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# THE 1989 NELPI ENERGY LAW ESSAY

## A JUST INJUSTICE: *MISSISSIPPI POWER & LIGHT CO. v. MISSISSIPPI*\*

Lorie J. Harris†

### I. INTRODUCTION

“If the regulated accept regulation, . . . they must be reconciled to the goldfishbowl life.”<sup>1</sup> The actions of a regulated entity are always subject to review. Review of a regulated entity includes after-the-fact examination of the reasonableness of its actions, frequently focusing on whether management acted prudently. The Federal Energy Regulatory Commission (FERC)<sup>2</sup> and the state utility commissions have exclusive jurisdiction, each independent of the other within its limits of authority. In addition, what is within the FERC’s jurisdiction, is not subject to review by the states.<sup>3</sup> A problem arises when the FERC examines a regulated entity’s actions, looks at the goldfish and calls the fish white, while the state utility commission looks at the same fish and calls it black.

In *Mississippi Power & Light Co. v. Mississippi*<sup>4</sup> the Supreme Court made it clear that where the FERC allocates expenses to operating utilities of a holding company, states are preempted from reviewing the prudence of those same expenses or the FERC allocation. If the state

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\* Winning essay of the Thirteenth Annual National Energy Law and Policy Institute Energy Law Essay Competition.

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1. 1 A. PRIEST, PRINCIPLES OF PUBLIC UTILITY REGULATION 13 (1969).

2. Congress created the Federal Power Commission in 1935. It was renamed and somewhat reorganized into the Federal Energy Regulatory Commission in 1974.

3. 2 A. PRIEST, *supra* note 1, at 555. See also W. FOX, FEDERAL REGULATION OF ENERGY, 128-29 (Supp. 1989).

4. 108 S.Ct. 2428 (1988).

commission believes that the expenses included in the wholesale power allocation to the operating company are unreasonable, it must raise its objections to the FERC. Thus, the state role is not to judge the reasonableness of the actions on which the FERC allocations are premised. Rather, the state commission must advocate its position regarding the prudence of those actions before the FERC.

## II. THE FACTS IN THE *MISSISSIPPI POWER* CASE

Mississippi Power & Light (MP&L) is one of four operating companies owned by Middle South Utilities, Inc. (Middle South).<sup>5</sup> Middle South is a registered holding company under the Public Utility Holding Company Act of 1935.<sup>6</sup> Three other operating companies owned by Middle South are Louisiana Power & Light Co. (LP&L), New Orleans Public Service, Inc. (NOPSI), and Arkansas Power & Light Co. (AP&L).<sup>7</sup> All of the operating companies sell electricity at both wholesale and retail.<sup>8</sup>

Interaction between the four operating companies of the Middle South system was specified by three "System Agreements."<sup>9</sup> These agreements were filed with the FERC in 1951, 1973, and 1982.<sup>10</sup> The purpose of the System Agreements was to coordinate the planning, operation, and construction of electrical generation plants for the operating companies and to provide a means of equalizing any imbalance in costs resulting from the construction, ownership, and operation of facilities used for the mutual benefit of all companies.<sup>11</sup>

In the late 1960's Middle South began diversifying from its predominately oil and gas based generation facilities to coal and nuclear facilities.<sup>12</sup> One of the Middle South operating utilities, AP&L, had insufficient capacity to meet the demands of its customers.<sup>13</sup> AP&L was the first of the operating companies to construct a nuclear power plant, bringing on line Arkansas Nuclear Unit 1 in 1974.<sup>14</sup> Unit 2 came on line

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5. *Id.* 2431.

6. *Id.* at 2432 n.4; See Public Utility Holding Company Act of 1935, ch. 2c, 15 U.S.C. § 79a-79z-6 (1982).

7. *Mississippi Power*, 108 S.Ct. at 2431 n.1.

8. *Id.* at 2431.

9. *Id.*

10. *Id.*

11. *Id.* see also *Mississippi Industries v. FERC*, 808 F.2d 1525, 1529 (D.C. Cir. 1987).

12. *Mississippi Power*, 108 S.Ct. at 2431.

13. *Mississippi Industries*, 808 F.2d at 1531.

