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SUPREME COURT OF THE UNITED STATES

In the Matter of:)
)
MISSISSIPPI POWER & LIGHT COMPANY,) No. 86-1970
)
Appellant,)
)
v.)
)
MISSISSIPPI EX REL. MICHAEL C.)
MOORE, ATTORNEY GENERAL OF)
MISSISSIPPI, AND MISSISSIPPI)
LEGAL SERVICES COALITION)
)

Pages: 1 through 44
Place: Washington, D.C.
Date: February 22, 1988

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1 IN THE SUPREME COURT OF THE UNITED STATES

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3 MISSISSIPPI POWER & LIGHT COMPANY, :

4 Appellant, :

5 V. : No. 86-1970

6 MISSISSIPPI EX REL. MICHAEL C. :

7 MOORE, ATTORNEY GENERAL OF :

8 MISSISSIPPI, AND MISSISSIPPI :

9 LEGAL SERVICES COALITION :

10 -----x

11 Washington, D.C.

12 Monday, February 22, 1988

13 The above-entitled matter came on for oral
14 argument before the Supreme Court of the United States
15 at 10:02 a.m.

16 APPEARANCES:

17 REX E. LEE, ESQ., Provo, Utah; on behalf of Appellant.

18 LOUIS R. COHEN, ESQ., Deputy Solicitor General, U.S. Department
19 of Justice, Washington, D.C.; for the United States and the
20 Federal Energy Regulatory Commission (FERC), as amici curiae,
21 in support of Appellant.

22 JOHN L. MAXEY, II, ESQ., Jackson, Mississippi; on behalf of
23 Appellees.

24

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1 FERC found that the Grand Gulf plant was constructed
2 to meet the needs of the system as a whole, including the
3 diversification of its fuel sources, which, until the mid-
4 1970s, were limited to oil and gas. Because of circumstances
5 unforeseen at the time Grand Gulf was originally planned, its
6 fixed costs, and therefore its total costs, were among the
7 highest on the Middle South system, even though its operating
8 expenses are the lowest.

9 For this reason, this case presents a circumstance
10 that is very common throughout the country today and indeed, is
11 inevitable in any integrated interstate electric system. In an
12 effort to diversify its fuel sources and to provide for the
13 long-range needs of its customers, any integrated system is
14 going to end up with several different generation sources and
15 the costs of some are going to be substantially higher than
16 others.

17 Moreover, the source that is the most expensive today
18 will not necessarily be the most expensive a few years from
19 now, depending on such variables as the world price of oil.

20 Each of the states served by such a system would, of
21 course, like to have for itself and its customers as much of
22 the system's low-cost power and as little of its high-cost
23 power as possible. Someone has to decide who gets how much of
24 each.

25 Fortunately, the Federal Power Act entitles the

1 Federal Energy Regulatory Commission to allocate these widely
2 differing costs among the companies and the states involved;
3 and FERC's authority to make those allegations is not at issue
4 in this case. For the purpose of this case, it is a given.

5 QUESTION: Mr. Lee, I am anxious to ask you a
6 question or two about this case.

7 As I understand it, the Federal Power Act does not
8 grant FERC any jurisdiction over generating facilities. So it
9 is not possible to apply to FERC in the first instance to get
10 permission to build a nuclear generating facility. Right?

11 MR. LEE: That is correct.

12 QUESTION: And that application for a certificate of
13 convenience and necessity was made to the State of Mississippi,
14 which granted it.

15 MR. LEE: Again correct.

16 QUESTION: Now, what if a state refuses the
17 permission to build and yet the plant is built elsewhere and
18 under the system's agreement some allocation is made to a
19 Mississippi utility company that is part of the system, and
20 FERC says the rates are just and reasonable.

21 Does that mean that then the State of Mississippi has
22 to accept and allow that quantity of power to be sold in the
23 state at those FERC-approved rates?

24 MR. LEE: In the context of an integrated system such
25 as this one is.

1 QUESTION: Even if they had denied the permission?

2 MR. LEE: That is correct. The division of authority
3 is between the initial authorization to construct the plant, as
4 you have correctly stated, and the authorization to set the
5 wholesale rates for the power that comes from that plant once
6 it is constructed. And Mississippi can say no, and that means
7 that it won't be built in Mississippi. It does not mean that
8 it won't be built in some other state. And the interstate
9 allocations are clearly under the jurisdiction of the Federal
10 Energy Regulatory Commission.

11 QUESTION: Is there any indication that FERC ever
12 decided that this allocation was prudent and that the
13 construction of the facility was prudent?

14 MR. LEE: We believe, for reasons stated in our
15 brief, and for reasons stated in FERC's brief itself, that the
16 answer to that question is yes.

17 QUESTION: It didn't do it in so many words, did it?

18 MR. LEE: That is correct. It is susceptible of
19 either interpretation. It is susceptible of either
20 interpretation. It is somewhat persuasive that FERC itself
21 believes that it decided the prudence issue. But the more
22 important point is that, regardless of whether it was done or
23 not, the only entity that has the authority under the Federal
24 Power Act to deal with those contracts affecting wholesale
25 rates is FERC itself. So that if prudence is going to be

1 decided, it must be decided by the Federal Energy Regulatory
2 Commission and not on a state to state basis.

3 QUESTION: I don't see that follows as the night the
4 day, as you apparently think it does.

5 MR. LEE: Well, let me just give you two factors for
6 your consideration, Mr. Chief Justice.

7 The one is, that is exactly what happened in
8 Nantahala. You had there not an integrated system of the type
9 that we have here, but you did have two wholly-owned
10 subsidiaries of a single company -- Alcoa -- and they had two
11 different sources -- one lower cost and one higher cost. And
12 the question was whether FERC's allocation of, in that case the
13 lower cost power, was binding on the North Carolina Utilities
14 Commission at the time that it set the retail rates for that
15 commission. And this Court held that the power to set retail
16 rates necessarily meant the power to make these allocations.

17 QUESTION: It isn't the allocation that is the source
18 of the controversy here. As I understand it, the state was
19 willing to accept that if this was a prudent investment, we are
20 stuck with 33 percent of it, or whatever the figure is.

