UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

NEXTERA ENERGY CAPITAL HOLDINGS, INC., NEXTERA ENERGY TRANSMISSION, LLC, NEXTERA ENERGY TRANSMISSION MIDWEST, LLC, LONE STAR TRANSMISSION, LLC, and NEXTERA ENERGY TRANSMISSION SOUTHWEST, LLC,

Plaintiffs,

v.

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,

Defendants.

Civil No. 19-cv-00626-LY

AMENDED PLAINTIFFS' OPPOSITION TO DEFENDANTS' MOTION TO DISMISS

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Earlier this year, the U.S. Supreme Court wrote of the Dormant Commerce Clause's "important role in the economic history of our nation," reflecting a central concern of the Framers and of the Clause's role as the "primary safeguard against state protectionism." *Tenn. Wine & Spirits Retailers Ass'n v. Thomas*, 139 S. Ct. 2449, 2460 – 61 (2019). When an interstate operator of transmission lines conducted a competitive auction to develop a transmission project, and NextEra won, the losing Texas utilities went to the legislature. Texas passed a protectionist law that grants owners of existing electric facilities in Texas the exclusive right to build, own, and operate new transmission lines approved by federally-regulated independent system operators and paid for by multiple States. Texas' law also impairs NextEra's preexisting contracts in violation of the Contracts Clause of the Constitution. The Defendants' motion to dismiss should be denied.

BACKGROUND

FERC fosters competition. Historically, most electricity was sold by "vertically integrated utilities that had constructed their own power plants, transmission lines, and local delivery systems." *New York v. F.E.R.C.*, 535 U.S. 1, 5 (2002). As newer, independent generation and transmission entered the market, the Federal Energy Regulatory commission ("FERC") "concluded that the economic self-interest of electric transmission monopolists lay in denying transmission or offering it only on inferior terms to emerging competitors." *S.C. Pub. Serv. Auth. v. F.E.R.C.*, 762 F.3d 41, 50 (D.C. Cir. 2014). Accordingly, FERC adopted a series of orders meant to foster competition in the transmission of electricity. *Id.* at 51-52. The combined effect of FERC's orders was to encourage states and utilities to participate in the development of regional transmission organizations and independent system operators (collectively, "ISO"). The ISOs, rather than the utilities, exercise "control over all network transmission facilities in [their] region" and are responsible to "provide open-access transmission service, allocate transmission revenues, and maintain system security" across the region. *MISO Transmission Owners v. F.E.R.C.*, 819

F.3d 329, 332 (7th Cir. 2016). So Defendants' assertion that SB 1938 simply allows existing owners to "build out their existing lines," Mtn at 1, is not quite right—the law also applies to new lines that are commissioned by, and that will be controlled by, federal ISOs.

The two ISOs at issue in this case. Two such ISOs involved in this case are the Midcontinent Independent System Operator ("MISO"), which spans much of the Midwestern United States, parts of Canada, and parts of eastern Texas; and the Southwest Power Pool ("SPP"), which runs from Canada into parts of eastern Texas and the Texas panhandle. The areas of Texas within SPP or MISO have transmission systems that cross state lines (and form part of the interstate grid), and thus, are subject to concurrent regulation by the FERC and the Public Utility Commission of Texas ("PUCT"). In these regions, the PUCT sets retail rates for the integrated utilities, Tex. Util. Code § 36.001, but FERC sets wholesale transmission rates; 16 U.S.C. § 824(b). A person must obtain a Certificate of Convenience and Necessity ("CCN") from the PUCT prior to providing transmission and/or distribution services and comply with PUCT safety and reliability rules. Tex. Util. Code §§ 37.051(a), 38.001. Nonetheless, while states retain authority over siting, routing, and permitting transmission, within the ISO's region, it is the ISO, and not the State, that decides whether to approve transmission lines that are part of the grid. *MISO Transmission Owners*, 819 F.3d at 331 (MISO is charged with "planning and supervising the expansion of the electrical transmission system throughout its vast region.").

FERC eliminates rights of first refusal. In 2011, FERC went further to promote competition in transmission by adopting Order No. 1000. Order 1000 required ISOs to remove "rights of first refusal" from their tariffs—that is, preemptive rights to construct all new transmission lines that interconnected with their old lines. FERC also required ISOs to adopt competitive processes to determine who would build certain new transmission lines, in accordance

with regional planning and cost-sharing mechanisms. FERC made these changes because granting incumbents rights of first refusal has "the potential to undermine the identification and evaluation of more efficient or cost-effective solutions to regional transmission needs, which in turn can result in rates for Commission-jurisdictional services that are unjust and unreasonable or otherwise result in undue discrimination by public utility transmission providers." Order No. 1000, 136 FERC ¶ 61051, ¶ 253 (F.E.R.C. July 21, 2011).

ISOs bring competition to Texas and Plaintiffs prevail. In Texas, MISO and SPP are subject to Order No. 1000.[1] Accordingly, they amended their tariffs to remove their rights of first refusal and to implement competitive bidding for certain new transmission projects. MISO adopted an intricate process governing competitive bids and regional cost allocation. While projects to improve local reliability and to repair existing lines are assigned to the incumbent line owner, with costs allocated locally, *MISO Transmission Owners*, 819 F.3d at 335, MISO designated a small number of bigger projects with regional benefits for competitive bidding and regional cost distribution. This case concerns those projects.