14. *Id.*

in 1980.<sup>15</sup> The combined capacity cost of the two plants was approximately \$500 per kilowatt.<sup>16</sup> Two additional nuclear power plants were planned and constructed by Middle South. One was the Waterford 3 unit, assigned to LP&L, and the other was Grand Gulf 1, initially assigned to MP&L.<sup>17</sup> The original planned capacity cost estimates per kilowatt for these plants were comparable to the actual costs of the Arkansas plants.<sup>18</sup> By the time Grand Gulf began commercial operation, however, the capacity cost was over \$2,900 per kilowatt.<sup>19</sup>

After Grand Gulf was assigned to MP&L, it became apparent that MP&L on a stand-alone basis lacked the financial resources to construct the plant due to the magnitude of the construction costs.<sup>20</sup> Thus in 1974, Middle South formed a new subsidiary, Middle South Energy, to finance Grand Gulf and each of the Middle South operating companies agreed to put their credit standing behind the plant.<sup>21</sup> In April 1982, Middle South filed a new System Agreement with the FERC which governed the exchange of power between the operating companies.<sup>22</sup> In June 1982, Middle South filed a Unit Power Sales Agreement (UPSA) with the FERC which allocated the output of Grand Gulf between the operating companies.<sup>23</sup> Although all of the operating companies signed the UPSA, none of the output of Grand Gulf was assigned to AP&L.<sup>24</sup>

### III. HISTORY OF THE CASE

#### A. *The FERC Proceedings*

When Middle South filed the System Agreement with the FERC, the agency instituted a proceeding to determine if the agreement was "just and reasonable within the meaning of the Federal Power Act."<sup>25</sup> When the UPSA was filed a few months later the FERC instituted a second, separate proceeding to determine if this second agreement was just and reasonable.<sup>26</sup> Two administrative law judges (A.L.J.), A.L.J. Head and A.L.J. Liebman, reviewed the allocation of the Grand Gulf

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15. *Id.* at n.15.

16. *Id.* (Capacity is the total amount of power generation capability available).

17. *Mississippi Industries*, 808 F.2d at 1531.

18. *Id.* at 1531 n.16.

19. *Mississippi Power*, 108 S.Ct. at 2432 n.5.

20. *Mississippi Industries*, 808 F.2d at 1533.

21. *Id.*

22. *Id.* at 1534.

23. *Id.* at 1533.

24. *Id.*

25. *Mississippi Power*, 108 S. Ct. at 2433.

26. *Id.*

expenses and concluded that the filed agreements should be rejected. However, they each determined a different method for allocating the costs of Grand Gulf among all of the operating companies.<sup>27</sup>

The FERC reviewed each of the A.L.J.'s opinions and affirmed their findings that Middle South operated as a highly integrated system.<sup>28</sup> The FERC, however, rejected A.L.J. Head's finding that Grand Gulf was an anomaly to the system's historic approach of planning and constructing new units to satisfy individual operating company's needs. Instead, the FERC adopted A.L.J. Liebman's findings that the Middle South nuclear units were constructed to meet the needs of the whole system and the fact that some were more expensive than others was simply a function of timing and problems unique to the nuclear industry.<sup>29</sup> It concluded that the 1982 System Agreement combined with A.L.J. Liebman's allocation proposal would result in "just and reasonable results."<sup>30</sup> The resulting allocation method gave rise to the assignment of 36% of the costs of nuclear capacity to AP&L, 33% to MP&L, 14% to LP&P, and 17% to NOPSI.<sup>31</sup> The UPSA filed by Middle South had allotted none of the cost of Grand Gulf to AP&L, 31.63% to MP&L, 38.57% to LP&L, and 29.80% to NOPSI.<sup>32</sup>

B. *Review of the FERC's Decision by the United States Court of Appeals for the District of Columbia*

Consolidating eighteen petitions for review of the FERC decision regarding Grand Gulf, the United States Court of Appeals for the District of Columbia addressed the issue of the FERC's jurisdiction and the merits of its decision.<sup>33</sup> The court likened the FERC's jurisdiction in Mississippi to the FERC's jurisdiction in what was then a recently decided Supreme Court case, *Nantahala Power & Light Co. v. Thornburg*.<sup>34</sup> The court stated that the FERC's allocation of Grand Gulf's costs was

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27. *Mississippi Industries*, 808 F.2d at 1534-37.

28. *Mississippi Power*, 108 S.Ct. at 2434.

29. *Id.* See also *Middle South Energy, Inc.* 31 F.E.R.C. ¶ 61,305, at 61,633 (1985).

30. *Mississippi Power*, 108 S. Ct. at 2434.

31. *Mississippi Industries*, 808 F.2d at 1558.

32. *Id.* at 1554.

33. *Id.* at 1528-68.