21 You can acknowledge the FERC is entitled to allocate
22 without acknowledging that FERC is entitled to decide whether
23 the investment was prudent to begin with, can't you?

24 MR. LEE: That brings us to the core legal question
25 that is raised by this case. And that is whether there

1 prudency determinations can be made by the states on a case-to-
2 case basis in the wake of a determination of an allocation by
3 FERC.

4 We submit, number one, that that issue was determined
5 by Nantahala, which did involve an allocation case, and number
6 two, that any other scheme permitting these allocations to be
7 redone by the states in the wake of an allocation that has
8 already been done by FERC would simply nullify the FERC
9 allocations that have already been made and make a shambles of
10 the Federal Energy Regulatory Commission's function. And that
11 is particularly true in an integrated system such as this one.

12 The prudence issue is relevant only in those
13 instances where a utility has a choice to make, and then
14 chooses the more expensive alternative. But it is irrelevant
15 to FERC allocations of system capacity among the operating
16 subsidiaries of a public utility holding company, for this
17 reason.

18 Mississippi Power & Light really has no alternative
19 to Grand Gulf power, because Mississippi Power & Light is part
20 of the Middle South system which planned and built Grand Gulf
21 to meet system needs as a whole.

22 The question is how that system's capacity, including
23 Grand Gulf, is to be allocated among the operating companies.

24 QUESTION: The thing that is so basically
25 troublesome, though, is that under your view, admittedly the

1 Federal Power Act does not let FERC decide in the first
2 instance to review generating facilities if a new one is going
3 to be built. FERC doesn't review that. It is left to the
4 states.

5 And yet, even if the states refuse to permit it to be
6 built, you say that a subsequent FERC determination about rates
7 precludes any review by the state as to the prudence of a new
8 facility when FERC itself doesn't review it. That just means
9 nobody does.

10 MR. LEE: Oh, no. It doesn't mean nobody does. It
11 means that if it is to be done, then the procedures which are
12 provided by the Federal Power Act which permit anyone,
13 including states, to participate and indeed to initiate those
14 proceedings, must do so before FERC.

15 Take the steps, Justice O'Connor, one at a time. The
16 first is the authorization of the plant. And that one is
17 vested in the states.

18 The second step, then, is the determination of just
19 and reasonable wholesale rates. And Nantahala clearly held
20 that the allocation of sources among wholly-owned subsidiaries
21 is included within the setting of wholesale rates.

22 Now, once that allocation has been made, if the
23 individual states can then come along in the wake of that
24 determination and make their own allocation, then each state
25 will necessarily favor its own parochial interests and the

1 careful plan of the Federal Power Act to vest those wholesale
2 rate determinations in one disinterested tribunal, the only
3 tribunal that does not have a constituency to serve will have
4 been frustrated.

5 And indeed, the very argument that Mississippi makes
6 in this case shows why it is that prudence determinations, that
7 the prudence issue simply is not an issue at all for anyone,
8 either state or Federal, in a case like this which involves an
9 integrated interstate system.

10 QUESTION: Mr. Lee, you are really arguing for a very
11 drastic departure from the traditional method of regulating
12 utilities. I mean, the return on the fair rate of the utility
13 is based on its prudent investment -- that has always been a
14 state matter before. Now, you are saying all of that is simply
15 taken away from the states.

16 MR. LEE: No.

17 QUESTION: I think you are. If a state can't
18 determine the prudence of an investment, one of its main
19 controls over fixing utility rates is gone.

20 MR. LEE: Well, prudence is simply not an issue in
21 the one narrow instance in which you have an integrated system
22 such as we have here, serving several different states in which
23 you have several different power sources, and all of those have
24 to be allocated among the separate states by some governmental
25 entity. And it has been done by FERC.

1 This leaves for the state all of the traditional
2 regulatory authority that they always had with the exception of
3 one narrow function. And that is that once the wholesale power
4 supply costs have been determined by FERC, then those
5 necessarily become costs for retail, the become part of the
6 revenue requirements for the retail ratemakers.

7 QUESTION: Mr. Lee, aren't all these nuclear plants
8 serving more than one state?

9 MR. LEE: In most instances, they are.

10 QUESTION: Sure. So it is a concern to know how
11 states can protect themselves from what they perceive today to
12 be a likely scenario of big cost overruns and concerns. How
13 are the states going to protect themselves?

14 MR. LEE: And the way they can protect themselves is
15 precisely by what Section 206 of the Federal Power Act says.
16 And that is to participate before FERC and to make an argument
17 before the only entity that has the authority to make that
18 determination. And that is exactly what they did. The FERC
19 determination, the FERC allocation in this case, was over three
20 years in the making. Every single interested jurisdiction,
21 including the State of Mississippi, through its attorney
22 general and its public service commission, participated in that
23 hearing. And each one of them presented its own separate
24 formula that served its own separate state interests as to how
25 those costs ought to be allocated.

1 QUESTION: Mr. Lee, can I interrupt you?

2 MR. LEE: Yes.

3 QUESTION: It seems to me that the question of
4 prudence breaks down into two or three different issues as to
5 whether the percentage of the total power goes to the state is
6 prudent, whether the wholesale rate is prudent, and there is
7 also a third point that I wanted to focus on. And that is the
8 initial investment.

9 Did I understand you correctly to say that that is
10 something that is controlled by the state, by means of issuing
11 a certificate of public convenience and necessity for the
12 original construction?

13 MR. LEE: Well, at the time that the original
14 investment, that the original certificate is issued, then the
15 state can take whatever factors into account it wants to in
16 deciding whether or not to --

17 QUESTION: And in this particular case, the plant is
18 in Mississippi?

19 MR. LEE: That is correct.

20 QUESTION: And they did get a certificate from the
21 Mississippi Commission?

22 MR. LEE: That is correct.

23 QUESTION: So do you contend that that decided the
24 portion of the prudence issue that relates to whether or not
25 there shall be a plant of this kind at all?