In February 2018, MISO started its first competitive process in Texas by soliciting bids for the construction of a transmission line known as the Hartburg-Sabine Transmission Project, to be built in East Texas, but with benefits and costs spilling over into Louisiana. Compl. ¶ 82. MISO received 12 bids from 9 qualified developers to build the line. Compl. ¶ 83. In November 2018, MISO selected NextEra Energy Transmission Midwest, LLC ("NEET Midwest"), to build the line, concluding that NEET Midwest's proposal offered "an outstanding combination of low cost and

[1] In the Electric Reliability Council of Texas, Inc. ("ERCOT,") which is entirely within Texas and not subject to FERC regulation, Texas acted in 2005 to promote competitive transmission to spur development of new lines with the Competitive Renewable Energy Zones ("CREZ") program. Texas Utilities Code § 39.904(g). Compl. ¶¶ 19, 22.

high value, with best-in class cost and design, best-in-class project implementation plans, and top-tier plans for operations and maintenance." Compl. ¶ 83. MISO also indicated that NEET Midwest's bid conveyed "substantial benefits to ratepayers over time." Compl. ¶ 83. After being selected to build the Hartburg-Sabine line, NEET Midwest and MISO entered into a "Selected Developer Agreement" for construction of the project. Compl. ¶ 84.

This case also concerns the sale of existing transmission projects. In late 2017, NextEra Energy Transmission Southwest, LLC ("NEET Southwest") entered into a multi-million dollar agreement to acquire transmission line facilities (the Jackson-Overton line) from Rayburn Country Electric Cooperative, Inc. in the SPP region. Compl. ¶¶ 10, 88. The NEET Southwest/Rayburn contract has received PUCT staff approval, and remains pending before the Commission.

Texas responds with SB 1938, a discriminatory law. Following NextEra's successful bid on the Hartburg-Sabine line and agreement to purchase the Jacksonville-Overton line, Texas passed SB 1938. Under the new law, "[a] certificate for a new transmission facility that directly interconnects with an existing electric utility facility may only be granted to the owner of that existing facility." SB 1938 § 4. Thus, only owners of an "existing facility" in Texas could be allowed to contract with ISOs to build a line connecting to that facility. Enforcement of this law would preclude NextEra from proceeding with either the Hartburg-Sabine project or Jacksonville-Overton transaction and prevents NextEra as well as all other companies, other than existing Texas facility owners, from constructing, acquiring, or owning a new transmission line.

ARGUMENT

I. PLAINTIFFS HAVE PROPERLY PLED A COMMERCE CLAUSE CLAIM

If a state law "[d]iscriminat[es] against interstate commerce in favor of local business or investment," then the law "is *per se* invalid," unless the state "can demonstrate, under rigorous scrutiny, that it has no other means to advance a legitimate local interest." *C & A Carbone, Inc. v.*

Town of Clarkstown, 511 U.S. 383, 392 (1994). State laws that discriminate against out-of-state entities on their face or discriminate in purpose and effect are subject to the virtually *per se* invalidity rule. *See id.; Allstate Ins. Co. v. Abbott*, 495 F.3d 151, 160 (5th Cir. 2007).

A. Senate Bill 1938 is Discriminatory and Per Se Invalid

1. Senate Bill 1938 Discriminates on Its Face

SB 1938 facially discriminates by allowing only in-state businesses—specifically, businesses that own an "existing electric utility facility" within Texas—to construct, own or operate new transmission lines on interstate electrical grids operated by ISOs. SB 1938 § 4. By definition, only companies that are literally "in" Texas (because they own and operate facilities in the state) can compete for the right to build, operate, and sell transmission services, while businesses without a Texas presence are entirely excluded from the transmission market. Limiting competition to a class of purely in-state businesses, while completely excluding businesses outside the state, is facial discrimination and *per se* invalid under the dormant Commerce Clause. *Tenn. Wine & Spirits*, 139 S. Ct. at 2457 (striking down in-state residency requirement, as it "blatantly favors the State's residents"); *Granholm v. Heald*, 544 U.S. 460, 475 (2005).

Defendants admit that SB 1938 creates a "preference for incumbents," Mtn. 11, ignoring the long history of courts striking down laws protecting incumbent local monopolies by limiting competition from non-local businesses in interstate commerce. *Carbone*, 511 U.S. at 392 (although ordinance favored only "a single local proprietor," this fact "just makes the protectionist effect of the ordinance more acute"); *Dean Milk Co. v. City of Madison*, 340 U.S. 349, 356 (1951) (striking down "an economic barrier protecting a major local industry against competition from without the State"). Indeed, in this way, SB 1938 resembles the "flow control" laws that the Supreme Court has struck down for decades. In "flow control" cases, a law requires that all waste in a given region be processed in a single in-state facility, or precludes out-of-state waste producers from using in-

