from owning

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generate, transmit, and distribute power for their members in rural areas. Co-ops may build new lines connecting the grid to their local member systems. *See* Tex. Util. Code § 37.056(f).

package stores or obtaining liquor sales permits. Wal-Mart argued that the law was intended to protect local businesses against interstate competition, but the court disagreed, holding that it permissibly distinguished among "business forms." 2019 WL 3822150, at *7, *9.

The same is true here. Texas has drawn a distinction based "on business form," *Allstate*, 495 F.3d at 161, favoring transmission-distribution utilities over transmission-only entities. As in *Allstate*, *Ford*, and *Wal-Mart*, the dormant Commerce Clause does not prohibit this choice. *See Allstate*, 495 F.3d at 162 (holding that "[t]he dormant Commerce Clause is no obstacle" to regulation "prevent[ing] firms with superior market position … from entering a downstream market … upon the belief that such entry would be harmful to consumers.").

Moreover, Plaintiffs are wrong to assert that this provision's effect is to discriminate against out-of-state companies. First, judicially noticeable facts establish that some transmission-distribution utilities are out-of-state companies and others are subsidiaries of out-of-state companies. SPS, for example, is a New Mexico company, owned by a Minnesota-based holding company. AEP Texas is owned by an Ohio-based holding company. Entergy is owned by a Louisiana-based holding company. Oncor is owned by a California-based holding company.[2] *See Wal-Mart*, 2019 WL 3822150, at *9 (no discriminatory effect where "several companies owned by out-of-state residents have entered the Texas liquor retail market").

Second, nothing prevents NextEra, or any other out-of-state company, from becoming a certificated transmission-distribution utility by buying an incumbent utility. *See* Tex. Util. Code § 37.154(a) (authorizing sale of CCN as a part of merger to purchaser non-certificated entity); *see*

[2] U.S. SEC, Xcel Energy, Form 10-K at 5 (2019) (reporting ownership of SPS); U.S. SEC, American Electric Power Company, Inc., Form 10-K, Part I: Item 1 (2019) (reporting ownership of AEP Texas); U.S. SEC, Entergy, Form 10-K at iii, viii (2019) (reporting ownership of Entergy Texas); U.S. SEC, Sempra Energy, Form 10-K at 16-17 (2019) (reporting ownership of Oncor); Fed. R. Evid. 201(b) (court may "judicially notice a fact that is not subject to reasonable dispute").

*Wal-Mart*, 2019 WL 3822150, at *9 (nothing prevented out-of-state companies from operating package stores, so long as they were not corporations). To be sure, Plaintiffs wish to construct transmission lines in Texas *without* becoming a distribution-transmission utility. But the dormant Commerce Clause does not empower Plaintiffs to abrogate Texas's contrary policy choice.

Third, S.B. 1938 even-handedly imposes the same limitations on in-state and out-of-state entities. *See id.* ("[T]he public corporation ban treats in-state and out-of-state public corporations the same. Neither in-state nor out-of-state public corporations may obtain a … permit or own a package store."). S.B. 1938 protects the incumbent transmission-distribution utility in a particular service territory against *all* competitors, in-state and out-of-state, and does so regardless whether the incumbent is an in-state or out-of-state company. *See* Tex. Util. Code § 37.056(e) (giving right of first refusal to electric utility to build new lines interconnected with its own existing system, but not otherwise); *id.* § 37.056(g) (permitting electric utility to designate utility to build transmission line if designee is also certificated within the same electric power region). Thus, SPS has no right to build transmission lines outside of its own service territory, and cannot build transmission lines in ERCOT at all. But Plaintiff Lone Star Transmission, a transmission owner in ERCOT, can build there. The preference for incumbency is not discrimination against interstate commerce: As the Fourth Circuit has held, "incumbency is not the focus of the dormant Commerce Clause," and "incumbency bias" is not the same as discrimination against out-of-state interests. *Colon Health Ctrs. of Am., LLC v. Hazel*, 813 F.3d 145, 154 (4th Cir. 2016). That is because, as here, "[o]ne can be … an incumbent recipient of some state … benefit without necessarily being an in-state resident." *Id.* S.B. 1938's effect is not discriminatory.

**B. The Supreme Court's Decision in *Tracy* Forecloses Plaintiffs' Challenge.**

If *Allstate* and *Ford* were not enough, the Supreme Court's decision in *Tracy* also

forecloses Plaintiffs' challenge. The Commerce Clause does not give out-of-state companies a right to compete with regulated utilities franchised to provide universal service.