1 MR. LEE: Well, it determines whether or not there
2 would be an authorization for the building of the plant. Now,
3 they could still come back. In fact, it would still be open to
4 them today to go before FERC and say that it was not prudent to
5 continue the plant or that it was not -- well, it has already
6 been determined that the allocation is prudent to give
7 Mississippi 33 percent. But chaos would be the result if that
8 is not the case, because FERC has carefully considered the
9 different positions that have been advanced by each of the
10 different states and has determined what is a just and
11 reasonable allocation.

12 QUESTION: Mr. Lee, you are proceeding along the line
13 that the state has, you mentioned earlier that the state would
14 be parochial and seek to defend its own interests. But surely
15 a state is allowed to do that. If someone comes in and says I
16 want to build a power plant that is going to serve the
17 consumers of this state, it is also going to serve the
18 consumers of the other state, and they really need it more than
19 our consumers do, but we're being nice guys and we want to
20 serve both. Surely the state can say well, that's very nice
21 but we have our consumers in mind. Can't a state be parochial
22 like that?

23 MR. LEE: That was exactly the issue that was before
24 this Court two terms ago in Nantahala when North Carolina
25 wanted to do just exactly that. And to say that even though

1 this has been determined to be a reasonable wholesale rate, we
2 are going to re-examine the prudence of the case at the state
3 level.

4 QUESTION: I don't understand that. Like Justice
5 Stevens, I see a lot of different prudence issues here. One
6 issue is whether it is prudent to build this plant for the four
7 states. The answer to that is not necessarily the same as the
8 answer of whether it was prudent for Mississippi to throw in
9 its lot with the other states. That could be quite different.
10 It could make sense for the four states but make no sense at
11 all for Mississippi to go along with it. Mississippi consumers
12 could be milked by the consumers of the other three states.

13 Now, can you tell me how the State of Mississippi can
14 protect its consumers against that? How can the State of
15 Mississippi say we don't want to go into this regional thing in
16 the first place? Where is that prudence issue determined?

17 MR. LEE: If the State of Mississippi says that it
18 doesn't want to go into it in the first place, it can of course
19 turn down the plant. That means that it may be built in
20 another state or it may not.

21 It can also make the same prudence arguments that it
22 made during the course of a three-year long proceeding before
23 the FERC and make its argument there.

24 QUESTION: What if the plant is being built in
25 another state? It can't protect itself by denying approval for

1 the building of the plant, can it?

2 MR. LEE: That is correct. But what it can do is to
3 protect its interests by arguing before the only entity that
4 has authority over the wholesale rates that come out of that
5 plant.

6 QUESTION: But FERC's interest is in the whole four-
7 state region. It's not in Mississippi alone. Who protects
8 Mississippi's narrow, selfish interest? It makes sense for the
9 four states, and FERC is going to say it makes a lot of sense.
10 Mississippi says it does, but it doesn't make sense for our
11 people.

12 MR. LEE: Well, there is no more reason to assume
13 that that issue can be decided any better by a court than it
14 can by an administrative agency. Certainly that is the only
15 administrative agency that has the authority over all of the
16 jurisdictions and not just one.

17 I'd like to save the rest of my time for rebuttal.

18 CHIEF JUSTICE REHNQUIST: Thank you, Mr. Lee. We
19 will hear now from you, Mr. Cohen.

20 ORAL ARGUMENT OF LOUIS R. COHEN, ESQ.

21 FOR AMICI CURIAE, IN SUPPORT OF APPELLANT

22 MR. COHEN: Mr. Chief Justice, and may it please the
23 Court:

24 Let me begin with Justice O'Connor's question. The
25 State of Mississippi had the power to decide whether or not to

1 license a plant located within Mississippi. And there are
2 various things on which it could condition that license. But
3 the one thing that it could not, and by the way, the State of
4 Mississippi did not attempt to impose as a condition on that
5 license, is that the power that is produced by that plant be
6 sold at wholesale in interstate commerce on terms other than
7 the terms filed with FERC. All of the power that is produced
8 by Grand Gulf I is sold at wholesale in interstate commerce,
9 and the terms for that sale can be determined only by FERC.

10 The question whether the wholesaler, MSE, should be
11 permitted to charge the full price, its full costs for
12 producing that power, or should be denied some of that return
13 on the ground that the investment was, in whole or in part,
14 imprudent, that question is a question that can only be decided
15 by FERC because --

16 QUESTION: Mr. Cohen, I thought Mr. Lee, in response
17 to Justice O'Connor's question, said it could be reasonably
18 argued either way whether FERC had decided this question or
19 not.

20 MR. COHEN: I think that FERC has decided it only in
21 the sense that the issue was not raised and some parts of the
22 issue have probably been decided by the failure of the state
23 which participated in the FERC proceeding to raise the issue.
24 There may be other parts that remain open.

25 QUESTION: You say then that FERC may have quote,

1 "decided" close quote, as you would use that term, it, simply
2 by doing nothing when nothing was presented to it on the
3 question?

4 MR. COHEN: We are talking about a potential
5 challenge to a wholesale rate charged by a wholesaler for
6 transactions in interstate commerce.

7 I think that the question whether and to what extent
8 FERC has decided prudence issues relating to that rate ought to
9 be left for FERC itself to decide if the State of Mississippi
10 or others now want to go back to FERC and argue that the whole
11 thing was imprudent or they put solid gold doorknobs on it and
12 that was an imprudent investment -- if somebody wants to go
13 back to FERC and argue --

14 QUESTION: Is that presently open, in FERC's view?

15 MR. COHEN: The question that I am explicitly
16 declining to answer is the extent to which such challenges are
17 precluded. Certainly some challenges are open. Indeed, FERC
18 is engaged in a continuous audit of the operation of this
19 plant. And the state can, under Section 206, go to FERC, argue
20 that the charges for the power that is produced by this plant
21 to the local utility are unjust and unreasonable because
22 expenses were not prudently incurred, and FERC decides that.

23 The present point is only that FERC's jurisdiction to
24 decide the prudence of facilities, all of whose power is sold
25 in wholesale and interstate commerce, must be exclusive.

1 QUESTION: Mr. Cohen, explain to me how the Federal
2 Power Act should be interpreted in this fashion to permit in
3 effect an end run around the omission in the Power Act of
4 authority in FERC to decide in the first instance whether a
5 generating plant should be built.