34. 476 U.S. 953 (1986). In *Nantahala*, a holding company received a fixed amount of low-cost power from the Tennessee Valley Authority (TVA). The company filed an agreement with the FERC which allocated the low cost power between two operating companies. The FERC modified the allocation. One of the operating companies filed with the state commission to reflect the cost impact of the FERC approved allocation in its retail rates. Instead, the state commission found a different allocation to be proper and allowed rates to reflect the allocation it had determined. The Supreme Court disallowed the state commission finding, holding that the allocation by the FERC

similar to the FERC's fixing of the low-cost power entitlement percentages for Nantahala.<sup>35</sup> In both cases the FERC allocated power between the operating companies and in doing so directly affected their costs.<sup>36</sup>

The court then addressed the merits of the FERC decision. The court found that the FERC could properly decide that all nuclear construction was planned to meet the needs of the whole Middle South system.<sup>37</sup> Further, by comparing the roughly comparable historical costs of power for each operating company with the large disparities in nuclear costs between the operating companies, the FERC could conclude that the filed agreements were not reasonable and that undue discrimination existed.<sup>38</sup> Moreover, the court held that the FERC's choice of allocating the entire nuclear investment was within the agency's discretion.<sup>39</sup>

The United States Court of Appeals for the District of Columbia Circuit initially denied petitions for rehearing. However, in reconsidering the denial, the court remanded the case to the FERC for reconsideration in order to allow it to explain the criteria used in determining undue discrimination and to explain why the FERC decision was not unduly discriminatory.<sup>40</sup> In response to the remand, the FERC issued an order reaffirming its prior decision on the allocation of Grand Gulf expenses.<sup>41</sup>

### C. State Commission Proceedings

MP&L filed an application with the Mississippi Public Service Commission (MPSC) in November 1984, requesting an increase in the rates it charged to Mississippi customers.<sup>42</sup> The costs justifying the requested increase included in part the costs associated with Grand Gulf.<sup>43</sup> The MPSC issued an order in June 1985, one day after the FERC issued its decision, allowing an increase only to recover non-Grand Gulf costs.<sup>44</sup> Citing the FERC decision, MP&L filed for rehearing.<sup>45</sup> The MPSC

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had to be recognized by the state commission and reflected in the rates that the operating company charged its retail customers.

*Id.*

35. *Mississippi Industries*, 808 F.2d at 1542.

36. *Id.*

37. *Id.* at 1556.

38. *Id.* at 1556-57.

39. *Id.* at 1557.

40. *Mississippi Industries v. FERC*, 822 F.2d 1104 (D.C. Cir. 1987).

41. *System Energy Resources, Inc.*, 41 F.E.R.C. ¶ 61,238 (1987).

42. *Mississippi Industries*, 108 S.Ct. at 2435.

43. *Id.*

44. *Id.* at 2435-36

45. *Id.*

thereafter issued a new order allowing recovery of all of the Grand Gulf costs allocated to MP&L by the FERC.<sup>46</sup>

#### D. *Proceedings in State Court*

The Mississippi Attorney General and the Mississippi Legal Services Coalition appealed the order issued by the MPSC to the Mississippi Supreme Court.<sup>47</sup> The primary assertion of error was that the MPSC had allowed recovery of expenses for Grand Gulf without first determining that those expenses had been prudently incurred.<sup>48</sup> The MPSC had authority to establish just and reasonable rates which allow the utility an opportunity to earn a fair rate of return.<sup>49</sup> The Mississippi Supreme Court had interpreted a fair rate to be "one which, *under prudent and economical management*, is just and reasonable to both the public and the utility."<sup>50</sup> The court concluded that Middle South appeared to have effectively evaded any review of the prudence of Grand Gulf.<sup>51</sup> Further, it did not believe that the law required it to blindly pass through a \$326 million rate increase without any look at the prudence of the expense.<sup>52</sup> The court stated,

we do not challenge the FERC's jurisdiction over interstate wholesale rates. We do not, however, construe *Nantahala* as forcing the MPSC to set rates based on the construction and operation of a plant (nuclear or otherwise) that generates power that is not needed at a price that is not prudent. . . . MP&L, however, asks us to take the position that, because Grand Gulf is owned by an out of state corporation, the Supremacy Clause of the United States Constitution precludes any review of Grand Gulf, and forces unneeded power down the throats of Mississippi ratepayers. We do not believe the preemption doctrine ever intended to accomplish such an inequitable and unjust result.<sup>53</sup>

The court noted that MP&L had enough generation without Grand Gulf to put it 85% over peak demand. Moreover, MP&L admitted to selling less expensive energy outside its system and retaining the more expensive Grand Gulf power for its retail customers.<sup>54</sup> The court also found that the FERC had made no finding regarding whether the completion of

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46. *Id.* at 2436.

47. *State ex. rel. Pittman v. Mississippi Pub. Serv. Comm'n*, 506 So.2d 978 (1987).

48. *Id.* at 979.

49. *Id.* at 984.

