Nos. 06-1457 and 06-1462

IN THE
Supreme Court of the United States

MORGAN STANLEY CAPITAL GROUP INC.,
Petitioner,
v.

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON, ET AL.,
Respondents.

CALPINE ENERGY SERVICES, L.P., ET AL.,
Petitioners,
v.

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON, ET AL.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF AMICI CURIAE COLORADO OFFICE OF CONSUMER COUNSEL, NEW MEXICO ATTORNEY GENERAL, PUBLIC CITIZEN, INC., AND NATIONAL CONSUMER LAW CENTER IN SUPPORT OF AFFIRMANCE

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INTEREST OF AMICI CURIAE

Amici represent a diverse group of advocates for the retail electricity consumers who in most cases will actually pay the rates and charges set by wholesale power contracts such as those at issue in this case, when they are passed through to consumers as part of retail electric rates.[1]

The New Mexico Attorney General is authorized by the State of New Mexico to represent retail electricity consumers under NMSA 1978 § 8-5-2(j)(2003) and § 8-5-7 (2003).

The Colorado Office of Consumer Counsel is authorized by the State of Colorado to represent residential, small business, and agricultural retail state electricity consumers.

Public Citizen, Inc., is a non-profit organization engaged in advocacy efforts on a range of issues including the fairness of electricity rates to retail consumers and the impact of electricity deregulation on such rates.

The National Consumer Law Center, Inc., is a non-profit organization representing the interests of low-income clients on a range of consumer issues including electricity deregulation.

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[1] Letters consenting to the filing of this brief are on file with the Clerk. This brief was not authored in whole or in part by counsel for a party, and no one other than amici curiae made a financial contribution to preparation of the brief.

STATEMENT

PUHCA and the Federal Power Act

In 1935, giant utility holding companies owned most of the electric utilities and natural gas pipelines and supplies in the nation. As this Court later described the situation: "[S]tate commissions, independent producers and communities … were becoming increasingly helpless before these combinations."[2] On the electric side, three holding companies produced almost 50% of the nation's privately-owned electric energy, and 13 others produced most of the rest.[3] In addition, this Court had determined in 1927 that no state could regulate electric sales for resale in interstate commerce, so those sales were completely unregulated. *Public Utility Comm'n of R.I. v. Attleboro Steam & Electric Co.*, 273 U.S. 83, 89 (1927).

Against this background and the financial crash of many utility holding companies in the late 1920s and early 1930s—when highly leveraged pyramids of corporate subsidiaries, with all financing based on operating utilities at the bottom, collapsed when banks called in their loans—Congress enacted the two-part Public Utility Act of 1935: Part I was the Public Utility Holding Company Act of 1935 (PUHCA), designed to break up or regulate the huge utility holding companies; Part II comprised the provisions of the Federal Power Act (FPA) granting a federal agency authority to regulate electric power wholesaling and electric

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[2] *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944).

[3] Division of Investment Management, U.S. Securities and Exchange Commission, *The Regulation of Public-Utility Holding Companies* 3 n.8 (June 1995).

transmission in interstate commerce to fill the so-called "*Attleboro* Gap."[4]

The historian of the Securities and Exchange Commission has summarized PUHCA's enactment as follows:

> The greatest showdown between Washington and Wall Street did not concern the Securities Act of 1933 or the Securities Exchange Act of 1934, but, rather, the Public Utility Holding Company Act of 1935. The restructuring of the public utility industry historically has been the SEC's single most useful accomplishment. It was also by far the most difficult to attain.

Seligman, *The Transformation of Wall Street*, *A History of the Securities and Exchange Commission and Modern Corporate Finance* 127 (rev'd ed. 1995).

Seligman notes that President Roosevelt felt that the defense of the Holding Company Act was so important that five of his early Supreme Court nominees had played prominent roles in either PUHCA's enactment or its courtroom defense.[5] It took until 1952 for the holding companies to be mostly broken up into single-state companies that could be effectively regulated by states, although some, such as American Electric Power Corp., managed to maintain operations in as many as seven states. Nonetheless, financial transactions of such interstate, registered holding companies with their utility subsidiaries were heavily regulated. Perhaps most importantly, non-utility companies could not own utilities without divesting themselves of their non-utility businesses. Seligman calls

[4] *See New York v. FERC*, 535 U.S. 1, 5-6 (2000).

[5] *Id. at* 135, n. 41.

enforcement of the PUHCA "the most successful antitrust enforcement program in United States history."[6]

Important as PUHCA was, the inclusion of the FPA in the Public Utility Act of 1935 reflected congressional recognition that it was not enough just to try to reduce the disparity in bargaining power between electric wholesalers and their customers by breaking up the giant power cartels: even the restructured industry that remained would require rate regulation for the protection of consumers.[7]

Compared to PUHCA, the FPA was a much more traditional rate-regulation statute. It was modeled on the Interstate Commerce Act (ICA), but with differences, because electricity customers needed individualized facilities and arrangements, and therefore used contracts instead of uniform tariffs.[8] Also, unlike the later Natural Gas Act of 1938 (NGA), the FPA gave the Commission no authority to certificate public utilities as it does natural gas companies. *Cf.* NGA Section 7, 15 U.S.C. § 717f. Indeed, the FPC/FERC were given no authority over electric generation *per se*; such authority was and is reserved to the states. FERC-jurisdictional "public utilities" either own transmission assets or the books, records and filed rates, in-

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[6] *Id.* at 247.