6 MR. COHEN: I don't think it is an end run.

7 QUESTION: Well, why isn't it? Because FERC can't
8 decide in the first instance whether a nuclear generating plant
9 should be built. That goes to the states.

10 MR. COHEN: But it can -- no, it cannot insist that
11 the plant be built if the state wants to say no. But it can
12 decide that a utility system that has built a plant will not be
13 allowed to charge the full costs of building that plant if they
14 were not prudently incurred and the power is being sold at
15 wholesale in interstate commerce.

16 QUESTION: What about my prudence question? Does
17 FERC decide my prudence question, too? That is, whether it was
18 prudent for Mississippi to throw in with the other three
19 states?

20 MR. COHEN: Yes.

21 QUESTION: Who decides that?

22 MR. COHEN: And FERC explicitly decided at least part
23 of that question. The State of Mississippi tried here and they
24 tried before FERC to analogize this to the kind of case at
25 which FERC has merely set a price, at which a wholesaler can

1 sell, but hasn't obliged the retailer to buy. But FERC here
2 set the terms, including the obligation of MP&L to buy one
3 third of the power. And in doing that, it explicitly rejected
4 Mississippi's argument that MP&L itself has excess capacity and
5 that Grand Gulf should be paid for by the short companies in
6 the system. And that, it seems to me, is close to the heart of
7 the issue.

8 This is a system that has been physically
9 interconnected --

10 QUESTION: But that could be based on the fact that
11 MP&L threw itself in with the deal a number of years ago.

12 MR. COHEN: Yes.

13 QUESTION: And FERC is just saying a deal is a deal.
14 You committed to take an equitable portion of it. This is an
15 equitable portion. But has FERC addressed the point of whether
16 it was wise in the first place for you to commit yourself to
17 take an equitable portion of this plant?

18 MR. COHEN: Talking about a decision in 19551 to
19 create this system, a decision which I believe Mississippi
20 would have had to approve the participation of its utility in.
21 But its utility joined in a petition to the SEC to form a
22 holding company system and that system was approved by the SEC.
23 In 1951 it filed a first system agreement. The plants that are
24 run by all four of the utilities on the system have been
25 physically interconnected ever since. All of the sources of

1 electrical capacity and power available to MP&L have been
2 subject, with the result of systemwide planning, and have been
3 subject to systemwide contracts, setting forth the terms on
4 which their capacity and their energy are available to the four
5 utilities ever since 1951.

6 FERC had all of the present versions of those
7 arrangements before it for review in this proceeding. FERC had
8 express power under Section 206 to determine, as it did, that
9 the agreements were unjust and to set just and reasonable
10 terms.

11 Mississippi did what it should. It argued to FERC
12 that Grand Gulf should be treated as added to the existing
13 sources of power in such a way that each company would first
14 get credit for its older, cheaper sources of power, and the
15 companies that are then short, the companies that say we don't
16 need this power because we've got plenty, should pay for Grand
17 Gulf.

18 FERC explicitly concluded that that would be unjust
19 and instead that the way that the system operated, the fact
20 that the nuclear capacity supplies the baseload and was
21 invested in on that basis, made it appropriate for the four
22 companies first to share the nuclear capacity in proportions
23 specified by FERC and that the companies that are then long
24 after they have bought their share of the nuclear power, should
25 sell the older, cheaper power to the other companies in the

1 system.

2 As I've said, all of the parties to this case, the
3 Mississippi parties participated in those proceedings before
4 FERC, they also participated in the review by the D.C. Circuit
5 in which that Court squarely upheld the power of FERC to impose
6 a third of the costs of Grand Gulf I on Mississippi -- or 33
7 percent -- on Mississippi Power and Light. We think that the
8 Mississippi Supreme Court's decision is trying to subject MP&L
9 to a state prudence review of costs that FERC has properly
10 ordered it to bear, and that under Nantahala, the Mississippi
11 Public Service Commission was required to do just what it did,
12 which is to accept that FERC-imposed cost as reasonable and to
13 give it effect in setting retail rates.

14 If there are no further questions, thank you, Mr.
15 Chief Justice.

16 CHIEF JUSTICE REHNQUIST: Thank you, Mr. Cohen. We
17 will hear now from you, Mr. Maxey.

18 ORAL ARGUMENT OF JOHN L. MAXEY, II, ESQ.

19 ON BEHALF OF APPELLEES

20 MR. MAXEY: Mr. Chief Justice, and may it please the
21 Court:

22 The Appellant invites the Court to take action the
23 result of which will be the transfer of a substantial amount of
24 the electric utility retail rate-making from the states to the
25 Federal Government.

1 The State of Mississippi and the Mississippi Legal
2 Services Coalition submit that such a result would be contrary
3 to this Court's prior decisions, to the enactment of
4 legislation by Congress -- the Federal Power Act -- and to
5 important policies of this Nation.

6 The Appellant has raised the significant issues on a
7 record that is far from complete. If Mississippi is permitted
8 to complete its regulatory responsibilities, we submit that
9 there will be no cause for this Court to take the extreme step
10 urged by the Appellant.

11 After describing several essential facts which the
12 Appellant failed to describe, we would like to summarize that
13 part which Mississippi plays in the dual regulatory system
14 contemplated by this Court and the legislation.

15 MP&L wears three hats in these proceedings. It is
16 the purchaser of wholesale power. It is the seller of retail
17 power. And it is the construction manager of Grand Gulf.

18 Let me address the latter first. In the early 1970s,
19 the operating companies of the Middle South Utilities System
20 decided to make a large investment in Grand Gulf, a huge
21 nuclear generating facility.

22 They did this to produce electricity for their
23 customers, but to also produce a large return on their
24 investment for their stockholders.

25 QUESTION: Could Mississippi have stopped that? Is

1 it your position that Mississippi would have authority to stop
2 its utility from participating in a multi-state energy
3 operation such as that? Would the Commerce Clause prevent it,
4 or anything else prevent it?

5 MR. MAXEY: No, sir. They could have stopped it in
6 the manner that it was presented to Mississippi at the time,
7 Your Honor. It was presented as a certificate for a license to
8 construct the unit. And I think Mississippi clearly had the
9 power to reject that application for a license.