*Tracy* considered an Ohio law that accorded different treatment to interstate gas transmission companies and domestic utilities. The domestic utilities operated in two markets: they provided universal gas service in a regulated market, and also sold gas alongside the interstate companies in a competitive market. 519 U.S. at 304. The Ohio law applied to the competitive market, where it taxed the retail sales of interstate companies but exempted the sales of domestic utilities. *Id.* at 281-82. The Court upheld the law, concluding that Ohio could accord preferential treatment to the domestic utilities *even in the competitive market* without running afoul of the dormant Commerce Clause—because the domestic utilities *also* served the regulated market, in which they had to comply with various regulatory requirements, including to serve all members of the public. *Id.* at 304, 310. Because of the domestic utilities' obligations in the regulated market, the Court held they were not "'similarly situated'" to the interstate transmission companies in the competitive market, and thus the "claim of facial discrimination" failed. *Id.* at 310. The Court emphasized the "importance of traditional regulated service" and "the values served by … traditional regulation." *Id.* at 304, 307. Indeed, the Court held that Ohio was not even required to risk an effect "at the margins" on the domestic utilities that could arise from treating them as "similarly situated" to interstate transmission providers. *Id.* at 310. *Tracy* thus recognizes that when States impose burdens on utilities, like the burden of universal service, they may also provide benefits to these utilities as part of their regulatory compact—and would-be competitors that do not carry these burdens are not "similarly situated." *Id.*

That principle controls this case. Like the domestic utilities in *Tracy*, Texas's distribution-transmission utilities bear distinct burdens that transmission-only companies would not. Under

Texas' regulatory regime for certificated utilities, they must "serve every consumer in the utility's certificated area," and "provide continuous and adequate service in that area," Tex. Util. Code § 37.151; must provide "safe, adequate, efficient, and reasonable" service, *id.* § 38.001; are largely restricted from withholding service, *id.* § 37.152; and can be ordered to construct or enlarge transmission facilities, *id.* § 35.005(b). Because transmission-only providers like Plaintiffs do not bear the burden of providing distribution service to every home and business in a service territory, they are not "similarly situated" to transmission-distribution utilities like SPS. Hence, as in *Tracy*, Texas' choice to favor distribution-transmission utilities is not "discrimination" under the Commerce Clause. *See LSP*, 329 F. Supp. 3d at 707-08 (applying *Tracy* to uphold statute limiting transmission line construction to incumbent regulated utilities).[3]

More broadly, *Tracy* instructs federal courts to act "cautiously" and defer to State policy choices when reviewing dormant Commerce Clause challenges to State utility regulations. 519 U.S. at 303-09. First, States have a legitimate interest in utility regulation because it "serves important interests of health and safety." *Id.* at 306. Indeed, *Tracy* emphasized that this interest is so strong that it can support regulation that "outright prohibit[s]" competition. *Id.* Here also, Texas' interests in regulating health and safety through S.B. 1938 is no less worthy of deference.

Second, because courts are "institutionally unsuited" and "ill qualified" to predict the economic consequences of upending carefully devised regulatory schemes, *Tracy* instructs that courts should refrain from decisions that could pose a risk to the balance that States have deemed

[3] Indeed, this case is much easier than *Tracy*. There, the Court held that the State could favor regulated utilities not only when they were serving captive customers, but also when they were participating in a competitive market for non-captive customers. Here, by contrast, there is no unregulated market. Transmission-distribution utilities in Texas *only* serve captive customers. The Commerce Clause permits States to make that choice: *Tracy* presupposes that a State is entitled to bar competition altogether.

necessary to protect reliable, regulated utility service. *Id.* at 309 (refusing to eliminate tax differential, in part, because doing so "*could* subject [utilities] to economic pressures that in turn *could* threaten" their ability to sell natural gas (emphasis added)). That caution, again, is equally warranted here. Texas has made a policy decision to close its market for transmission line construction to competition, has limited participation to distribution-transmission utilities, and has carefully balanced the benefits and consequences of doing so. *See infra* I.C (discussing legislative history). *Tracy* teaches that courts should respect that policy judgment.

Third, *Tracy* recognizes that judicial restraint is appropriate because Congress "has both the resources and the power" to act if necessary. 519 U.S. at 304. In exercising the Commerce Clause power, Congress and FERC have expressly accommodated the kind of siting and construction regulations at issue in this case. *See supra* at 5-8. Given that neither FERC nor Congress has concluded that these kinds of regulations unduly burden interstate commerce, there is no cause for this Court to enforce a different policy choice as constitutionally mandated.