state facilities. *Carbone*, 511 U.S. at 383, 391 ("the flow control ordinance is just one more instance of local processing requirements that we long have held invalid"); *Fort Gratiot Sanitary Landfill Inc. v. Mich. Dept. of Nat. Res*, 504 U.S. 353, 361 (1992). Courts have routinely found flow control laws facially discriminatory because they allow "only the favored operator to process waste." *Carbone*, 511 U.S. at 391. Texas' law suffers the same defect as the countless flow control ordinances that have been struck down: It secures lucrative business opportunities, the right to build and operate transmission lines, for favored local operators. SB 1938 therefore "squelches competition in" transmission "service altogether, leaving no room for investment from outside." *Id* at 392. If a state could enact facially discriminatory laws giving in-state incumbents a monopoly when competing for interstate commerce—whether that would be for waste processing, *Carbone*, milk pasteurization, *Dean Milk*, or highway transportation services, *Buck*—there would not be much left of the dormant Commerce Clause viewed so central to the Constitution. Where a system operator solicits bids for transmission lines to support an interstate grid, Texas's "preference for incumbents" here is no more lawful than in these other businesses.[2] Other than a single Minnesota district court decision, Defendants can point to no case—and we are aware of none—where courts have sustained a state law that reserves interstate benefits, such as the right to do business with an ISO here, to only companies that have a preexisting physical presence in the state.[3]

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[2] Defendants rely on a one Fourth Circuit case for the idea that "incumbency is not the focus of the dormant Commerce Clause." *Colon Health Centers of Am., LLC v. Hazel*, 813 F.3d 145, 154 (4th Cir. 2016). But neither party there argued that the law was facially discriminatory, and the court distinguished decisions striking down similar programs because studies showed "no appreciable difference in the treatment of in-state and out-of-state entities." *Id.* at 153.

[3] The Minnesota decision, *LSP Transmission Holdings, LLC v. Lange*, 329 F. Supp. 3d 695 (D. Minn. 2019), upholding a right-of-first refusal law for electric transmission projects is on appeal in the 8th Circuit, where the appellant and the United States have argued that the decision is flawed and should be vacated and remanded. Br. of United States, *LSP Transmission Holdings, LLC v. Lange*, No. 18-2559, at 5-17(8th Cir. 2018); *see also* Statement of Interest, *LSP Transmission Holdings, LLC v. Lange*, No. 17-cv-04490, at 2 (D. Minn. 2017) ("[T]he United States believes

Defendants wrongly argue SB 1938 makes a permissible distinction "based on business form." Mtn. at 11. But under the law, any business with an "existing facility" can build transmission connecting to that facility, regardless of what form the business takes. Thus, many different businesses can build new transmission in Texas—including not just the supposedly favored vertically integrated utilities, but also transmission-only companies, municipalities, and cooperatives. The common denominator between these is not their business form, but the presence of their facilities in the state of Texas. Moreover, a "restrictive in-state presence requirement violates the Commerce Clause, even if it is combined with a business-form requirement. *See, e.g., Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 42 (1980), *Granholm*, 544 U.S. at 474-75.

Texas's demand for pre-existing physical presence is especially concerning in MISO and SPP, where SB 1938 limits competition for classic instrumentalities of interstate commerce: transmission lines connected to interstate electrical grids, operated by multistate independent system operators. *New York*, 535 U.S. at 7 ("any electricity that enters the grid immediately becomes a part of a vast pool of energy that is constantly moving in interstate commerce"). This is unlike the business-form or incumbency-protection cases that Texas relies on, which dealt with local businesses like liquor stores, body shops, or medical-service providers.[4]

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that a state law which grants local electricity monopolists the right to obtain new monopolies in transmission projects in interstate commerce . . . unconstitutionally regulates interstate commerce in violation of the dormant Commerce Clause.").

[4] This in-state presence requirement distinguishes this case from the business-form cases that Texas relies on, none of which included such a requirement. In *Walmart Stores Inc. v. Tex. Alco. Bev. Comm'n*, No. 18-50299, 2019 WL 3822150 (5th Cir. Apr. 14, 2019), the court addressed a law precluding public corporations from obtaining permits to sell liquor at retail, and remanded a decision striking down the law for further consideration. The *Walmart* law distinguished only between public and private corporations; in-state presence was not required to obtain the necessary permit. *Id.* at *7. In *Allstate Ins. Co. v. Abbott*, 495 F.3d 151 (5th Cir. 2007), the court rejected a Commerce Clause challenge to a law preventing auto insurers from owning body shops in Texas. Again, the law distinguished only between insurers and non-insurers, and did not exclude insurers based on their lack of in-state presence. *See id.* at 162-63. Similarly, *Ford Motor Co. v. Tex. Dep't*

Here the facial discrimination is particularly egregious because SB 1938 will necessarily affect new transmission projects that must be funded by all regional participants in the grid, including those located in other states. Whatever Texas's power to limit competition in local concerns, Texas cannot connect to interstate grids and then limit competition for the transmission lines that serve the entire grid. *See Ark. Elec. Co-op. Corp. v. Ark. Pub. Serv. Com'n*, 461 U.S. 375, 377 (1983) ("[T]ransmission of energy is an activity particularly likely to affect more than one State, and its effect on interstate commerce is often significant enough that uncontrolled regulation by the States can patently interfere with broader national interests."); *Buck v. Kuykendall*, 267 U.S. 307, 316 (1925) (striking down certificate-of-need requirement for use of interstate highways because it was "a regulation, not of the use of [the state's] own highways, but of interstate commerce").