50. *Mississippi Power*, 108 S.Ct. at 2436 (emphasis added).

51. *Id.*

52. *Mississippi Pub. Serv. Comm'n*, 506 So. 2d at 984.

53. *Id.* at 985.

54. *Id.* at 985.

Grand Gulf was prudent, because the issue was never presented.<sup>55</sup> Thus, it concluded that state review was not preempted. Accordingly, the court remanded the case to the MPSC to review the prudence of the investment before allowing recovery of the costs in retail rates.<sup>56</sup> Specifically, the court stated that the review should determine whether MP&L and Middle South acted reasonably in constructing Grand Gulf.<sup>57</sup>

#### IV. THE *MISSISSIPPI POWER* DECISION AND ITS IMPLICATIONS

MP&L appealed the Mississippi Supreme Court decision to the United States Supreme Court.<sup>58</sup> The United States Supreme Court phrased the question presented in this case as “whether the FERC proceedings have pre-empted such a prudency inquiry by the State Commission.”<sup>59</sup> The Court answered the question indirectly, rather than directly. First, it stated that the FERC has exclusive authority over wholesale rates and allocations, and states may not alter those rates or allocations.<sup>60</sup> This inability to modify an allocation is consistent with *Nantahala*, where the Court stated that “when FERC sets a rate between a seller of power and wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate.”<sup>61</sup> The Court then stated that the question is not whether the FERC has examined a specific issue, but whether it was in the FERC’s jurisdiction to examine it at all. It supported that finding, stating that the “bright line”<sup>62</sup> between state and federal jurisdiction was developed to make such case by case analysis unnecessary.<sup>63</sup> Finally, it concluded that the FERC’s order bars the state commission from examining the prudence of MP&L and Middle South actions because any such review would have to

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55. *Id.* at 987.

56. *Id.*

57. *Id.*

58. *Mississippi Power*, 108 S.Ct. at 2431.

59. *Id.*

60. *Id.* at 2438.

61. *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953, 960 (1986).

62. The “bright line” doctrine followed from *F.P.C. v. Southern Cal. Edison Co.*, 376 U.S. 205 (1964). In that case, the FPC asserted jurisdiction over a wholesale transaction in California because a portion of the power delivered could be traced to an out of state source. The Supreme Court stated, “Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction, making unnecessary such case-by-case analysis.” To establish that bright line, the Court interpreted the Federal Power Act to give the FPC jurisdiction over “all wholesale sales in interstate commerce except those which Congress has made explicitly subject to regulation by the States.” *Id.* at 215-16.

63. *Mississippi Power*, 108 S.Ct. at 2440.

consider at least some of the same transactions that the FERC had already reviewed in determining a reasonable allocation of costs between the operating companies.<sup>64</sup>

The Supreme Court decision raises at least five questions:

1. Did the decision in *Nantahala* compel the conclusion here?
2. Was the *Mississippi Power* decision reasonable?
3. How did the decision affect the role of the state utility commission in reviewing interstate holding company actions?
4. What are the broader implications for jurisdiction of prudence reviews?
5. What was the impact on state commission review of quantity purchases under a FERC approved wholesale rate?

Because the Supreme Court based its holding in *Mississippi Power* on the holding in *Nantahala*, a thorough review of *Nantahala* is necessary before responding to the questions raised here.

#### A. *Does Nantahala Govern This Case?*

##### 1. The *Nantahala* Decision

Nantahala Power & Light and Tapoco, Inc. are wholly owned subsidiaries of Aluminum Company of America (Alcoa).<sup>65</sup> The power produced by the facilities of both subsidiaries went to the Tennessee Valley Authority (TVA).<sup>66</sup> In exchange, Nantahala and Tapoco received a fixed amount of low-cost power from TVA.<sup>67</sup> Nantahala met its additional power requirements through purchases of more expensive power from TVA.<sup>68</sup> Alcoa filed an agreement with the FERC which allocated 20% of the low-cost power to Nantahala and 80% to Tapoco.<sup>69</sup> In 1976, Nantahala filed a proposal for a wholesale rate increase with the FERC.<sup>70</sup> One of its wholesale customers objected to the allocation of low-cost power, arguing for a different methodology that would lower Nantahala's costs and increase Tapoco's.<sup>71</sup> The FERC reviewed the allocation agreement and found that it was unfair to Nantahala.<sup>72</sup> Accordingly, the FERC modified the rate increase proposal to allow Nantahala

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64. *Id.*

65. *Nantahala*, 476 U.S. at 954.

66. *Id.* at 955.

67. *Id.*

68. *Id.* at 955-56

69. *Id.* at 956.

