UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

NEXTERA ENERGY CAPITAL HOLDINGS, INC., *et al.*, *Plaintiffs*, v. DEANN T. WALKER, Commissioner of the Public Utility Commission of Texas, *et al.*, *Defendants*.	§ § § § § § § § §	CIVIL ACTION NO. 1:19-cv-00626

TEXAS'S REPLY IN SUPPORT OF MOTION TO DISMISS UNDER FED. R. CIV. P. 12(B)(6)

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I. NextEra has not pleaded a dormant Commerce Clause claim.

A. The dormant Commerce Clause does not preclude Texas's regulatory approach to the construction of new transmission lines.

Plaintiffs' argument rests on the premise that the dormant Commerce Clause gives them the right to compete to build transmission lines. It does not. The dormant Commerce Clause does not "constitutionalize" any particular approach to utility regulation. *See Colon Health Ctrs. of Am. LLC v. Hazel*, 813 F.3d 145, 158 (4th Cir. 2016) ("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 of the public interests at stake."). A key underlying premise of the United States Supreme Court's opinion in *General Motors v. Tracy*—totally ignored by NextEra—is that state utility regulation is an important health and safety interest supporting regulation that "outright prohibit[s] competition." *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 306 (1997). Indeed, under NextEra's theory in this case, state electric utility regulation would be impossible because states would be prohibited from limiting competition at all.

Texas has regulated transmission lines for over 40 years, imposing a comprehensive regulatory regime as a substitute for competition. Tex. Util. Code §§ 31.001(b); 39.001(a). "The electricity market is unlike an ordinary market for goods or services because of the unique attributes of electricity" that "create problems that do not arise in other competitive markets." *TXU Generation Co., LP v. Pub. Util. Comm'n of Tex.*, 165 S.W.3d 821, 827 (Tex. App.—Austin 2005, pet. denied). Electric transmission service is a natural monopoly, and Texas "favors 'displac[ing] competition with regulation or monopoly public control' in this area." *United Haulers Ass'n, Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 344 (2007). NextEra "may or may not agree with that approach, but nothing in the Commerce Clause vests the responsibility for that policy judgment with the Federal Judiciary." *Id.* at 344-45. Although

NextEra repeatedly asserts that SB 1938 only allows in-state transmission providers to compete, while excluding out-of-state providers, the statute actually prohibits competition entirely, reaffirming the state's longstanding regulation of transmission as a monopoly. "Congress has done nothing to limit its unbroken recognition of the state regulatory authority that has created and preserved the local monopolies," *Tracy*, 519 U.S. at 304–05. As such, prudence "counsels against running the risk of weakening or destroying a regulatory scheme of public service and protection recognized by Congress despite its noncompetitive, monopolistic character." *Id.* at 309.

NextEra's subsidiaries are transmission-only utilities, meaning they would not also provide distribution service to end-use customers. They complain that SB 1938 has limited the construction of new transmission lines to traditional transmission and distribution utilities. *See*, *e.g.*, Compl. ¶¶ 23, 61, 72, 74. However, this is a legislative preference for a particular type of business form, not for in-state economic interests, and thus does not run afoul of the dormant Commerce Clause. *See Wal-Mart Stores, Inc. v. Tex. Alcoholic Beverage Comm'n*, 935 F.3d 362, 372 (5th Cir. 2019); *Allstate Ins. Co. v. Abbott*, 495 F.3d 151, 161-62 (5th Cir. 2007).[1]

In demanding the right to compete in a regulated market, NextEra overstates the significance of FERC's Order No. 1000 to this case. The Electric Reliability Council of Texas ("ERCOT") grid covers most of the state. Located entirely within Texas and generally not interconnected with the other grids, the ERCOT grid accounts for more than 90% of the

[1] The use of new entrant transmission providers for the construction of the Competitive Renewable Energy Zone ("CREZ") lines was a limited exception to the general practice giving incumbents a preference. It was a response to a unique situation in which the Legislature mandated a substantial build-out of the transmission grid to bring wind power from West Texas to population centers. Mot. 12 n.21. CREZ produced additional incumbents, like NextEra affiliate and plaintiff Lone Star Transmission, that have a right-of-first-refusal under SB 1938. The Texas Utilities Code provisions regarding the build-out of the CREZ transmission facilities have been repealed.

