

***MAYER, BROWN, ROWE & MAW'S  
SUPREME COURT DOCKET REPORT  
OCTOBER TERM, 2002 – NUMBER 7***

Today the Supreme Court granted certiorari in two cases of potential interest to the business community. Amicus briefs in support of the petitioners are due on Monday, March 3, 2003, and amicus briefs in support of the respondents are due on Wednesday, April 2, 2003. Any questions about these cases should be directed to Miriam Nemetz (202-263-3253) or Robert Bronston (202-263-3244) in our Washington office.

**1. *Public Utilities — Preemption — Recovery of Rates Allocated by FERC.*** The Supreme Court granted certiorari in *Entergy Louisiana Inc. v. Louisiana Public Service Commission*, No. 02-299, to decide whether a state public utility commission has jurisdiction to deny an electric utility member of a multi-state power system the right to recover, in its retail rates, payments made to other utilities under a System Agreement approved by the Federal Energy Regulatory Commission (“FERC”), based on the state commission’s decision that the payments did not comply with the System Agreement and thus that it was “imprudent” for the utility to incur those costs.

Entergy Louisiana Inc. (“ELI”) is an electric utility which, together with other subsidiaries of Entergy Corporation, operates an integrated electric generation and transmission system serving parts of Louisiana, Arkansas, Mississippi, and Texas. The five Entergy operating companies cooperate and share costs under a System Agreement, which has been filed as a federal tariff and approved by FERC. Schedule MSS-1 of the System Agreement establishes a formula for determining how much power-supply capability each company must contribute to the system and provides that when a company supplies less than its allocated capacity it must make deficiency payments to those system members that cure the shortfall. During the 1980’s, the Entergy companies implemented an Extended Reserve Shutdown (“ERS”) Program to place excess generating units into inactive status, but decided that units in ERS status should be considered “available” for purposes of evaluating a company’s capacity and calculating MSS-1 payments. As a result, ELI made higher MSS-1 payments than it would have made if none of the ERS units had been included in the MSS-1 computation.

In 1993, FERC initiated a proceeding to determine whether the inclusion of ERS units in the MSS-1 computations violated the System Agreement. On August 5, 1997, FERC issued an order concluding that the ERS facilities could not be considered “available” under the language of the Agreement. However, FERC declined to order a refund of past payments, and it approved a negotiated amendment to the System Agreement that would, in the future, permit ERS units to be considered “available” under certain circumstances.

The Louisiana Public Service Commission (“LPSC”) annually sets ELI’s retail rates based on its cost of providing service. In the 1997 rate proceeding, the LPSC ruled that ELI’s

payments to other Entergy companies that resulted from the treatment of ERS units as “available” did not satisfy the amended System Agreement, and were thus “imprudent” and could not be recovered through ELI’s retail rates. *Re Louisiana Power & Light Co.*, Order No. U-20925-G, 1998 WL 1285300 (Dec. 22, 1998). The LPSC recognized that FERC “has exclusive jurisdiction over whether the System Agreement has been violated” (*id.* at \*19), but found that, in the absence of a specific determination by FERC that the deficiency payments complied with the System Agreement, “this Commission can scrutinize the prudence of [ELI’s] decision without violating the supremacy clause insofar as that decision affects retail rates.” *Id.* The LPSC further determined that it could use “the FERC-set standard for treating ERS units as available” as “an additional test for reasonableness and prudence” of the utility’s expenses. *Id.* A Louisiana district court affirmed the LPSC’s order in an unpublished decision.