10 QUESTION: But didn't?

11 MR. MAXEY: But it did not. No, sir.

12 QUESTION: Well, what if it rejected it but a
13 neighboring state granted it, so the facility was purchased,
14 and in fact, it's an integrated system?

15 MR. MAXEY: Your Honor, the question raises the
16 conflict between the FERC jurisdiction to rule on these kind of
17 multi-state agreements with the state's rights to protect
18 itself through prudence inquiries when those rates come to
19 Mississippi as retail rates.

20 QUESTION: I suppose some systemwide review makes
21 sense, though, doesn't it?

22 MR. MAXEY: Well, I think it does, at a wholesale
23 level, Your Honor.

24 QUESTION: And that's what FERC does.

25 MR. MAXEY: FERC did so in this case.

1 QUESTION: Right.

2 MR. MAXEY: Or claims to have done so.

3 QUESTION: Right.

4 MR. MAXEY: But it did not do anything with regard to
5 the prudence of the retail rates which are those paid by the
6 ultimate consumer.

7 What Mississippi seeks to do at this point is to be
8 able to carry out its responsibilities under the dual
9 regulatory system and investigate the prudence of the rates
10 that are flowing to it from this system.

11 QUESTION: Well, the effect might be to veto what
12 FERC has done, in effect.

13 MR. MAXEY: Mississippi cannot veto what FERC has
14 done. That is conceded.

15 QUESTION: But the practical result of what you are
16 urging might be just that.

17 MR. MAXEY: Your Honor, we would disagree in that the
18 practical result would be to establish whether Mississippi
19 Power & Light was prudent in its undertakings as a retail
20 seller of power to the ultimate consumer.

21 QUESTION: Well, FERC has required that Mississippi
22 Power & Light pay for one third of the nuclear power that is
23 generated.

24 MR. MAXEY: That is correct.

25 QUESTION: So they are going to have to do that no

1 matter what.

2 MR. MAXEY: That is correct.

3 QUESTION: And you say Mississippi can now make a
4 determination that they can pay for it but none of that cost
5 can be recouped?

6 MR. MAXEY: That is correct. Our position is that
7 the shareholders, I mean the rate payers should not be required
8 to pay for the imprudence of the management of a company in its
9 undertakings to sell retail power to the ultimate consumer.
10 This is based on the fact that when MP&L decided to construct
11 this unit, it made representations to the Mississippi Public
12 Service Commission in order to get its license, and it did so,
13 in acknowledging the jurisdiction of Mississippi to grant or
14 reject that license.

15 It said, for example, that the cost of this two-unit
16 plant was going to be \$1.4 billion when completed, and the
17 first unit would be completed in 1979 and the second in 1981.
18 It also represented that the specific methodology that would be
19 used to allocate both the costs and the electricity to the
20 customers was that which was going to be put in place before
21 the FERC.

22 It also made representations that the retail rate
23 payers at that time in Mississippi really had no need for the
24 electricity to be produced by Grand Gulf but it would be
25 valuable in the future and it would accrue to the benefit of

1 the rate payers of Mississippi to support the construction of
2 this plant, but they wouldn't have to pay for it until they
3 needed it and they wouldn't have to take the power until they
4 needed it.

5 MP&L continued to serve as construction manager,
6 supervising all phases of the design and construction of the
7 facility. We now know that the cost of that facility
8 skyrocketed to some 400 percent of the original estimations so
9 that the completion of Unit I alone was some \$3.6 billion.

10 The demand for electricity began to decline during
11 this period shortly after construction began, and the cost
12 escalated, so that MP&L and its sister subsidiaries came
13 together and arrived at a different methodology.

14 The plan was adopted by the MSU companies in 1908,
15 but it wasn't presented to the Mississippi Public Service
16 Commission until 1981 and then it was revealed only through
17 cross examination of one of the company officials who was there
18 testifying about the acquisition of substantial capacity other
19 than Grand Gulf, a coal-fired plant in Arkansas called
20 Independence.

21 QUESTION: What action, if any, did the Mississippi
22 Corporation Commission take in 1981 when it found out about
23 this?

24 MR. MAXEY: It took no action then. In 1983, it
25 reviewed that situation and found that the representations had

1 been made and entered an order making a finding that the
2 changes had taken place without any permission being given by
3 the Mississippi Public Service Commission. But it did not take
4 any action at that time.

5 The President of MP&L represented to the Commission
6 in 1981 that irrespective of the changes that had been made by
7 the operating companies with regard to this agreement and the
8 allocation of the cost and electricity from Grand Gulf, that
9 the Public Service Commission of Mississippi still had the
10 authority, it had the ultimate authority, when MP&L decided to
11 put these rates into the retail rate structure.

12 Of course, we've heard how the ultimate '82 agreement
13 and the allocation agreement were submitted to the FERC for
14 approval and after being modified Mississippi ended up with 33
15 percent instead of the 31.63 percent that MP&L had agreed to do
16 in this agreement subsequent to the certification of the unit.

17 MP&L then, of course, came to the Mississippi Public
18 Commission to obtain the rates at retail to pay them for the 33
19 percent allocation of Grand Gulf.

20 Prudence of MP&L's actions with regard to its
21 acquisition of such a large percentage of Grand Gulf was
22 acknowledged as an issue in the case. But the MPSC
23 unilaterally carved that out and it was not addressed by the
24 Public Service Commission. Matters of excess capacity, Grand
25 Gulf, and an acquisition of some coal-generated capacity from

1 Independence were carved out of the proceedings considering the
2 Grand Gulf rates.

3 The MPSC issued its decision then, which allowed the
4 entire 33 percent, or 100 percent of the FERC allocation, to go
5 into effect as retail rates through a tiered phase-in plan.

6 When that was appealed to the Mississippi Supreme
7 Court, the issue of prudence and whether or not the state had
8 fulfilled its regulatory responsibilities under state law, was
9 the principal issue before the Mississippi Supreme Court, and
10 of course, it reversed and said you just comply with state law
11 in order to be able to adopt rates and pass them on to the
12 customer to be paid. And what the Mississippi Supreme Court
13 did is, it sent it back to the Public Service Commission to
14 carry forward its duties and responsibilities.