70. *Id.*

71. *Id.* at 957.

72. *Id.* at 958.

to recover only those increased costs it would have if it received 22.5% of the power and Tapoco received 77.5%.<sup>73</sup> Thereafter, Nantahala filed a request with the North Carolina Utilities Commission (NCUC) to raise its intrastate retail rates. The NCUC rejected the costs which the FERC had allowed, finding them unreasonable. They found that Nantahala should have received 24.5% of the low-cost power. The NCUC disallowed costs incurred as a result of receiving less.<sup>74</sup> The state supreme court affirmed the NCUC decision, finding that the decision did not order Nantahala to violate a FERC order.<sup>75</sup> Rather, the court said, the NCUC decision merely prevented Nantahala from recovering costs which it need not have incurred if it had reached a fair agreement for allocating the low cost power.<sup>76</sup> The court found this to be within the jurisdiction of state regulation.<sup>77</sup>

The United States Supreme Court found that the filed rate doctrine<sup>78</sup> assists in enforcing the supremacy clause, and held that the state utility commission must allow costs in retail rate proceedings which the FERC has allowed as reasonable operating expenses in wholesale rate proceedings.<sup>79</sup> The Court referenced *Narragansett Electric Co. v. Burke*<sup>80</sup> in concluding that state review was preempted,<sup>81</sup> and went on to

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73. *Id.* at 958-59.

74. *Id.* at 960-61.

75. *Id.* at 961.

76. *Id.*

77. *Id.*

78. The filed rate doctrine was established in *Montana-Dakota Util. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246 (1951). In that case the Supreme Court reversed a District Court holding that a contract filed with the FERC was void and unreasonable. The District Court had determined a reasonable rate. The Supreme Court held that "the right to a reasonable rate is the right to the rate which the [Federal Power] Commission files or fixes, and that, except for review of the Commission's orders, the courts can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable one."

*Id.* at 251-52.

79. *Nantahala*, 476 U.S. at 964-65.

80. 119 R.I. 559, 381 A.2d 1358 (1977). In *Narragansett*, the state supreme court reviewed the state Public Utility Commission (PUC) decision and held that the PUC was preempted by the Federal Power Act from investigating the reasonableness of an interstate wholesale rate. *Narragansett*, a wholly owned subsidiary of The New England Electric System, filed proposed rates with the PUC to pass through to its retail customers the increased expense of purchasing power from a sister operating company. This increased expense resulted from the sister operating company filing a wholesale rate with the FPC, which the FPC approved. The PUC evaluated the reasonableness of the costs underlying the new FPC wholesale rate and concluded that *Narragansett* could recover approximately 60% of the expense it incurred. However, the state supreme court held that the FPC filed rate must be treated as an actual operating expense. The PUC, however, did not have to pass through the increase but could investigate the overall financial position of the company and determine if offsetting cost savings had occurred.

*Id.*

81. *Nantahala*, 476 U.S. at 965.

say that the state may look only at whether other cost savings might offset the increase.<sup>82</sup> The Court further discussed the filed rate doctrine, recognizing that this case did not follow the typical application of the doctrine.<sup>83</sup> The Court stated, “[t]he filed rate doctrine ensures that sellers of wholesale power governed by FERC can recover the costs incurred by their payment of just and reasonable FERC-set rates.”<sup>84</sup>

The Court went on to say that the North Carolina Supreme Court should not have relied on cases like *Pike County Light & Power Co. v. Pennsylvania Public Utility Commission*,<sup>85</sup> which discussed the reasonableness of purchasing from a particular source rather than the payment of a FERC rate.<sup>86</sup> In dictum, the Court preserved a *Pike County* exception by discussing the reasonableness of purchase situation saying, “we may assume that a particular *quantity* of power procured by a utility from a particular source could be deemed unreasonably excessive if lower cost power is available elsewhere, even though the higher cost power actually purchased is obtained at a FERC-approved, and therefore reasonable, *price*.”<sup>87</sup> The Court concluded that Nantahala could not have treated itself as having access to more power than allowed by the FERC.<sup>88</sup> Thus, its purchase of more expensive power from TVA was not unreasonable.

## 2. The *Mississippi Power* Decision

The Supreme Court stated that the facts of *Mississippi Power* cannot be distinguished in any relevant way from those underlying its decision in *Nantahala*.<sup>89</sup> In *Nantahala*, the FERC had allocated low-cost power between two subsidiaries.<sup>90</sup> The state utility commission reviewed the same

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82. *Id.* at 967-68.

83. *Id.* at 969.

84. *Id.* at 970.