electricity used in the state. Order No. 1000 has no application to ERCOT, which is not subject to FERC jurisdiction. In the limited part of Texas outside ERCOT where it does apply, Order No. 1000 only involves the largest transmission projects; most projects were exempted from its competitive solicitation process. And as Texas explained in its Motion, the federal agency then expressly recognized state right-of-first-refusal statutes such as SB 1938. *See S.C. Pub. Serv. Auth. v. FERC*, 762 F.3d 41, 76 (D.C. Cir. 2014) (in eliminating the federal right-of-first-refusal, FERC "t[ook] great pains to avoid intrusion on the traditional role of the States" as to the siting and construction of transmission facilities.) FERC thus permitted Independent System Operators ("ISOs") to incorporate state rights-of-first-refusal into their tariffs, a decision that was upheld by the Seventh Circuit. *MISO Transmission Owners v. F.E.R.C.*, 819 F.3d 329, 336 (7th Cir. 2016). And Congress has not responded to the FERC's position by amending the Federal Power Act. The dormant Commerce Clause prohibits "discriminatory state legislation" in the face of congressional silence, but "Congress has not been silent about electricity." *Elec. Power Supply Ass'n, v. Star*, 904 F.3d 518, 525 (7th Cir. 2018). Because state authority over transmission lines has been reserved in the Federal Power Act, NextEra cannot argue there is conflict preemption here—yet it tries to use the dormant Commerce Clause to the same end.

B. *General Motors v. Tracy* forecloses NextEra's claim.

The United States Supreme Court's opinion in *General Motors v. Tracy* controls here. Under *Tracy*, Texas has a right to differentiate between existing facility owners and potential new entrants in the construction of new lines. NextEra's Response obscures the central lesson for this case from *Tracy*—that the threshold question is whether the in-state and out-of-state entities are "similarly situated." *Tracy*, 519 U.S. at 298-99; *accord Allco Fin. Ltd. v. Klee*, 861 F.3d 82, 105 (2d Cir. 2017); *Allstate*, 495 F.3d at 163. *Tracy* upheld the challenged Ohio law,

reasoning that a state could provide preferential treatment to domestic utilities even in the competitive market without violating the dormant Commerce Clause because the domestic utilities also served a regulated market, in which they were subject to the associated regulatory requirements, including a requirement to serve all members of the public. *Id.* at 304, 310. The utilities' obligations in the regulated market meant that they were not similarly situated to the interstate transmission companies in the competitive market and thus the facial discrimination claim failed. *Id.* at 310.

Here, NextEra ignores the inherent differences between the existing incumbent transmission owners and new entrants that do not have existing infrastructure in Texas. Outside ERCOT, the existing transmission-line owners are almost exclusively vertically integrated utilities, with an obligation to serve retail customers and significant associated regulatory burdens; within ERCOT, most transmission lines are owned by transmission-and-distribution utilities with similar regulatory obligations. NextEra claims that it is similarly situated with current owners of transmission lines in Texas because they both seek to provide transmission service, and thus would "compete" in the same market. Resp. at 14. However, in *Tracy*, the out-of-state marketers and in-state utilities did directly compete for industrial customers. The court's analysis turned on differences between the two types of entities. Here, as in *Tracy*, there are significant differences between the transmission-only utilities and the incumbent transmission-and-distribution utilities that have the preferential right to build new lines in Texas. The differences are especially stark outside ERCOT, where every investor-owned utility provides "fully-bundled" service to captive end-use customers, just like the favored local distribution companies in *Tracy*. NextEra, if it owned transmission facilities outside ERCOT, would not have any retail customers at all. As a transmission-only utility, NextEra would provide only wholesale service. *See* Compl. ¶ 28, 41, 103. The incumbent

vertically integrated utilities in Texas, like the LDCs in *Tracy*, are subject to pervasive state regulation over their retail rates and services, Tex. Util. Code §§ 11.001, 36.051, 38.002, and have an obligation to serve "every consumer in the utility's certificated area" and "provide continuous and adequate service in that area." Tex. Util. Code § 37.151.