2. Senate Bill 1938 Discriminates in Effect

Defendants do not seriously dispute that the effect of SB 1938 will be to exclude all companies that currently lack physical presence in Texas from building, owning, or operating transmission in the state in an area where there could be competition under FERC Order 1000. That is a textbook discriminatory effect. *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 271 (1984) ("[T]he effect of the exemption is clearly discriminatory, in that it applies only to locally produced beverages[.]"). Defendants argue (without citation) that SB 1938 is not discriminatory because "many out-of-state entities are favored, and some in-state entities are disfavored[.]" Mtn. at 15. But it is well established that a law "is no less discriminatory because in-state or in-town processors

of Transp., 264 F.3d 493 (5th Cir. 2001) upheld a law prohibiting an auto manufacturer from owning a dealership or selling cars at retail—again, discriminating between manufacturers and non-manufacturers, without distinguishing based on presence, *id.* at 498. All of these "business form cases" rely on *Exxon Corp. v. Maryland*, 437 U.S. 117 (1978), which similarly distinguished between business types (there, petroleum producers and refiners were precluded from operating retail service stations) without distinguishing between in- and out-of-state presence.

are also covered by the prohibition." *Carbone*, 511 U.S. at 391.

Nor is it correct that many out-of-state entities are favored. All of the utilities benefitted by SB 1938 are Texas companies. Defendants are arguing that they really should not be considered Texas companies because they are ultimately controlled by out-of-state interests. Mtn. at 15. But Defendants cite nothing in support of their view that ultimate beneficial ownership determines which companies are in-state under the commerce clause. To the contrary, Courts have routinely found discriminatory effects when a state reserves benefits to businesses "according to the extent of their contacts with the local economy" without any consideration of beneficial ownership or ultimate control. *Lewis*, 447 U.S. at 42. *See also Granholm*, 544 U.S. at 475 (not considering whether New York's wineries were owned by New York citizens); *W. Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 194 (1994) (not considering whether Massachusetts dairy farms were owned by out-of-state interests); *Fla. Transp. Servs. v. Miami-Dade Cty.*, 703 F.3d 1230 (11th Cir. 2012) (rejecting law favoring local operators even though some were incorporated out of state).

What is important in determining whether a business is in-state is whether it has a meaningful in-state presence, as do each of the Texas utilities favored by S.B. 1938. The Commerce Clause analysis does not turn on where its beneficial owners or a parent company resides. Indeed, were beneficial ownership the touchstone, Texas could pass a law allowing only Exxon Mobil to own gas stations in Texas and then defend the law on the grounds that Exxon's shareholders are domiciled around the world. Or Texas could pass a law limiting business opportunities in Texas only to companies that currently employ Texas workers—an obvious Commerce Clause violation—even if these companies were headquartered out of state.

3. Senate Bill 1938 Was Passed With Discriminatory Purpose

Defendants argue that SB 1938 is not motivated by a protectionist purpose because Texas had purportedly good reasons for preferring its in-state transmission providers. Mtn. at 11-13. That

gets the inquiry wrong by confusing purpose with motive. At the initial stage of determining whether a law is discriminatory, courts do not ask whether the State had a good motivation for discriminating against interstate commerce; they only ask whether the State purposefully discriminated. *See Bacchus*, 468 U.S. at 273 (finding discriminatory intent notwithstanding state's motive of promoting local industry); *S.D. Farm Bureau, Inc. v. Hazeltine*, 340 F.3d 583, 593, 596-97 (8th Cir. 2003) (analyzing local interests after finding discriminatory purpose). Once that question is answered, then the State may attempt to justify its discrimination. *Carbone*, 511 U.S. at 392.

When, as here, "a clear pattern of discrimination emerges from the effect of the state action," courts may infer discriminatory intent. *Allstate*, 495 F.3d at 160. As explained above, SB 1938 has the clear effect of protecting in-state operators from out-of-state competition.

But even going further, the "the historical background of" SB 1938 shows discriminatory purpose. *Id.* SB 1938 was passed in response to the recent introduction of competitive transmission following the implementation of FERC Order No. 1000. Prior to FERC Order No. 1000, Texas had accepted the benefits of out-of-state transmission development by using out-of-state, transmission-only companies to build certain CREZ lines. *See* n.1, *supra*. Texas law further allowed the PUCT to certificate transmission-only companies both inside and outside of ERCOT.[5] Chairman Phelan, the sponsor of the house bill made clear that SB 1938 was introduced in response to "doors opened by FERC with their order." House State Affairs Committee, April 1, 2019 at 8:41:02-8:41:43; *see also* Compl. ¶ 61. It is thus no accident that SB 1938 was adopted