15 Now, we talk about prudence, and we chase the term
16 around, and it is a bit elusive. But in this context, we would
17 submit that a fair definition would be what was the quality of
18 the managerial judgment exercised by MP&L as the company with
19 the exclusive right to provide adequate electrical service to
20 its retail customers at a price both fair and reasonable to
21 those customers and to give it the opportunity to earn a
22 reasonable rate of return.

23 Prudence takes on several characterizations. It can
24 be the prudence of construction, which has been referred to
25 earlier in the arguments. Whether MP&L, for example, looked at

1 the cost overruns. Did it examine the projections of costs
2 during construction? MP&L was in a peculiarly advantageous
3 position to be able to find that, since it was the construction
4 manager.

5 QUESTION: Did the State of Mississippi attempt to
6 litigate these kind of questions before the FERC?

7 MR. MAXEY: No, Your Honor. And I can't tell you the
8 entire reason, but the issue of prudence appeared very early in
9 the proceedings before the FERC, and the question was are the
10 Administrative Judges, or is the Administrative Law Judge that
11 is going to hear this case going to determine the matter of
12 prudence?

13 And he said, and it is cited in several of the
14 briefs, no, we're not going to consider prudence. That's not
15 the office or province of the FERC. And the FERC, or anyone,
16 would really have to strain and torture a reading of that
17 record to come up with any finding that the FERC conducted
18 anything that might resemble a prudence --

19 QUESTION: May I interrupt you, Mr. Maxey?

20 MR. MAXEY: Yes, sir.

21 QUESTION: Supposing that it appeared during the FERC
22 proceedings that they had spent \$100 million on gold doorknobs,
23 to use your opponent's example, and that was, although the
24 whole project might be perfectly wise and prudent, that
25 particular expenditure was imprudent and should not be

1 incorporated into the rate base either for wholesale rates or
2 retail rates.

3 Could Mississippi have argued in that proceeding that
4 you should disallow \$100 million of cost of gold doorknobs?

5 MR. MAXEY: Yes, sir. I understand your question to
6 be at the FERC?

7 QUESTION: Yes. Before the FERC.

8 MR. MAXEY: Yes, sir.

9 QUESTION: So you could have at least argued some
10 kinds of prudence issues?

11 MR. MAXEY: Yes, sir.

12 QUESTION: But you tell me you didn't. You didn't
13 raise any questions of prudence at all?

14 MR. MAXEY: No, sir. They were not raised at that
15 time. They were preserved in the retail setting to
16 Mississippi, to the appropriate time, which would be at the
17 time --

18 QUESTION: Then why wouldn't Mississippi have an
19 interest even at the wholesale level in saying look, half this
20 plant is totally wasted money. You should back out half of the
21 capital costs and not build it into the rate base? You
22 certainly had an interest in doing that at both the wholesale
23 and retail levels in that proceeding.

24 MR. MAXEY: That just wasn't done.

25 QUESTION: It just wasn't done. But it certainly

1 could have been done, I would think.

2 MR. MAXEY: Well, it could have been done. I can't
3 argue that the wholesale, that FERC should be very sensitive to
4 the prudence at the wholesale level.

5 QUESTION: But if a litigant raises the issue and
6 says look, this is just a lot of water in this plant that we
7 should take out of the capital costs, certainly the Commission
8 would review that, I would think.

9 MR. MAXEY: I would think so, too, Your Honor. The
10 question I would have with that is the posture that FERC has
11 before, that has these companies before it, which, all of which
12 are concerned with the allocation of the FERC of that plant,
13 because some may need it and some may not need it. FERC sort
14 of rises above those internecine disputes and decides what it
15 thinks is fair as between those companies.

16 QUESTION: In rising above it it has to consider the
17 arguments made by for example the Mississippi Commission which
18 might say well, look at all this waste here and there you could
19 make your arguments on this point. At least that is one forum.

20 MR. MAXEY: Yes, sir. Absolutely. We would concur
21 in that. And my answer stands as it just was not done in this
22 case.

23 QUESTION: Mr. Maxey, and I guess you also clearly
24 litigated before FERC how much, what quantity of power should
25 be allocated to each state out of this plant?

1 MR. MAXEY: Yes, Ma'am, absolutely.

2 QUESTION: Clearly, the quantity issue was litigated.

3 MR. MAXEY: Yes.

4 QUESTION: Along with price and costs.

5 MR. MAXEY: The principal issue was what allocation
6 was coming to each state. That was one of the debates. Yes,
7 it was, Your Honor.

8 QUESTION: So the question is whether the state now
9 has to take the quantity that FERC said it would have to take,
10 and that was litigated?

11 MR. MAXEY: Well, it was litigated in the sense that
12 each state was trying to get an allocation that was most
13 suitable to them at the time or at least I think each state was
14 trying to get the least amount it could take so as to avoid the
15 high cost that would ultimately be passed on if all of it were
16 passed on.

17 QUESTION: Now, if it were lower cost power being
18 distributed, and that had been litigated before FERC, and this
19 was the lowest cost power that was available, I guess you agree
20 that Nantahala would preclude you from now saying the state can
21 order a different quantity to be sold to it?

22 MR. MAXEY: We don't read Nantahala with the same
23 reading that the other side does.

24 QUESTION: Did you understand my question?

25 MR. MAXEY: Yes. I think I did.

1 QUESTION: Suppose that this power that we're
2 talking about turned out to be the lowest cost power rather
3 than the highest and FERC had litigated the quantity and price
4 question as it did here.

5 Now, you don't argue that Mississippi could base its
6 retail rates on a different allocation of low-cost power, do
7 you?

8 MR. MAXEY: Oh, yes.

9 QUESTION: Oh, you do? You don't think Nantahala
10 spoke to that?

11 MR. MAXEY: Nantahala says, had before it a different
12 set of facts. The facts were, as the Opinion reflected, that
13 there was only one source of power flowing to Nantahala and
14 when the ratio went from lower cost power, more than the
15 entitlement, then it raised the cost in the other state, and if
16 that were modified as it were by the North Carolina Utilities
17 Commission, and they took more of the lower cost entitlement
18 power from that one source, then it raised the cost in
19 Tennessee. So there was a seesaw effect.