[7] Petitioners Calpine and AEP thus are incorrect when they assert that the FPA "was enacted in 1935 to limit the control by a few public utility holding companies of the Nation's electric utility systems…." Calpine/AEP Br. 2. That was the purpose of the FPA's sister legislation, PUHCA; the FPA was designed to regulate transactions by wholesale power sellers regardless of whether they were part of holding companies.

[8] *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332, 339 (1956).

cluding rate contracts, for the sale of electric energy for resale. *See Hartford Electric Light Co. v. FPC*, 131 F.2d 953 (2d Cir. 1942).

FPA sections 205 and 206 set forth the standards and procedures by which the Federal Energy Regulatory Commission ("FERC") regulates rates for the sale of electric energy for resale by "public utilities." Section 205(a) mandates that all such rates "be just and reasonable," and provides that any rate that is not just and reasonable is unlawful. 16 U.S.C. § 824d(a). Section 205(b) prohibits FPA public utilities from making or granting any undue preference or from subjecting any person to undue prejudice or disadvantage. 16 U.S.C. § 824d(b). FERC's review of wholesale rates is made possible by Section 205(c), which requires public utilities to file and keep open to the public schedules showing all rates and contracts, practices, etc. that affect such rates, and Section 205(d), which requires all changes in rates, practices, etc. to be filed sixty days in advance for FERC and public review. 16 U.S.C. §§ 824d(c) & (d).

Changed or increased rates can be set for hearing under Section 205(e), which allows FERC to suspend changes for up to five months and make their collection subject to refund. 16 U.S.C. § 824d(e). Section 205(e) places the burden of justifying an increased rate on the seller. Initial rates and changed rates that FERC has allowed to become effective (without refund liability) can be investigated on FERC's motion or upon complaint under Section 206(a). 16 U.S.C. §824e(a). In the case of both Sections 205(e) and 206(a), once FERC finds *after hearing* that a rate is unjust and unreasonable, or unduly preferential or discriminatory, FERC must determine the lawful rate to be observed and enforced.

This Court has expressly found that under the FPA, the advance *notice by filing* requirements of sections 205(c) and (d) are "no more than are necessary" to implement sections 205(e) and 206(a):

> The filing requirements are obviously necessary to permit the Commission to exercise its review functions, and the requirement of [60]-days' advance notice of changes is essential to afford the Commission a reasonable period in which to determine whether to exercise its suspension powers under [§ 205(e).]

Mobile, 350 U.S. at 342 (applied to FPA in *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956)) (together "*Mobile-Sierra.*")

FERC's Market-Based Rate Regime

In the late 1980s, FERC began on its own (without a change in the statute by Congress) to allow certain isolated power plants to sell power at "market-based rates" (MBRs)—that is, whatever they could negotiate with buyers—because FERC believed such plant owners had no "market power." Under FERC's MBR regime, sellers no longer file contracts containing new rates, or changes in rates, with FERC before they go into effect, and FERC permits the market, rather than the statutory criteria that rates be just and reasonable, and not discriminatory or preferential, to determine what sellers may charge.

Meanwhile, utility companies lobbied Congress to pass the Energy Policy Act of 1992, which created Exempt Wholesale Generators (EWGs), which could be owned 100% by traditional utilities and utility holding companies. EWGs were exempted from PUHCA, but Congress made no changes to FPA rate regulation for

EWGs. FERC nonetheless allowed them to sell at "market-based rates."

EWGs included entities that only owned one actual power plant but controlled the output of many, many generators by "owning" contracts for their power. (Simple energy brokers were exempted from FERC's jurisdiction.) Generators could sell to marketers, often affiliates, and marketers could sell to each other, all at market rates deemed "just and reasonable" under FERC's MBR regime as "negotiated" rates. Enron Power Marketing, for example, was granted MBR authorization because, *inter alia*, "[T]here is no evidences (sic) that Enron will engage in any self or reciprocal dealing." 65 FERC ¶ 61,305, 62,405 (1993). (One wonders what "evidence" there could have been before Enron started to sell.) In any event, FERC found no evidence of Enron's self-dealing or other abuses until 2003, when FERC finally revoked Enron's market-based rate authorization after FERC's staff had found evidence of such abuse, but long after the market rate debacle in California and the West had peaked. *Enron Power Marketing, Inc.*, *et al.*, 103 FERC P 61,343 (2003).