**C. S.B. 1938 Was Not Enacted With Protectionist Intent.**

Even though S.B. 1938 does not in fact discriminate against out-of-state companies, either on its face or in effect, NextEra contends it should be invalidated because it was enacted with a protectionist intent. In assessing such a claim, the Court applies a "presumption of good faith." *Wal-Mart*, 2019 WL 3822150, at *6. Here, Plaintiffs' intent-based allegations do not state a claim. The legislative record discloses not a shred of protectionist intent.[4]

Two concerns drove legislators to act. First, they did not want to mess with success. Each chamber heard testimony explaining the importance to the Texas economy of new transmission

[4] *See* Hearing on House Bill 3995, Apr. 1, 2019, https://bit.ly/2TIcAFC, 7:47:50-8:42:15 ("House Hr'g"); Hearing on Senate Bill 1938, Apr. 2, 2019, https://bit.ly/2zaEhgI, 0:00-30:55 ("Senate Hr'g").

lines, especially in West Texas. Senate Hr'g at 6:39; House Hr'g at 7:54:00. Under the rules that S.B. 1938 codified, Texas had built many thousands of miles of transmission lines in recent years. In contrast, one legislator noted, not a single line had been built in any State by a competitive transmission company under the framework of FERC's Order No. 1000. House Hr'g at 8:16:30.

Second, legislators were concerned that the PUCT would effectively lose authority to regulate the rates paid by retail customers for transmission services. The PUCT sets those rates for transmission-distribution utilities. But for transmission-only companies in non-ERCOT regions, FERC would set the transmission rate to be passed through to Texas retail customers. Senate Hr'g at 26:00-28:05 (describing this arrangement). One legislator described this as "the most important point": the legislature did not want to cede to FERC responsibility for protecting Texas customers. House Hr'g at 7:54:28-7:56:00.

In alleging protectionist intent, Plaintiffs point to one phrase—"boots on the ground"—in hearings that together lasted nearly 90 minutes. Compl. ¶ 64. But they take that phrase out of context. Legislators valued "boots on the ground" because of the reliability benefits. As a witness testified, reliability is served by having new lines built by utilities "who have boots on the ground ready to restore those facilities when a storm comes through," rather than relying on transmission-only companies who may not have sufficient depth of personnel in place locally. House Hr'g at 8:40:00. That interest is not protectionist. Hence, "[t]he floor debate was devoid of discriminatory remarks directed toward out-of-state competition." *Wal-Mart*, 2019 WL 3822150, at *5. Instead, it confirmed the "legislative desire to treat differently two business forms … a distinction based not on domicile but on business form." *Id.* (quoting *Allstate*, 495 F.3d at 161).

**D. Texas' Legitimate Interest in Regulating the Provision of Electricity Far Outweighs Any Indirect Effect on Interstate Commerce.**

Plaintiffs' backup argument is that S.B. 1938 is invalid under *Pike v. Bruce Church, Inc.*,

397 U.S. 137 (1970), which prohibits even nondiscriminatory laws if their burden on interstate commerce is "clearly excessive" relative to the putative local benefits, *id.* at 142. This burden is rarely met, and courts routinely dismiss *Pike* claims once they have found an absence of discrimination. *See, e.g.*, *Elec. Power Supply Ass'n v. Star*, 904 F.3d 518, 524-25 (7th Cir. 2018); *Allco Finance Ltd. v. Klee*, 861 F.3d at 82, 103-08 (2d Cir. 2017); *Grand River Enters. Six Nations, Ltd. v. Beebe*, 574 F.3d 929, 941-43 (8th Cir. 2009); *Doran v. Mass. Turnpike Auth.*, 348 F.3d 315, 318-23 (1st Cir. 2003). Plaintiffs cannot satisfy the stringent pleading standard under *Pike*.

First, a *Pike* claim cannot survive when Congress and the relevant federal agency charged with regulating the interstate market have exercised the Commerce Clause power and decided that the state law at issue does not unduly burden the interstate market. *See Sw. Power*, 151 FERC ¶ 61,045 at P 31 (explaining that FERC "struck an important balance" when it removed the federal ROFR but accommodated state laws limiting siting and construction certificates to incumbent utilities); *Star*, 904 F.3d at 525 (rejecting *Pike* challenge to state regulation of power plants because "[t]he commerce power belongs to Congress; the Supreme Court treats silence by Congress as preventing discriminatory state legislation. Yet Congress has not been silent about electricity.").