20 We contend here that there is present both before
21 this Court in the record and before the Public Service
22 Commission below, the availability of other sources of lower
23 cost power.

24 Mississippi Power & Light has a history of off-system
25 purchases, which are referred to in the briefs. And those are

1 sources of perhaps lower cost power.

2 The point that we would make, Your Honor, is that
3 that is a determination that has yet to be made. It is to be
4 made by the Mississippi Public Service Commission sitting
5 before the evidence which it has assembled and raising the
6 questions of whether there was the availability of lower cost
7 power that could be used in the Pike County sense to reduce the
8 ultimate rates to the retail consumer.

9 Whether or not Mississippi Power & Light exercised
10 prudence in reducing the risk to its rate payers while it
11 watched these construction costs escalate, it watched the price
12 of oil, which had been projected to rise to astronomical
13 levels, stay under \$20. What did it do during this period of
14 time when Three-Mile Island came down, or occurred, and then
15 the resulting additional regulatory oversight occurred which
16 increased the cost? What did MP&L do during this period of
17 time to reduce the risk to the rate payers of Mississippi when
18 it realized that the cost of capital had increased due to
19 inflation?

20 Those are matters of prudence which relate to the
21 rate payers of Mississippi which the Mississippi Public
22 Service Commission deserved the opportunity under our dual
23 regulatory system to continue and make findings. And we would
24 suggest to the Court that that would present a substantially
25 more reliable record than you have before you now.

1 The Nantahala case had been to the North Carolina
2 Supreme Court twice. It had been remanded back to the North
3 Carolina Public Service Commission. When it came before this
4 Court, it had been thoroughly reviewed at the administrative
5 level and again at the Supreme Court of North Carolina. And
6 I'm not suggesting that what we're attempting to do is
7 perpetuate litigation. But I am submitting that the finality
8 of the order before you is subject to substantial question in
9 view of the additional --

10 QUESTION: Mr. Maxey, could I ask you another
11 question? Is it your position, does Mississippi take the
12 position that the whole project is imprudent and that all the
13 capital costs should be absorbed by the shareholders?

14 MR. MAXEY: No, sir. Mississippi takes the position
15 that it really doesn't know what it is going to find in the way
16 of prudence when it conducts the prudence inquiry.

17 QUESTION: Theoretically, then, I suppose you could
18 find that failure to make a proper readjustment, after Three-
19 Mile Island and so forth and so on, that there is a certain
20 portion of the costs that is imprudent and therefore that the
21 rate base for retail purposes would be different than the rate
22 base for wholesale purposes. Is that what it boils down to?

23 MR. MAXEY: Yes, sir.

24 QUESTION: I see. So you chip away at the rate base
25 rather than totally reject the whole thing?

1 MR. MAXEY: Well, there are a number of ways, yes,
2 sir, that that could be accomplished. And we have seen it
3 happen in one of the subsidiary companies already, that
4 explored the various kinds of managerial judgments that were
5 made during these periods of time and made the attempt to avoid
6 bringing any conflict of its jurisdiction with that of the
7 FERC, in an effort to, rather than saying the all or none kind
8 of argument, saying we have to live together in a dual
9 regulatory system and we recognize that the FERC has issued its
10 allocation and we're not going to take from the company the
11 ability to meet that payment that it is obligated to make to
12 Middle South Energy or SERE, that it is now called.

13 But what we are going to do is we are going to try to
14 reduce the ultimate impact on the rate payers as a result of
15 the imprudence that the company conducted itself during that
16 period of time. That is the nature of the exploration that
17 would be made by the Public Service Commission in Mississippi.

18 QUESTION: Is it fair to say, Mr. Maxey, that all of
19 the arguments that Mississippi wishes to present now with
20 reference to prudence could have been made before FERC even
21 though FERC is being asked to draw a different conclusion than
22 the Mississippi Regulatory Commission would be?

23 MR. MAXEY: Your Honor, I don't think that there is
24 any rule of law that would have kept Mississippi from making
25 these presentations to the FERC. There is an election of forum

1 that would have, that gave Mississippi the chance to say, we
2 understand that if you address these problems at the FERC level
3 they will be at the wholesale level. But we want to have a
4 determination of the prudence at the retail rate level and we
5 will do that in Mississippi, which is preserved to the states
6 by the Federal Power Act.

7 So our position would be that of course you could
8 present anything that the Administrative Law Judge would
9 authorize you or permit you to introduce at that point, but
10 that it was not done and it was not done because FERC did not
11 have jurisdiction over the prudence at the retail level. It
12 had only at the wholesale level.

13 QUESTION: Would you be bound by FERC's determination
14 if you had raised those issues at the FERC level seeking to
15 effect wholesale prices? Would you acknowledge that you could
16 not then take a second bite and raise the same issues at the
17 retail level?

18 MR. MAXEY: Your Honor, I suspect that the opposing
19 side would raise some defense like collateral estoppel if you
20 had attempted to take both bites at the apple.

21 QUESTION: I'm sure they would. I'm asking you
22 whether it would be successful.

23 MR. MAXEY: I don't know the answer to that, Your
24 Honor.

25 QUESTION: Your answer has to be no, because you are

1 saying that you have a right to present those arguments to the
2 State Commission regardless of what the Federal body does.
3 That seems to me the essence of your position. You have to
4 answer that no.

5 MR. MAXEY: Well, it is the position that the roles
6 are dual and that they sometimes overlap or appear to overlap,
7 but the same evidence presented with regard to the prudence at
8 the wholesale level --

9 QUESTION: You are arguing it could be prudent at the
10 wholesale level but you can still say, Mississippi is still
11 free to say it is imprudent at the retail level.

12 MR. MAXEY: Yes, sir.

13 QUESTION: I understand your position.

14 MR. MAXEY: That's absolutely --

15 QUESTION: So there would not be a res adjudicata bar
16 if your view is correct?

17 MR. MAXEY: No, sir, we would argue that it would
18 not. We would suspect that the other side would argue that it
19 would, however, in response to the question. But we think that
20 there is absolutely a division between the wholesale and retail
21 rate making that is set up by Congress, the Federal Power Act,
22 and while the two may appear to overlap, that the two have very
23 different functions and very different goals.