85. 77 Pa. Commw. 268, 465 A.2d 735 (1983). *Pike County* purchased power from its parent holding company through an agreement filed with the FERC. The Pennsylvania Public Utilities Commission (PUC) disallowed recovery of a portion of the expense incurred by *Pike County* under the agreement because alternative, more economical supplies of power existed. The court differentiated between the purchase and the sale of wholesale power and upheld the PUC decision. It concluded that the FERC determined whether it was in the public interest for the parent company to *charge* a particular rate in light of its costs, but that the FERC made no determination as to whether it is in the public interest for an operating company to *pay* that price given its alternatives. The latter determination was left to the state PUC.

*Id.*

86. *Nantahala*, 476 U.S. at 972.

87. *Id.*

88. *Id.* at 972-73.

89. *Mississippi Power*, 108 S.Ct. at 2439.

90. *Id.*

allocation that the FERC reviewed, but reached a different interpretation of what is a just and reasonable allocation of low-cost power.

In *Mississippi Power*, the FERC reviewed a contract which allocated costs of Grand Gulf among affiliates and set allocations for each affiliate. The FERC proceedings focused on the issue of cost allocation, rather than the prudence of those costs. The state public utility commission initially allowed MP&L to recover the costs of Grand Gulf allocated by the FERC. However, the state supreme court remanded the state utility commission decision, ordering the commission to examine the prudence of the investment in Grand Gulf. The state court essentially told the commission to re-examine the reasonableness of costs that were the basis for the allocation established by the FERC. Because any disallowance of expense due to imprudent investment would have effectively reduced the allocation of Grand Gulf costs to MP&L below the percent allocated by the FERC,<sup>91</sup> the case was similar to *Nantahala*. In *Nantahala*, the state utility commission directly re-examined the reasonableness of the FERC allocation. Here, if the state utility commission addressed the prudence of the investment, it would have indirectly re-examined the FERC allocation.

*Mississippi Power* is unique because it addresses both the explicit question of the prudence of an investment in a nuclear power plant and the allocation of that investment by the FERC. The FERC had previously reviewed transactions of interstate pool arrangements for their prudence and concluded that states are preempted from reviewing the same transactions for prudence.<sup>92</sup> However, in prior reviews of the prudence of transactions, the FERC did not establish an allocation. Thus, in the prior cases the state could not reconsider the cost that was found reasonable by the FERC as part of the wholesale rate, but the state could review the retail ratepayers' need for the quantity of power purchased under the rate in light of the other alternatives available.<sup>93</sup>

Here, the FERC had determined the reasonableness of the allocation of the expenses. Given the FERC's exclusive authority over allocations established in *Nantahala*, the states were then barred from any review which would result in finding a different allocation reasonable.

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91. *Id.*

92. See AEP Generating Co., 29 F.E.R.C. ¶ 61,246 (1984) (FERC concluded the prudence of an agreement to purchase power between two subsidiaries of an interstate holding company was within its jurisdiction. However, it stated it did not intend to consider the prudence of the agreement in light of available alternative power supplies.)

93. *Id.* See also Pike County Light & Power Co. v. Pennsylvania Pub. Util. Comm'n, 77 Pa. Commw. 268, 465 A.2d 735 (1983).

### B. *Was the Decision Reasonable?*

Justices Brennan, Marshall, and Blackmun questioned the reasonableness of the decision. Their dissent stated that the issue of the allocation of the Grand Gulf investment was different from the issue of the prudence of the investment. The dissent noted that the states traditionally have had jurisdiction over the question of who paid.<sup>94</sup> If expenses were prudently incurred, recovery from retail customers was allowed through increased prices. If they were imprudently incurred, the stockholders would absorb the expenses which would result in a lower return on their investment. Moreover, the dissenters argued that the FERC had not addressed the question of prudence of the investment in Grand Gulf and the state utility commission had jurisdiction over the issue.<sup>95</sup> The dissenters apparently believed that the FERC allocated costs between operating companies, but the state decided how much of those costs were prudent and effectively allocated the operating company's costs between the stockholders and the retail customers of the operating companies.

The problem with this argument is the two-level review that would result from its application. Under the argument in the dissent, the state could review the same costs on which the FERC had premised the allocation. Under the second review, if a state found a cost to be imprudent, it could exclude those costs from the costs that the operating company was allowed to recover from retail ratepayers. Thus, the state would have effectively disallowed the operating company from recovering costs that the FERC found were reasonably allocated to the company. To avoid such two-level review the majority and the concurrence by Justice Scalia concluded that the FERC has jurisdiction over the prudence of the costs underlying an allocation regardless of whether the issue is raised in a particular proceeding.<sup>96</sup>

The two-level review advocated by the dissent is inappropriate for three reasons; (1) it undermines the FERC allocation, (2) it is not consistent with prior interpretations of FERC jurisdiction, and (3) it can not be practically applied because of the structure of Middle South. First, the majority recognized that if state review of prudence were allowed, the FERC's allocation of costs would be undermined. The majority stated "[i]t is clear that the only purpose of the prudence review ordered by the Mississippi Supreme Court was to determine whether the costs the

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94. *Mississippi Power*, 108 S.Ct. at 2446 (Brennan, J., dissenting.)

