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Entergy Louisiana, Inc. v. Louisiana Public Service Commission: Preemptive Effect of Federal Energy Regulatory Commission Orders

Michael V. Seitzinger
Legislative Attorney
American Law Division

Summary

In *Entergy Louisiana, Inc.* v. *Louisiana Public Service Commission* the United States Supreme Court faced the issue of whether a Federal Energy Regulatory Commission (FERC) tariff delegating discretion to the regulated entity to determine precise cost allocation pre-empted a FERC order that had judged those costs imprudent. Reversing the Louisiana Supreme Court, the United States Supreme Court held that the FERC order pre-empted any attempt at modification and that, therefore, the costs determined as imprudent could not be allowed. The case continues the line of Supreme Court cases holding that, when FERC approves a "just and reasonable" rate, a state agency may not reconsider the rate.

The Federal Energy Regulatory Commission (FERC) is charged by statute with regulating the sale of electricity at wholesale in interstate commerce.[1] FERC is further charged with making certain that wholesale rates are "just and reasonable."[2] The United States Supreme Court in previous cases[3] held that under the filed-rate doctrine[4] cost allocations between affiliated energy companies which had been approved by FERC could not be reevaluated by state ratemaking agencies. In *Entergy Louisiana, Inc.* v. *Louisiana Public Service Commission*, decided June 2, 2003 (No. 02-299), the Court faced the issue

[1] 16 U.S.C. § 824(b).

[2] 16 U.S.C. § 824d(a).

[3] Mississippi Power & Light Co. v. Mississippi ex rel. Moore, 487 U.S. 354 (1988); Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953 (1986).

[4] The filed rate doctrine states that "interstate power rates filed with FERC or fixed by FERC must be given binding effect by state utility commissions determining intrastate rates." Nantahala Power & Light, at 962. The filed rate doctrine applies to state regulators because of the doctrine of federal preemption as set forth in the Constitution's Supremacy Clause. Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571, 581-582 (1981).

of whether a FERC tariff delegating discretion to the regulated entity to determine precise cost allocation pre-empted a FERC order that had judged those costs imprudent. The case continues the line of Supreme Court cases holding that, when FERC approves a "just and reasonable" rate, a state may not reconsider the rate.

Entergy Louisiana, Inc. (ELI), is one of five public utilities owned by Entergy Corporation. ELI operates in Louisiana and shares capacity with other Entergy utilities operating in Arkansas, Mississippi, and Texas. This arrangement allows a company to access additional capacity when needed, but the costs associated with keeping excess capacity available must be allocated. The cost allocation is an important component of the setting of retail rates by state regulators.

Entergy allocates costs through a system agreement approved by FERC under section 205 of the Federal Power Act.[5] The formula for the agreement contains an automatic adjustment clause, necessary because of the possible monthly change in the cost allocation, and this clause is exempted from the Federal Power Act's usual requirements for rate changes.

The cost allocation determination was based not simply upon the power used from generating facilities; rather, certain generating units shut down because of overcapacity, but which could be brought back up if necessary, were also figured into the cost allocation. An operating committee was given the discretion to determine the status of these "mothballed" units. Because of this allocation, ELI often found that its cost equalization payments were increased.

In December 1993 FERC initiated a proceeding to determine for formula purposes whether the "mothballed" generating units should be treated as available. FERC found that, although the units should not have been classified as available for purposes of the formula, a refund was not warranted because the cost allocations had not been "unjust, unreasonable, or unduly discriminatory." FERC also approved an amendment to the system agreement to allow a "mothballed" unit to be treated as available if the operating committee determined that at a future date it intended to return the unit to service.

ELI filed with the Louisiana Public Service Commission (LPSC) in May 1997 its annual rate. A contested issue in the filing was whether the cost of "mothballed" generating units should be included or excluded from its revenue requirement.[6] The LPSC confined its review to payments made after August 5, 1997, the date on which FERC's order allowing inclusion of the "mothballed" units as just and reasonable had been issued. Despite concluding that it was preempted from determining whether the filing was just and reasonable because of FERC's authority over the matter, the LPSC held that it was not preempted from disallowing as imprudent these costs after August 5, 1997.

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[5] 16 U.S.C. § 824d.

[6] Allowed revenue would typically permit an operating company to recover its costs and a reasonable rate of return.

ELI's petition for review in state district court was denied. ELI then appealed to the Supreme Court of Louisiana, which upheld the LPSC's decision.[7] The Supreme Court of Louisiana held that the LPSC's order was not barred by preemption because the LPSC was neither attempting to regulate interstate wholesale rates nor challenging FERC's declining to order refunds. The Louisiana Supreme Court also stated that FERC had not ruled on whether continuing after August 5, 1997, to include the cost of the "mothballed" units was prudent. The United States Supreme Court granted ELI's petition for writ of certiorari to determine whether the LPSC's order was preempted. The United States Supreme Court reversed the Louisiana Supreme Court.

In *Nantahala & Light* and *Mississippi Power & Light* the Court applied the filed rate doctrine in holding that FERC-mandated cost allocations could not be modified by state regulators. The Court stated in *Nantahala*:

> Nantahala must under NCUC's order calculate its retail rates as if it received more entitlement power than it does under FERC's order, and as if it needed to procure less of the more expensive purchased power than under FERC's order. A portion of the costs incurred by Nantahala in procuring its power is therefore "trapped."[8]

Applying these earlier decisions to the facts in *Entergy Louisiana*, the Court held that the LPSC's order impermissibly "trapped" costs allocated in a FERC tariff. The Court went on to state that, because Congress had specifically allowed the use of automatic adjustment clauses in the Federal Power Act, the Louisiana Supreme Court's conclusion that leaving the classification of the "mothballed" generating units to the discretion of an operating committee could substantially limit FERC's flexibility in approving cost allocation arrangements.

As for the Louisiana Supreme Court's upholding the LPSC's order based upon its belief that FERC had not specifically approved the cost allocation after August 5, 1997, when it issued its order, the Court stated that the Louisiana Supreme Court had revived the same erroneous reasoning used by the Mississippi Supreme Court in *Mississippi Power & Light.* In that case the Court stated:

> The Mississippi Supreme Court erred in adopting the view that the pre-emptive effect of FERC jurisdiction turned on whether a particular matter was actually determined in the FERC proceedings.... We have long rejected this sort of "'case-by-case analysis of the impact of state regulation upon the national interest'" in power regulation cases. *Nantahala*, 476 U.S., at 966 (quoting *FPC* v. *Southern California Edison Co*., 376 U.S. 205, 215-216 (1964)). Congress has drawn a bright line between state and federal authority in the setting of wholesale rates and in the regulation of agreements that affect wholesale rates. States may not regulate in areas where FERC has properly exercised its jurisdiction to

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[7] 815 So. 2d 27 (La. 2002).

[8] 476 U.S., at 971.

> determine just and reasonable wholesale rates or to insure that agreements affecting wholesale rates are reasonable.[9]

Finally, the Court addressed the argument by respondents that the inclusion of the "mothballed" generating units in the rate calculations violated the amended system agreement and that, therefore, the LPSC's order cannot be pre-empted. The Court is uncertain as to why respondents advanced this argument, since the LPSC's prior holding stated that it did not have jurisdiction to determine whether the system agreement was violated and since the Louisiana Supreme Court accepted that position. Therefore, the Court stated that it had no reason to address the question.

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[9] *Mississippi Power & Light*, at 374.