And as Texas noted in its Motion, a Minnesota Federal district court, applying *Tracy*, dismissed a dormant Commerce Clause challenge to a similar Minnesota right-of-first-refusal statute. *LSP Transmission Holdings, LLC v. Lange*, 329 F. Supp. 3d 695 (D. Minn. 2018) appeal docketed. Like SB 1938, the Minnesota statute granted a preference to incumbent utilities to build and own the transmission lines that connect to their own facilities. *Id.* at 701-02, 708. Noting the possibility of competition between the incumbent providers for the right to build transmission lines, the court gave "controlling weight to the monopoly market," as this was necessary to "avoid any jeopardy or disruption to the service of electricity to the state electricity consumers and to allow for the provision of a reliable supply of electricity." *Id.*

C. SB 1938 does not facially discriminate against out-of-state economic interests.

NextEra's Response argues that all the providers with a right-of-first-refusal under SB 1938 have a physical presence in Texas—thus, NextEra reasons, the statute discriminates in favor of these "in-state" entities and against "out-of-state" entities. But what is at issue in this case is the construction of transmission lines *in Texas*, that will transmit electricity within Texas. The existing providers with transmission lines in Texas are, necessarily under this definition, "in-state" because their facilities are in the state. So too will all new lines be built by "in-state" companies. Thus, by NextEra's own logic, these new lines can never be constructed by "out-of-state" companies. Discrimination against out-of-state entities is necessarily impossible.

Courts have rejected such attempts to treat all companies with in-state facilities as in-state for the purposes of the Commerce Clause. For example, in *Colon Health*, 813 F.3d at 154,

out-of-state companies challenged a Virginia law prohibiting them from building new medical facilities without a certificate of need, arguing it discriminated in favor of existing facilities and against new, predominantly out-of-state firms. The court rejected this argument, holding that "incumbency bias" is not the same as discrimination against out-of-state interests and "is not a surrogate for the 'negative[ ] impact [on] interstate commerce' with which the dormant Commerce Clause is concerned." *Id.* at 152–54 (regulatory regime that benefitted existing service providers and made no distinction between in-state and out-of-state providers not facially discriminatory). Treating "incumbency . . . as the proxy for in-state status would be a risky proposition." *Id.* at 154. And it would have no support in the law. Courts focus instead on whether a statute differentiates between entities based on residency or citizenship. *See, e.g., CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 87 (1987) (upholding state statute that had "the same effects . . . whether or not the offeror is a domiciliary or resident"); *Wal-Mart Stores,* 935 F.3d at 370 (statute facially neutral because it banned "all public corporation from obtaining . . . permits irrespective of domicile").

NextEra does not allege that SB 1938 treats *Texas* incumbent transmission providers differently than *out-of-state* incumbents. It could not. Under the legislation, all existing incumbent transmission owners, regardless of residency, received the benefits (and burdens) of the statute; the nonincumbents do not. SB 1938 applies to all incumbents equally, "irrespective of geography." *Churchill Downs Inc. v. Trout*, 979 F. Supp. 2d 746, 751 (W.D. Tex. 2013), *aff'd*, 589 F. App'x. 233 (5th Cir. 2014). If an incumbent utility wanted to build a new line off the endpoints from a line of another incumbent utility in another part of state, SB 1938 precludes it from doing so. Its right-of-first-refusal to build lines physically connected to its *own* system does not give that utility a right to build a line anywhere in Texas, thus discouraging the Balkanization of transmission ownership. For example, Oncor, Entergy and

SPS are all prohibited from building a new line from the endpoint of one of the existing lines of plaintiff Lone Star Transmission; the NextEra affiliate has the preference to build that new line.