[5] *Pub. Util. Comm'n of Tex. v. Cities of Harlingen*, 311 S.W.3d 610, 616-21 (Tex. App.—Austin 2010, no pet.); *Sw. Pub. Serv. Co. v. Pub. Util. Comm'n of Tex.*, No. D-1-GN-18-000208 (459th Dist. Ct., Travis County, Tex. Sept. 27, 2018); Tex. Pub. Util. Comm'n, *Joint Petition of Southwestern Public Service Company and Southwest Power Pool, Inc. for Declaratory Order*, Docket No. 46901 (Oct. 26, 2017) (Order).

immediately following the Hartburg-Sabine bid, which was the first MISO-run competitive bid in Texas in which the Texas incumbent lost. *See Lewis*, 447 U.S. at 32 (noting that Florida legislature acted to curtail market in response to introduction of competition). Indeed, the legislative record is clear that SB 1938 arose because of complaints about this type of interstate competition. Compl. ¶ 61. It was then introduced late in the session and sped through the legislature, even though the Department of Justice took the extraordinary step of writing to the Texas Legislature and informing it that there were significant constitutional and practical concerns with the bill it was considering. Compl. ¶ 65. The contemporaneous statements of lawmakers also show a discriminatory purpose. The sponsor of the house bill, Representative Phelan, flat out said he was discriminating against out-of-staters, stating, "transmission operations are best managed by accountable companies with boots on the ground in our communities." Compl. ¶ 64.[6]

B. The State Has Not Satisfied Its High Burden of Justifying Its Discriminatory Statute

Because SB 1938 discriminates against interstate commerce on its face, in effect, and on purpose, the law is "virtually *per se* invalid." *Or. Waste Sys.*, 511 U.S. at 99. As a result, SB 1938 "must be invalidated" unless Texas can show that the law "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *Id.* at 100-01 (quotations omitted). This is a "strict[]" test; indeed, the "State's burden of justification is so heavy that 'facial discrimination by itself may be a fatal defect.'" *Id.* at 101. The State cannot come close to meeting its burden, and indeed, Texas does not even suggest that it can.

SB 1938 cannot be justified as a matter of reliability. Mtn. at 12. All transmission providers

[6] Texas argues that in context this statement really just expresses a preference for state regulation and local management. But that is just another way of saying that Texas passed a law to protect local companies at the expense of out-of-staters, which is not a defense at all. Texas also claims that even though the statement is protectionist, it was stray, but the statement was made by the Bill sponsor and occurred in the very explanation of why the Bill was introduced in the first place.

must meet federal reliability standards, and thus, it is dubious that Texas' incumbents possess any special reliability skills. *See* Order No. 1000, 136 FERC ¶ 61051, at ¶ 266 (F.E.R.C. July 21, 2011). Indeed, Texas allowed out-of-staters to build lines in the CREZ program without suffering any reliability problems. Compl. ¶ 80. Regardless, "neutral alternatives" are "adequate to protect [the state's] interests." *Cooper v. McBeath*, 11 F.3d 547, 554 (5th Cir. 1994). The federal ISO can—and does—consider reliability in awarding project bids. Order No. 1000, 136 FERC ¶ 61051, at ¶ 264. Once a project is awarded, the winning bidder must seek a certificate from the PUCT for the line to operate, and in that process the PUCT may use all of its traditional powers to ensure reliable service before granting the certificate. Tex. Util. Code § 37.051. Moreover, once a line is approved, the new transmission company will become a Texas "electric utility," and accordingly, will be subject to PUCT regulations to ensure that "its service, instrumentalities, and facilities . . . are safe, adequate, efficient, and reasonable," Tex. Util. Code § 38.001, including by following the standards promulgated by the National Electrical Safety Code. Tex. Util. Code § 38.0004. The significant regulation of transmission reliability in Texas shows that there is no "reason to conclude that outright prohibition of entry, rather than some intermediate form of regulation, is the only effective method of protecting against [Texas'] presumed evils[.]" *Lewis*, 447 U.S. at 43.

Texas also cannot justify SB 1938 as a matter of cost. Mtn. at 13. To the contrary, FERC has already found that "competition among firms for the right to build transmission facilities would result in lower rates to consumers of electricity." *MISO Transmission Owners*, 819 F.3d at 333. If out-of-staters cannot offer Texas lower prices or better service in competition, it follows that federal ISOs will not select them to build lines. Compl. ¶ 83 (NextEra included significant cost caps in the Hartburg-Sabine bid). In addition, the PUCT still possesses rate making power to ensure that Texas distribution customers pay reasonable rates for electricity. Tex. Util. Code § 36.001.

Nor can Texas justify SB 1938 as a matter of allocative efficiency. SB 1938 only affects certain larger projects subject to competition under federal tariffs. For these large projects, whose costs will be borne across state lines, FERC has already found that the benefits of competition outweigh the costs. As FERC explained, large projects need a "robust process" to identify and provide "regional solutions to regional needs." Order No. 1000, 136 FERC ¶ 61051, at ¶ 320.