The Louisiana Supreme Court affirmed. 815 So. 2d 27 (2002). The court pointed out that the LPSC was “not attempting to regulate interstate wholesale rates” and had “not challenged the validity of the FERC’s declination to order refunds of amounts paid in violation of the System Agreement prior to the amendment.” *Id.* at 38. Instead, the court held, “the LPSC has merely examined the prudence of ELI’s failure to make steps to minimize its MSS-1 payments” under the amended Service Agreement. *Id.* Further, the court reasoned, “FERC never ruled on the issue of whether ELI’s decision to include the ERS units is a prudent one” or “whether ELI must continue to make overpayments to the other Entergy operating companies.” *Id.* Accordingly, the court concluded that the LPSC’s decision was not preempted by federal law. Pointing out that “FERC has exclusive jurisdiction over the issue of whether ELI has violated the System Agreement,” the dissent asserted that “the LPSC is simply trying to do indirectly what it may not do directly, namely, determine that ELI violated a FERC tariff.” *Id.* at 39.

This case is significant to all electric utilities that operate in interstate commerce.

**2. Equal Protection Clause — Differential Taxation.** The Supreme Court granted certiorari in *Fitzgerald v. Racing Association of Central Iowa*, No. 02-695, to determine whether a State may, consistent with the Equal Protection Clause, tax revenues from racetracks at a substantially higher rate than revenues from riverboat casinos.

Iowa authorizes two types of gambling establishments. Racetracks offer parimutuel wagering on horse and dog races, and riverboat casinos offer an assortment of games. Although each of these forms of gambling enjoyed initial success, both types of gaming establishments eventually encountered financial difficulties. The Iowa legislature passed a law in 1994 that permitted racetracks to operate slot machines and removed betting and loss limitation restrictions that had previously affected riverboats. The law also imposed a new taxation scheme. Gambling revenues above three million dollars were initially taxed at a rate of 20%. Beginning in 1997, however, the tax rate applicable to racetrack revenues became 22% and increased two percent every year until it reached 36%. The increase applied only to racetracks, and the tax rate remained at 20% for riverboats. See Iowa Code § 99F.11.

Three racetracks filed suit in Iowa state court, seeking to have the law struck down on equal protection grounds, and the parties cross-moved for summary judgment. The district court partially granted the State’s motion, upholding the constitutionality of the statute on rational basis review.

The Iowa Supreme Court reversed by a 4-3 vote. 648 N.W.2d 555 (2002). The court first held that racetracks and riverboats were similarly situated for purposes of the equal protection analysis. Looking at empirical data in the record, the court determined that “the bulk of both entities’ revenue is from slot machines,” and that “the essence of the tax is that it treats racetrack slot machines differently than riverboat slot machines.” *Id.* at 559. The court then considered whether the statute was rationally related to a legitimate governmental interest. Central to its analysis was “the fact that the 1994 legislation was designed to save the racetracks and riverboats from financial distress.” *Id.* at 560. The court found, however, that “[a]s a result of the differential tax rate, riverboats have a competitive advantage over racetracks” and that “the thirty-six percent tax on gross receipts will seriously jeopardize the racetracks’ viability.” *Id.* at 561. Concluding that the effect of the statute was “disabling an industry it was allegedly designed to aid” (*id.* at 562), the court struck down on equal protection grounds the portion of the statute imposing the escalating tax on racetracks, leaving in place the 20% tax rate for both forms of Iowa gambling establishments. *Id.* at 563.

Three justices dissented, observing that “[r]iverboats are not the same as racetracks” because “rightly or wrongly, a legislative majority could rationally determine that a riverboat casino holds more romantic tourist appeal than a casino stuck in a dog track.” 648 N.W.2d at 563. The dissenters also relied on the fact that riverboats are mobile whereas racetracks are not, reasoning that the legislature might rationally have wanted to favor riverboats in order to prevent them from relocating to another State. *Id.* Finding “a number of rational reasons why the legislature might tax land-based casinos differently from river-based ones” (*id.* at 564), the dissenters would have sustained the Iowa tax scheme.

This case is of great significance to businesses that either benefit from or are disadvantaged by differential treatment under state and local tax laws. The Court is likely to address several important issues arising in equal protection challenges to such laws, including the role of post-enactment empirical data concerning the real-world effects of the challenged statute.

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