NextEra does not dispute that most incumbents are owned by out-of-state interests; some (such as Southwestern Public Service, a New Mexico company) are actually out-of-state companies. NextEra merely claims in response that dormant Commerce Clause analysis does not turn upon "beneficial ownership." Resp. 9. But what is involved is the differential treatment of in-state and out-of-state "*economic interests.*" *Churchill Downs*, 979 F. Supp. 2d at 750 (quoting *Granholm v. Heald*, 544 U.S. 460, 472 (2005) (emphasis added).

This case is not analogous to the cases involving "flow-control" laws that NextEra cites. Resp. 5-8. Unlike this case, these cases involved restrictions on the flow of goods in interstate commerce or burdensome requirements as a precondition for allowing the flow of goods in interstate commerce. SB 1938 does neither of these. The bill did not purport to regulate the transmission of electricity in interstate commerce. It only regulates the construction and operation of transmission facilities that will be located wholly within Texas. This is not a matter of economic protectionism but necessity and physical reality. This simple fact distinguishes SB 1938 from the cases that NextEra cites such as *C &A Carbone, Inc. v. Town of Clarkstown, N.Y.*, 511 U.S. 383 (1994).[2] These cases involve the use of facilities that

[2] *Carbone* for example involved a requirement that garbage be processed at an in-state facility before it could be transported out of state. *Id.* at 392 ("essential vice" is the law bars the import of processing service; "the flow control ordinance is just one more instance of local processing requests we have long invalidated"). Likewise for *Granholm*, 544 U.S. at 460. Under the statutes at issue in *Granholm*, in-state wineries were allowed to ship directly to in-state consumers but out-of-state wineries were not; they were required to sell through a wholesaler (Michigan) or ship through an in-state operations facility (New York), imposing additional costs on out-of-state wineries. Other flow-control cases NextEra cites are likewise distinguishable. *Fort Gratiot Sanitary Landfill Inc. v. Mich. Dept. of Nat. Res.*, 504 U.S. 353, 361 (1992) (restriction on importation of solid waste from outside county unless authorized by county plan violated

could have been located out of state; here, the transmission lines must be built and operated in Texas.

Finally, and significantly, SB 1938 does not preclude out-of-state interests from entering the Texas market for transmission services by buying a Texas utility. Section 7 of SB 1938 allows the incumbent providers to "sell, assign, or lease a certificate or a right obtained under a certificate" to an entity that has not been previously certificated, with PUCT approval, if the transaction will not diminish the retail rate jurisdiction of the state. Tex. Util. Code § 37.154(a). Rather than excluding out-of-state interests, Section 7 of SB 1938 provides them the means to enter the Texas market.

D. SB 1938's purpose was not to discriminate against out-of-state interests.

In assessing a discriminatory purpose argument, the Court applies a "presumption of good faith." *Wal-Mart Stores,* 935 F.3d at 373. NextEra's complaint includes only conclusory allegations of discriminatory purpose. It does not allege specific facts on any of the four factors from *Wal-Mart* and *Allstate*, 495 F.3d at 160. First, there is no pattern of discrimination. NextEra does not allege "a history of hostility toward [NextEra] singularly or towards out-of-state companies in general." *Allstate*, 495 F.3d at 160-61. Second, there was no sudden and dramatic change in state law; SB 1938 continues the long-time general practice of allowing existing providers to build needed new lines. Third, the bill followed a standard path from filing to passage. NextEra does not allege any facts that indicate SB 1938 resulted from a legislative process that departed from "normal procedures." *Allstate*, 495 F.3d at 160–61. It admits that there were numerous public hearings on the bill, at which opponents of the bill

Commerce Clause); *Dean Milk Co. v. City of Madison*, 340 U.S. 349, 356 (1951) (prohibition on sale of milk as pasteurized unless processed within five miles of city center discriminated against interstate commerce).

(including NextEra) testified against it. Compl. ¶ 62-64. Merely alleging the proceedings were "perfunctory" is insufficient. *Allstate*, 495 F.3d at 161. Fourth, there is no indication in the legislative history of any discriminatory purpose. Like *Wal-Mart*, the SB 1938 debate was "devoid of discriminatory remarks directed toward out-of-state competition." *Wal-Mart*, 935 F.3d at 372.