Finally, Texas' purported desire to preserve PUCT jurisdiction in areas outside of ERCOT that clearly involve interstate commerce cannot save SB 1938. Mtn. at 13-14. Texas cites no authority for its remarkable claim that a State has a legitimate interest in *avoiding* federal regulation of interstate commerce. But even assuming that ousting FERC jurisdiction is a legitimate State interest, there is no reason to think that SB 1938 creates rate-making jurisdiction where it did not otherwise already exist. Compl. ¶ 76. In other cases, the State of Texas has acknowledged as much. Five months ago, the State conceded that: "Certificating transmission owned by transmission-only electric utilities outside of ERCOT will result in no change of jurisdiction or change in procedures at the Commission." Br. of Texas, *Entergy v. Pub. Util. Comm.*, No. 03-18-006666-CV (3d Ct. App.), at 30. SB 1938 does not alter that conclusion.

C. *Tracy* Does Not Save the State's Discriminatory Law

The Supreme Court's decision in *General Motors v. Tracy*, 519 U.S. 278 (1997), does not save SB 1938. *Tracy* does not exempt regulated utilities from Dormant Commerce Clause analysis or require courts to simply defer to state justifications for discrimination. On the contrary, the Supreme Court stated that "utilities should not be insulated from our contemporary dormant Commerce Clause jurisprudence by formalistic judge-made rules." *Id.* at 291 n.8. Defendants' argument also flies in the face of U.S. Supreme Court precedent applying the Commerce Clause in the regulated utility field, *see, e.g.*, *Wyoming v. Oklahoma*, 502 U.S. 437 (1992); *New England Power Co. v. New Hampshire*, 455 U.S. 331 (1982), and is contrary to the position of the federal

government. See Br. of the United States, *LSP Transmission Holdings, LLC v. Lange*, No. 18-2559, at 10-15 (8th Cir. 2018).

Nor does *Tracy*'s holding or analysis apply here—for several reasons. *First*, the Supreme Court recognized in *Tracy* that "[o]f course, if a State discriminates against out-of-state interests by drawing geographical distinctions between entities that are otherwise similarly situated, such facial discrimination will be subject to a high level of judicial scrutiny[.]" *Tracy*, 519 U.S. at 307 n.15. Unlike the law in *Tracy*, that is exactly what is at issue here. SB 1938 does not draw a line between utilities and others, rather it separates those who operate in-state and those who do not.

Second, *Tracy* turned on the fact that the entities in that case were not similarly situated as the Court found that local utilities' core customers—the captive retail gas purchasers—could only purchase from local utilities, not marketers, and thus marketers and local utilities primarily served different markets. *Id.* at 302. Here Defendants *concede* that there is only one market at issue: the market for interconnected transmission services. Mtn. at 9.[7] Whereas *Tracy* involved a state's decision to apply different taxes to different products sold primarily in different markets, here Texas has entirely excluded out-of-state transmission providers from the single market for constructing, owning, and operating transmission lines, including those which an ISO opens to competitive processes. Thus, unlike *Tracy*, Texas' law does not treat two different products in separate markets differently; it treats two competitors for the same project differently based on whether one is the in-state incumbent.[8] Because there is only one transmission market and product,

[7] Texas relies on *Allco Fin. Ltd. v. Klee*, 861 F.3d 82 (2d Cir. 2017), where the Second Circuit allowed Connecticut to give "renewable energy credits" only to generators connected to the ISO-NE grid. As in *Tracy*, the *Allco* court found that the law discriminated between products in different markets that did not compete. *Id.* at 105. But, as Texas concedes, there is only one market here.

[8] *See Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 583 n.16 (1997) ("[T]his case is quite unlike [*Tracy*]. There, the Court premised its holding that the statute at issue was not facially discriminatory on the view that sellers of 'bundled' and 'unbundled' natural gas

the in- and out-of-state utilities here are "similarly situated" for purposes of facial discrimination under the Commerce Clause. Thus, this case is not like *Tracy* but rather like *Tennessee Wine*, *Granholm*, and *C & A Carbone, Inc*., where the Court struck down facially discriminatory laws.[9]

Third, unlike *Tracy*, this case involves Texas upsetting decisions by an interstate entity, an ISO, regarding the allocation and building of transmission projects for the *interstate* transmission service it will then provide to retail utilities. Defendants wrongly assert that the case "only involves a fully regulated Texas transmission market." Mtn at 9. To the contrary, SB 1938 allows Texas to limit who can compete for contracts (those in Texas) with an ISO that is charged with identifying appropriate regional transmission projects, selecting those that are appropriate for competitive bidding, and then identifying from the bids the best entity with which the ISO chooses to work to deliver reliable transmission at the best price. The ISO then contracts with utilities to build those transmission facilities, requiring both in- and out-of-state participants in the grid to fund the new project. Defendants' assertion that the statute applies "only to transmission lines in Texas, and does not purport to regulate the flow of electricity in interstate commerce," ignores that these are interstate transmission lines and that "transmission of energy is an activity particularly likely to affect more than one State." *Ark. Elec. Co-op.*, 461 U.S. at 377.

Fourth, unlike in *Tracy*, there is no danger that a decision by this Court could jeopardize a captive retail utility market, and Texas does not even suggest it could. Even absent SB 1938, proposed transmission projects must go through a competitive bidding process and are subject to

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were principally competing in different markets."); *Jordan v. Dep't of Motor Vehicles*, 75 Cal. App. 4th 449, 462 (1999) (noting same distinction).