24 There might be evidence, of course, that would apply
25 to both, but nonetheless, in the final analysis, the division

1 would be clear.

2 QUESTION: Do you know of any case, Mr. Maxey, in
3 which FERC has denied an element of wholesale rates on the
4 basis that the investment was imprudent? Has FERC ever done
5 that to your knowledge?

6 MR. MAXEY: Not to my knowledge.

7 QUESTION: Have they ever said in any of their
8 opinions that they had the authority to do it? Or are you just
9 not that familiar with their opinions?

10 MR. MAXEY: I think I'm familiar with decisions where
11 the FERC says it has the authority to consider prudence, yes,
12 sir. In fact, an example of sort of the dual regulatory system
13 was where, in a case that was cited in one of the briefs, I
14 believe it's the Union Electric case, that where the state had
15 conducted a prudence inquiry at the state level about the
16 retail rates, and then carried its findings to the FERC and
17 said we found imprudence here, and we would like to have, like
18 to be able to have you recognize the imprudence at the FERC
19 level.

20 The FERC said we have the right to conduct a prudency
21 inquiry and we may take into consideration what the state has
22 found but we're not bound by it, I think, thereby recognizing
23 the dual regulatory system that is contemplated by the Federal
24 Power Act, and FERC is trying to walk the line to do.

25 MP&L claims that there will be unlawful shifting of

1 prices between the -- or costs, rather -- between the operating
2 companies, if MP&L grants, if the MPSC grants less than the
3 full passthrough of the 33 percent to MP&L. That is certainly
4 not borne out by the record. The other three operating
5 companies, AP&L, LP&L and NOPSI, have all taken less as retail
6 rates than the total amount that has been allocated to them by
7 the FERC. Their shareholders have, in varying measures,
8 absorbed some of the allocations that are granted to them by
9 the FERC. And testimony which is referred to in the briefs
10 indicates that that has not resulted in a shifting of costs
11 back to MP&L. In other words, an absorption by LP&L of its
12 partial allocation has not resulted in costs shifting back to
13 Mississippi. We would take issue with that.

14 We consider that the Federal Power Act was adopted to
15 provide the regulation of interstate wholesale sales of
16 electricity and expressly created the dual regulatory system
17 which this Court, in a similar fashion recognized, in the
18 recent case of Federal Communications Commission v. Louisiana
19 Public Service Commission.

20 To those that argue that this interferes with the
21 efficiency of broad regulation, which we heard this morning,
22 this Court has admonished that the courts should not assume a
23 role which our system has assigned to Congress.

24 Now, MP&L seeks to move these lines drawn by the
25 Court and adopted as law by Congress under the guise of

1 furthering the national policy of economy and efficiency in the
2 delivery of electric service.

3 But that in fact is wrong. That would defeat the
4 efficiency that now exists in the electric utility rate making.

5 For example, the states would be less than interested
6 in granting a license to a large nuclear power plant or any
7 kind of power generating plant today if it knew tomorrow that
8 it is not going to be able to protect its citizens and
9 constituents which it has elected or appointed to serve,
10 because the FERC might well come along and later change that
11 and then send those rates right back to them as retail rate
12 payers that they would not be able to regulate or even
13 investigate under the Appellant's theory.

14 This is not an isolated case which compels this
15 Court's decision. In fact, we've counted some 22 states that
16 would be directly affected because they have utilities that are
17 involved in a multi-state pooling arrangement or an integrated
18 system. This is a case which will have an impact on all
19 investor-owned utilities which engage in any such interstate
20 pooling or joint ventures. The Appellant raises these
21 questions of widespread and harmful potential on a record that
22 is far from complete. This Court should have the benefit of
23 thorough development in these issues. This case should be
24 returned to Mississippi where that can take place.

25 Thank you.

1 CHIEF JUSTICE REHNQUIST: Thank you, Mr. Maxey. Mr.
2 Lee, you have two minutes remaining.

3 ORAL ARGUMENT OF REX E. LEE, ESQ.

4 ON BEHALF OF APPELLANT - REBUTTAL

5 MR. LEE: First, I would like to just clarify that
6 every single one of these prudence issues could be raised
7 before FERC, and also, that FERC can and does reject increases
8 in the wholesale rate base on the basis that the costs are
9 imprudently acquired.

10 Footnote 15 of our reply brief discusses the cases in
11 which that happens.

12 FERC did not consider these issues, or said they did
13 not consider them -- we think they did -- but in any event, the
14 ALJ said that he wasn't going to consider anything that was not
15 raised.

16 The crucial point is that these matters can and must
17 be raised before FERC if they are to be raised at all, and the
18 reason lies right at the heart of why the Federal Power Act was
19 enacted.

20 It was enacted in order to preclude violations of the
21 Commerce Clause that would otherwise occur. It is very
22 apparent that the alternatives to the use of Grand Gulf Power
23 to which the Mississippi Attorney General refers is the use of
24 otherwise, of the other sources within the Middle South System,
25 oil and gas, which are cheaper, which are located right within

1 Mississippi and which, if Grand Gulf has not used, will then be
2 sent out of state to other parts of the Middle South system.
3 That is the NEPCO case, and NEPCO squarely declares that this
4 would be a violation of the Commerce Clause. And that is why
5 we have a Federal Power Act, because we are one Nation and we
6 need one entity that can prevent these violations of the
7 Commerce Clause that would otherwise occur.

8 The fact of the matter is that FERC has made a
9 determination that it is just and reasonable for Mississippi to
10 bear 33 percent of the costs of Grand Gulf. And what we have
11 here is nothing less than an attempt to have the states test
12 the prudence of the costs that FERC has ordered that
13 Mississippi bear.

14 Thank you.

15 CHIEF JUSTICE REHNQUIST: Thank you, Mr. Lee. The
16 case is submitted.

17 (Whereupon, at 11:01 a.m., the case in the above-
18 entitled matter was submitted.)

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