Second, even when the federal government has not already struck a balance, courts cannot "second-guess the empirical judgments of lawmakers concerning the utility of legislation," *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69, 92 (1987), but instead must credit a putative local benefit "so long as an examination of the evidence before or available to the lawmaker indicates that the regulation is not wholly irrational in light of its purposes," *Allstate Ins. Co.*, 495 F.3d at 164 (quotation mark omitted). In particular, challenges to "part of a complex regime" for public utility regulation face a "substantial burden" in stating a claim under *Pike*. *S. Union Co. v.*

*Mo. Pub. Serv. Comm'n*, 289 F.3d 503, 508 (8th Cir. 2002).

Texas rationally concluded that limiting transmission line construction to incumbent distribution-transmission utilities will "ensure the geographic continuity" of the State's electricity grid, "in a way that further facilitates reliability." *See* Senate Research Center, Bill Analysis: S.B. 1938, at 1 (May 29, 2019), https://bit.ly/2Nqpjvk. The Texas Legislature is uniquely situated to make the policy judgments that underpin S.B. 1938—*i.e.*, judgments regarding the "health, life, and safety" of its citizens—even if those judgments "might indirectly affect the commerce of the country." *Tracy*, 519 U.S. at 306. And the Legislature heard testimony to inform its judgment.

To be sure, Plaintiffs allege that the "purported local benefits" of Texas' choice of regulation over competition are "insignificant and illusory," because "basic economic theory" shows that competition "benefits the markets and consumers." Compl. ¶ 103. But the dormant Commerce Clause does not constitutionalize one economic or regulatory theory. "The battle between laissez fairists and regulators is as old as the hills…. Legislators, not jurists, are best able to compare competing economic theories and sets of data and then weigh the result against their own political valuations the public interests at stake." *Colon Health*, 813 F.3d at 158.

## II. PLAINTIFFS FAIL TO PLEAD A PROPER STATUTORY BASIS, SUBSTANTIVE CLAIM, OR PROPER REMEDY FOR THEIR CONTRACTS CLAUSE CLAIM.

Plaintiffs' Contract Clause claim should be dismissed for three reasons. First, the Contracts Clause is "a structural limitation placed upon the power of the States," not a federal guarantee of individual rights enforceable via Section 1983. *See Kaminski v. Coulter*, 865 F.3d 339, 346 (6th Cir. 2017); *Crosby v. City of Gastonia*, 635 F.3d 634, 640 (4th Cir. 2011). The Fifth Circuit has yet to decide this question, *see Dennis Melancon, Inc. v. City of New Orleans*, 703 F.3d 262, 279 n.14 (5th Cir. 2012), but this Court should follow *Crosby* and *Kaminski*.

Second, Plaintiffs' claim fails on the merits. The Contract Clause prohibits only

"substantial" impairments, *see Powers v. United States*, 783 F.3d 570, 577-78 (5th Cir. 2015). Here, Plaintiffs' "reasonable expectations have [not] been impaired." *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 416 (1983). Plaintiffs' contracts at all times required regulatory approvals. Compl. ¶¶ 10, 84. By entering into contracts "structured against the background" of "extensive regulation" by Texas, Plaintiffs "knew [their] contractual rights were subject to alteration" by the Legislature. *See Energy Reserves Group*, 459 U.S. at 415-16.

Moreover, even substantial impairments do not offend the Contract Clause if they serve a significant and legitimate public purpose. *Powers*, 783 F.3d at 577-78. And when a contract is "between two private parties, the court does not independently review the reasonableness of the legislation, but instead defers to the judgment of the legislature." *Id.* (internal quotation marks omitted). Here, S.B. 1938 serves the significant and legitimate public purpose of "protect[ing] consumers," *Energy Reserves Group*, 459 U.S. at 416-17, as discussed above, *supra* Part I.C.

Third, the Contract Clause claim should be dismissed because Plaintiffs seek an improper remedy. They ask the Court to invalidate an entire regulatory scheme. That far exceeds what the Contracts Clause permits as relief. "It has been clear since 1827 that the [Contracts] Clause applies only to laws with retrospective, not prospective, effect." *Local Div. 589, Amalgamated Transit Union, AFL-CIO, CLC v. Massachusetts*, 666 F.2d 618, 637 (1st Cir. 1981). Hence, S.B. 1938 cannot be declared invalid nor its enforcement enjoined prospectively. *M.D. by Stukenberg v. Abbott*, 907 F.3d 237, 271-72 (5th Cir. 2018) ("[R]emedies fashioned by the federal courts to address constitutional infirmities 'must directly address and relate to the constitutional violation itself,'" (quoting in part *Milliken v. Bradley*, 433 U.S. 267, 282 (1977)).

## CONCLUSION

For the foregoing reasons, Plaintiffs' Complaint should be dismissed with prejudice.

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Respectfully submitted,

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