[9] *See also Fort Gratiot*, 504 U.S. at 361 (invalidating flow control statutes that gave "local waste producers complete protection from competition from out-of-state waste producers"); *State ex rel. Brady v. Preferred Florist Network, Inc.*, 791 A.2d 8, 18 n.28 (Del. Ch. 2001) (*Tracy* "inapposite" when statute "patently discriminates against businesses based on their geographic location").

approval by the PUCT and the system operator, both of whom can monitor any new projects for adverse effects on consumers. Moreover, FERC, the federal agency with expertise here has already determined that a right of first refusal, like the one created by SB 1938, is neither necessary nor helpful for protecting consumers. Thus, this Court need not "predict the effects of judicial intervention" here, *Tracy*, 519 U.S. at 304, because federal and state regulators will be able to monitor any new entrants to the transmission market and ensure that consumers are protected.

D. Neither Congress Nor FERC Gave Texas License to Discriminate

Defendants argue that FERC or the Federal Power Act authorizes its discriminatory law. *First*, the fact that FERC has not preempted a state law does not mean that FERC insulated it from a Commerce Clause challenge. *Wyoming*, 502 U.S. at 458 (decision not to preempt is not approval to violate Commerce Clause); *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941, 960 (1982). Even so, Defendants are wrong when they claim FERC declined to find that right-of-first-refusal laws violated the dormant Commerce Clause. Mtn at 16. FERC Chairman Bay made this point explicit in his concurrence approving the MISO tariff, where he noted: "The Commission's order today does not determine the constitutionality of any particular state right-of-first-refusal law. That determination, if it is made, lies with a different forum, whether state or federal court." *Midwest Indep. Transmission Sys. Operator, Inc.*, 150 FERC ¶ 61037, 61195 (F.E.R.C. Jan. 22, 2015) (Bay, Comm'r, concurring). Thus, FERC's decision not to preempt, does not absolve SB 1938 from Commerce Clause scrutiny. *Second*, as for the Federal Power Act, the only provision Texas cites simply preserves state power where FERC lacks it. 16 U.S.C.§ 824(a). But that cannot bless discriminatory state laws. Texas concedes FERC has power over wholesale transmission, and therefore, its statutory citation is inapplicable—this is not an area reserved to the states. Indeed, in *Wyoming*, the Supreme Court reviewed the same section, 16 U.S.C. § 824, and concluded that "[o]ur decisions have uniformly subjected [dormant] Commerce Clause cases implicating the

Federal Power Act to scrutiny on the merits." 502 U.S. at 458; *accord New England Power*, 455 U.S. at 341 ("[n]othing in the legislative history or language of the [Federal Power Act] evinces a congressional intent to alter the limits of state power otherwise imposed by the Commerce Clause" (quotation marks and citation omitted)).

II. SB 1938 FAILS UNDER *PIKE*

Even laws that do not directly discriminate are unconstitutional if they impose burdens on interstate commerce that are "clearly excessive in relation to the putative local benefits." *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970). This test is fact-intensive, and therefore, is generally inappropriate for resolution before discovery. *Teladoc, Inc. v. Texas Med. Bd.*, 1-15-CV-343 RP, 2015 WL 8773509, at *12 (W.D. Tex. Dec. 14, 2015). Here, NextEra has adequately pleaded a *Pike* claim because SB 1938 imposes clearly excessive burdens on interstate commerce.

NextEra has alleged facts sufficient to show that SB 1938 itself burdens interstate commerce. *See Pioneer Military Lending, Inc. v. Manning*, 2 F.3d 280, 283 (8th Cir. 1993) (burden on single firm can violate Commerce Clause). Indeed, the burden here is significantly greater than the burden condemned by *Pike* itself: NextEra is entirely precluded from a hundred-million-dollar interstate opportunity, whereas in *Pike*, Arizona required a cantaloupe grower to invest only $200,000 in a packing plant before shipping out-of-state. *Pike*, 397 U.S. at 145. Moreover, in assessing burden, courts examine "not only . . . the consequences of the statute itself, but also . . . what effect would arise if not one, but many or every, State adopted similar legislation." *Healy v. Beer Inst., Inc.*, 491 U.S. 324, 336 (1989). If every State adopted a law like SB 1938, the cumulative effect of such statutes would nullify FERC's abolition of federal right of first refusals and eliminate competition in the transmission market, taking away the benefits of greater reliability and lower prices FERC sought in Order 1000. *Cf. Ark. Elec. Co-op*, 461 U.S. at 377 ("uncontrolled regulation by the States" of transmission "can patently interfere with broader national interests").

NextEra's well-pled allegations that SB 1938's burdens substantially outstrip its benefits requires denial of Defendants' motion. Compl. ¶¶ 75-77, 103. Indeed, as explained above, the justifications of SB 1938 are wholly illusory, particularly in light of the federal ISOs and Texas' preexisting authority to ensure cheap, efficient, safe, and reliable transmission. *Piazza's Seafood World, LLC v. Odom*, 448 F.3d 744, 750 (5th Cir. 2006) (under *Pike*, courts must examine whether local benefit could be obtained with a lesser impact on interstate commerce). At the motion to dismiss stage, it cannot be shown as a matter of law that this total exclusion of competition for interstate transmission lines will not impose a significant burden on interstate commerce—and thus, NextEra's *Pike* claim should proceed.