NextEra's discrimination claim is based upon the conclusory allegation that SB 1938 was a reaction to an ISO's designation of a NextEra affiliate for the Hartburg-Sabine transmission line. The legislative history reflects to the contrary that SB 1938 was a reaction to a 2017 PUCT declaratory order opining that vertically integrated utilities operating outside of ERCOT did not have an exclusive right to build new transmission lines in their certificated retail service areas.[3] The Texas Legislature evidently disagreed with the statutory analysis reflected in the PUCT's declaratory order, and enacted SB 1938 to eliminate any uncertainty as to Texas law and codify the longstanding practice.

E. NextEra has not pleaded a Pike *claim.*

Plaintiffs' burden under the *Pike* test—that the law's burden on interstate commerce is "clearly excessive" relative to the putative local benefits—is seldom met. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970). Courts routinely dismiss *Pike* claims once they have found no discrimination. *See, e.g., Elec. Power Supply*, 904 F.3d at 524-25; *Allco*, 861 F.3d at 103-08. Neither Congress nor the FERC has indicated there is a compelling need for national uniformity, *Tracy*, 519 U.S. at 298 n.12, instead striking a balance between the state and federal roles in utility regulation.

[3] *See* Compl. ¶ 59

II. NextEra has not pleaded a Contract Clause claim.

NextEra fails to distinguish the litany of cases holding that a party's reasonable expectations are not upset when it enters into a contract in a heavily regulated industry. For example, *United Healthcare* involved health insurance providers' contracts with a state. *United Healthcare Ins. Co. v. Davis*, 602 F.3d 618, 622-23 (5th Cir. 2010). Weeks after the contracts took effect, a new Louisiana law changed the providers' obligations under them and eliminated an exclusivity provision. *Id.* at 629-30. Effectively the state used its legislative power to unilaterally change the terms of the contracts. But when a state is not a party to the contract, courts have over and over held that a legislative change in a heavily regulated industry does not disrupt a party's reasonable expectations or extensively impair the contract.[4] NextEra additionally responds that by entering into the contracts it has shown that it had a reasonable expectation of being able to complete them. Resp. 19-20. NextEra's argument would eliminate the expectation prong of Contract Clause analysis. If entering into a contract facially showed an expectation of no further legislation in that area, courts would never need to consider a party's reasonable expectations. *Energy Reserves* is controlling here. Mot. 19.

III. Conclusion and prayer

For the foregoing reasons, Texas respectfully requests that the Court dismiss NextEra's complaint in its entirety.

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[4] *See e.g. Alliance of Auto. Mfrs., Inc. v. Currey,* 984 F. Supp. 2d 32 (D. Conn. 2013), *aff'd*, 610 F. App'x 10 (2d Cir. 2015) (car manufacturing and dealing), *Hawkeye Commodity Promotions, Inc. v. Vilsack*, 486 F.3d 430, 437-38 (8th Cir. 2007) (gambling industry), *Me. Educ. Ass'n Benefits Tr. v. Cioppa*, 842 F. Supp. 2d 373, 383 (D. Me. 2012), *aff'd*, 695 f.3d 145 (1st Cir. 2012) (insurance industry); *see also Am. Express Travel Related Servs., Inc. v. Sidamon-Eristoff*, 669 F.3d 359, 370 (3d Cir. 2012) ("a reasonable modification of statutes ... is much less likely to upset expectations than a law adjusting the express terms of an agreement") *quoting U.S. Tr. Co. of N.Y. v. New Jersey*, 431 U.S. 1, 19 (1977).

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CERTIFICATE OF SERVICE

I hereby certify that on September 27, 2019, a true and correct copy of the foregoing document was served via the Court's CM/ECF system to all counsel of record and via email to the following individuals who have provided their written consent in accordance with FRCP 5(b)(2)(E) to receive service by electronic means:

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