95. *Id.* at 2445.

96. *Id.*

FERC had directed MP&L to pay for its allocation of Grand Gulf power should be 'trapped' or passed on to MP&L's retail customers."<sup>97</sup> In *Nantahala*, the Court held that the trapping of federally mandated costs was preempted. The Court described trapping as preventing the seller of the wholesale power from recovering the costs of paying a FERC approved wholesale rate.<sup>98</sup> A two-level review of transactions would likely result in such a trapping.

Second, the dissenters' argument violates the traditional interpretation of FERC jurisdiction. The transactions at issue in this case were transactions for wholesale power between operating companies in different states. Therefore, it made sense that regulation of those interstate transactions occurred at the federal level. A conclusion to the contrary not only would defeat the *Nantahala* holding regarding the exclusive jurisdiction of the FERC but also would allow each state to set retail rates based on their determination of the prudence of the costs on which the FERC allocation was premised. Such multiple review of the same issue in each state would be counter to the purpose of the Federal Power Act,<sup>99</sup> which gives the FERC jurisdiction over interstate sales of power.<sup>100</sup> Further, the two-level review violates the filed rate doctrine<sup>101</sup> by allowing state utility commissions to indirectly price wholesale power at a rate other than that approved by the FERC.

Third, the Court's decision is reasonable for interstate holding companies because of their interstate structure. Absent other problems, the dissenters' argument could only function in a practical sense if each operating company had different stockholders from each of the other operating companies. But MP&L and its sister operating companies were wholly owned subsidiaries of Middle South. Therefore, the stockholders were stockholders of Middle South, the interstate holding company. With this type of interstate structure, federal jurisdiction over the stockholder/customer question is more sensible than state jurisdiction. With state jurisdiction, each state would make an independent decision concerning the amount that the stockholders of the interstate company

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97. *Id.* at 2439 n.12.

98. *Nantahala*, 476 U.S. at 970.

99. In 1927, the Supreme Court held in *Pub. Util. Comm'n v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927), that the states cannot regulate interstate sales of electricity. The Court further held that regulation of rates for interstate service was an area for Congress. Thus, what is commonly referred to as the Attleboro gap was created. To fill the gap Congress passed the Federal Power Act of 1935, which created the Federal Power Commission (FPC). The FPC was renamed and somewhat redefined as the Federal Energy Regulatory Commission (FERC) in 1974.

100. See The Federal Power Act, ch. 12, 16 U.S.C § 824d (1982).

101. See *supra* note 77.

should pay. These decisions would likely reflect a states' self interest and not fairly consider the stockholder's interest in the economic viability of the interstate holding company. Such an outcome would be counter to the purpose of regulation, which is to protect the public interest while allowing the utility company an opportunity to earn a reasonable return on its investment.<sup>102</sup>

### C. *Future Implications of the Mississippi Power Decision*

#### 1. The Role of the State Public Utility Commission

The *Mississippi Power* decision is significant because it clarifies the meaning of the FERC's exclusive authority established in *Nantahala*. It clarifies that exclusive means not shared *at all*. Therefore, the *Nantahala* decision has removed from the states *any* jurisdiction over major sources of expense of interstate holding companies' wholesale power transactions, when the FERC has set an allocation of costs based on those transactions.

The Supreme Court in *Mississippi Power* clearly limits the state agency to participation in front of the FERC and does not allow it a second look at the same actions on which the FERC premises the wholesale cost allocation under the guise of a prudence review.<sup>103</sup> As pointed out earlier, this means that there will not even be a second look at the amount of wholesale power that has been prudently purchased because the FERC will also have set the allocations.<sup>104</sup>

In sum, the Court's decision defines the role of the state agency as an advocate, not a judge in regard to the wholesale power transactions of an interstate holding company when the FERC allocates costs based on those transactions. The state must make its argument regarding the prudence of a wholesale power investment or transaction entered into by an interstate holding company, in front of the FERC or lose the opportunity to be heard.<sup>105</sup> In addition, in a FERC proceeding addressing the allocation of costs, the state agency must raise any questions concerning the prudence of the quantity of purchase.