III. NEXTERA HAS PROPERLY PLED A CONTRACTS CLAUSE CLAIM

The Contracts Clause imposes limits on a state's power to "abridge *existing contractual relationships*, even in the exercise of its otherwise legitimate police power." *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 242 (1978). The Supreme Court has confirmed that the "threshold inquiry is whether the state law has, in fact, operated as a substantial impairment of *a contractual relationship*." *Energy Reserves Grp., Inc. v. Kan. Power & Light Co*., 459 U.S. 400, 411 (1983) (citation omitted) (emphasis added). The Selected Developer Agreement ("SDA"), which is such a "contractual relationship," provides that NEET Midwest will "construct, implement, own, operate, maintain, repair, and restore" the Hartburg-Sabine line." (SDA at p. 2.) It is that right to construct the line—a result of NextEra being selected in a rigorous, competitive bidding process—that SB 1938 not only impairs, but destroys. While NEET Midwest is required under the SDA to "seek and obtain all required authorizations or approvals from Governmental Authorities as soon as reasonably practicable[,]" *id*. Article 23.1, it is not conditioned on approval by the PUCT.[10]

[10] Effectiveness of the SDA is expressly conditioned on acceptance by FERC of the required "financial security." SDA. Article 2.1.

Enactment of SB 1938 made such approval impossible, by definition impairing NEET Midwest's rights under the SDA. Similarly, SB 1938 has outright precluded NEET SW from proceeding with its contract for the purchase of the Jacksonville-Overton transmission line. Compl. ¶ 107.

The State argues that "because the electric industry is heavily regulated … further regulation of the industry is not an impairment of any alleged NextEra rights." Mtn. at 19. But the Supreme Court has repeatedly made clear that "whether the industry the complaining party has entered has been regulated in the past" is simply one factor the court must consider in "determining the extent of the impairment." *Energy Reserves*, 459 U.S.at 411; *United Healthcare Ins. Co. v. Davis*, 602 F.3d 618 (5th Cir. 2010) (Contracts Clause violated in heavily regulated healthcare industry).

A further "important consideration in [the] substantial impairment analysis is the extent to which the law upsets the reasonable expectation the parties had at the time of contracting, regarding the specific contractual rights the state's action allegedly impairs." *United Healthcare*, 602 F.3d at 627. Those reasonable expectations are gauged against the nature of existing regulation of the industry. In particular, "[c]ourts look to *the terms of the contract* to determine the parties' reasonable expectations, including whether the risk of a change in the law was contemplated at the time of contracting." *Id.* at 628 (emphasis added). Here, when NextEra entered into the SDA, there was no Texas law precluding non-incumbents from building transmission lines in Texas. Indeed, it would have made no sense for MISO to go through the time, expense, and effort of running a rigorous and competitive bidding process—with nine entities submitting twelve proposals—if it expected the entity it determined was best-suited for the job would be prevented from doing it simply because it was not an incumbent. Compl. ¶¶ 81-84. Nor would it have made sense for NextEra to devote its resources to preparing its bids for the project if it anticipated that SB 1938

would make that investment worthless. *Six Kingdoms Enterprises, LLC v. City of El Paso*, 2011 WL 65864, at *6 (W.D. Tex. Jan. 10, 2011) ("It would not have been a rational business investment . . . to open this franchise in a market subject to potential regulations of the type at issue[.]").

The facts here are thus different from those in *Energy Reserves*, cited by Defendants, which turned on new regulation that was contemplated by the parties at the time of contracting. There, the challenged law regulated prices for natural gas. Because the contracts "suggest[ed] that the [gas company] knew its contractual rights were subject to alteration by state price regulation," the court found that the gas company's "reasonable expectations [had] not been impaired" by the new law regulating gas prices. *Energy Reserves*, 459 U.S. at 416. That is not the case here.

Resolution of the question of impairment is particularly inappropriate on a motion to dismiss when, as here, the challenged law destroys a party's contractual rights. "The severity of the impairment is said to increase the level of scrutiny to which the legislation will be subjected." *Energy Reserves*, 459 U.S. at 411. "Severe impairment…will push the inquiry to a careful examination of the nature and purpose of the state legislation." *Allied Structural*, 438 U.S. at 245.

Furthermore, as the Fifth Circuit has recognized, the use of the State's police power to impair contract rights is limited to "remedying a broad and general social problem." *United Healthcare*, 602 F.3d at 631. This is yet another fact-driven inquiry, in which the court must determine whether a "broad and general social problem" that would justify SB 1938 even exists here. *Nat'l Solid Wastes Mgmt. Assoc. v. City of Dallas*, 2012 WL 13055145, at *10 (N.D. Tex. Jan 31, 2012). The issues raised by the State are not appropriate for a motion to dismiss. *Kuritz v. New York*, 2012 WL 6020039, at *22 (N.D.NY. Dec. 3, 2012).

CONCLUSION

For the foregoing reasons, NextEra requests that Texas' motion to dismiss be denied.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

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