However, jurisdiction does remain with the state commission to review the overall financial condition of the operating company and to offset the increased expenses resulting from the FERC allocation with any

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102. A. PRIEST, *supra* note 1, at 4.

103. *Mississippi Power*, 108 S.Ct. at 2440.

104. *Id.*

105. *Id.* at 2441.

cost savings that have occurred in other areas.<sup>106</sup> Further, the state commission can shape the recovery of the FERC mandated costs to moderate the impact on the retail customer as long as the utility is allowed to recover eventually its expenses.<sup>107</sup>

## 2. Selecting Jurisdiction

The majority of the Court stated that while the FERC did not directly discuss the issue of prudence, the FERC could have considered it in determining the allocation if the issue had been raised.<sup>108</sup> Thus, the majority opinion clearly establishes that the FERC's jurisdiction includes the evaluation of the prudence of management decisions which are related to an interstate pool's operation.

The dissent has correctly recognized the implication of this decision. It stated that an interstate pool arrangement could choose whether it wanted the prudence of the construction of a generating facility to fall under FERC or state jurisdiction.<sup>109</sup> If power were needed by one operating company and the plant were constructed and operated as part of the operating company, selling power to its retail customers, the issue of the prudence of the investment would fall under state jurisdiction. However, if one operating company needed power and the holding company or interstate pool formed a subsidiary responsible for the generating facility, it could sell the power at wholesale and the prudence of the investment would fall under the jurisdiction of the FERC. For example, assume a situation where all of the output of a new generating facility is needed to meet the needs of MP&L retail customers. If the new plant had been constructed solely by MP&L, with all the power used to serve the needs of MP&L retail customers, the issue of prudence would be within the jurisdiction of the state utility commission. However, if Middle South preferred to have the prudence of the new power plant subject to the review of the FERC, it would construct the plant through a wholly owned subsidiary and sell all the power wholesale to MP&L for MP&L retail customers. Given the perception of more favorable regulation by the FERC, one would anticipate that interstate holding companies would

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106. *Nantahala*, 476 U.S. at 967-68.

107. The Mississippi Public Service Commission had originally ordered one half of the increase to be phased in over a five year period with the remaining one half deferred and recovered over a forty year period.

108. *Mississippi Power*, 108 S.Ct. at 2440-41.

109. *Id.* at 2449.

construct any future electrical generation plant through construction subsidiaries.

### 3. State Review of the Quantity of Purchase

The Court clearly stated in *Mississippi Power* that where the FERC has allocated the quantity of purchase in an interstate pool arrangement the state must accept that quantity as reasonable. The Court made broad statements that could be cited to support an argument that state review of the quantity of power purchased under a FERC wholesale rate has been eliminated. However, all discussion was in the context of an interstate pool arrangement where the FERC had set the quantity purchased by establishing allocation. Moreover, the Court specifically stated that MP&L had no legal right to purchase less than the FERC allocated amount; thus, it did not fall within the exception in *Nantahala*.

In dicta in *Nantahala*, the Court preserved for the states the ability to review the quantity of power purchased under a FERC rate where the FERC did not set an allocation.<sup>110</sup> Since *Mississippi Power* dealt only with an interstate pool arrangement, it did not affect the dicta in *Nantahala*. Therefore, state review of the quantity of wholesale power purchased for non-interstate pool arrangements will still be allowed according to the dicta in *Nantahala* and the decision in *Pike County*.

## V. CONCLUSION

At least the language, if not the outcome, of the *Mississippi Power* decision reflects a confusion that results from an interstate pool arrangement because the "entities wholesaling the power are the same ones purchasing and retailing that power."<sup>111</sup> However, the *Mississippi Power* decision impacts the law in the area of interstate pool arrangements in three significant ways. First, the Supreme Court clearly reinforces the FERC's exclusive jurisdiction over allocations affecting wholesale rates.<sup>112</sup> Second, it reaffirms that the states cannot find FERC wholesale rates and any associated allocation unreasonable.<sup>113</sup> Finally, it clarifies that the FERC has jurisdiction over review of the prudence of investment or operations of an interstate pool arrangement.<sup>114</sup>

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110. *Nantahala*, 476 U.S. at 972.

111. *Mississippi Power*, 108 S.Ct. at 2446.

112. *Id.* at 2440.

113. *Id.*

114. *Id.* at 2441.

In conclusion, *Mississippi Power* eliminates any state utility commission review of the prudence of interstate holding company's wholesale power transactions, where the FERC has established the allocation of the costs to the operating utilities. An exception remains for the review of the prudence of the quantity purchased in a situation where the FERC has not preempted such review by establishing an allocation of the cost.