Indeed, FERC found that virtually no seller, even huge, registered utility holding companies, had "market power." *See Southern Co. v. Energy Marketing, L.P.*, 86 FERC ¶ 61,131 (1999). States, with the encouragement of Enron Corp. and other traders, either allowed or required their state utilities to sell off their power plants to become EWGs in the wholesale "market." New entrants eagerly entered the California "market" in 2000 and soon rates were skyrocketing.

Although this is contrary to what "markets" are supposed to do, even theoretical experiments have shown that, with adequate capacity and no manipulation, electricity "market" prices will still rise because buyers are forced to buy.[9] Where, as in the California crisis, sellers manipulate supply and engage in other abusive practices, prices will skyrocket.

Energy Policy Act of 2005: PUHCA Repealed

After trying to repeal PUHCA for 70 years, the industry finally succeeded in the EPAct of 2005, effective in 2006. Since then the rate of utility mergers has tripled, and hedge funds and private equity funds have acquired one of the largest "registered" utility holding companies in Texas. PUHCA did not allow utility holding companies to own non-utility companies, or vice versa, because of conflicts of interest and other abuses leading to passage of the Act. Holding companies such as AEP are now free to own unrelated, non-utility businesses, and oil companies or investment banks, for example, can now acquire electric (and gas) utility holding companies. Under the FPA, investment bankers are not allowed even to sit on the boards of public utilities without special permission, but now they can own them.[10]

PUHCA also confined the ownership of public utilities to those in a single, geographically-integrated system. Holding companies are now free to move about the country, and indeed, other countries have been invited in. With China and Abu Dhabi bailing out major U.S. investment bankers, who in turn own utilities, such countries may soon have *de facto* control over American utilities. Other countries, such as Eng-

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[9] Johnston, *Free Lunch* 187 (2007).

[10] Section 305(b) of the FPA still requires investment bankers to obtain FERC's permission to sit on the boards of public utilities. *See* 16 U.S.C. § 825d(b).

land and Spain, already own American utility holding companies outright.[11]

AEP now operates "traditional" vertically integrated utilities in eleven states, in addition to any "independent" plants or marketers that it owns or controls. Obviously, no single state can effectively regulate AEP's operations, so the pre-PUHCA conditions of the 1920s and 1930s are already being replicated.

In light of the abandonment of PUHCA's project of restraining concentration of ownership of power suppliers, as well as of transmission and distribution utilities, the consumer protections of the FPA, which remain essentially unaltered, are all the more critical.

SUMMARY OF ARGUMENT

Petitioners and FERC submit that the rates at issue in this case, based on contracts entered into under economic duress during a period of obvious market dysfunction, bear a heavy if not insurmountable presumption of lawfulness under the FPA even though, under FERC's MBR regime, such contracts were never filed with FERC before they went into effect and were never subject to review by the Commission under the statutory "just and reasonable" and "not unduly preferential or discriminatory" standards. In effect, they argue that the *Mobile-Sierra* doctrines—created by this Court long before FERC ever conceived of its MBR regime—guarantee the primacy of private contracts and divest FERC of any power

[11] For the impact on utility rates resulting from foreign ownership, see "As energy prices surge, FOREIGN energy giants accused of treating UK like Treasure Island," *Daily Mail*, January 5, 2008.

ever to review contractually established rates under the statutory standard.

FERC's authority to allow its MBR regime is not directly presented by these cases. Nonetheless, it is critically important for this Court to understand how that regime differs from the one established by the FPA, for two reasons.

First, FERC and the petitioners repeatedly refer to the MBR regime and make assertions about its consistency with the FPA, and many of their arguments are premised on the lawfulness of market-based rates. Thus, even though the issue is not directly before it in this case, and has not been fully briefed by the parties, it is essential that the Court recognize that there are extremely serious arguments that FERC's MBR regime is unlawful under the FPA. Those arguments start with the proposition that only Congress can change rate-filing regulatory statutes and relieve regulated entities of the obligation to file all rates for review. *Maislin Indus. U.S. v. Primary Steel Inc.*, 497 U.S. 116 (1990), *MCI Telecomms. Corp. v. Am. Tel. & Tel. Co.*, 512 U.S. 218 (1994). In addition, the courts have long required that, even where sellers are thought to be competitive, "the marketplace cannot be the final measure of 'just and reasonable' rates," but FERC must determine whether "competition" *in fact* drives rates down into a "zone of reasonableness" and must "check" rates if it does not. *FPC v. Texaco*, 417 U.S. 380, 400 (1974); *Interstate Natural Gas Ass'n of America v. FERC*, 284 F.3d 18, 31 (D.C. Cir. 2002) (quoting *Farmers Union Cent. Exchange v. FERC*, 734 F.2d 1486, 1509 (D.C. Cir. 1984)). Although FERC assured the court in *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866 (D.C. Cir. 1993), a case on which FERC and petitioners rely here,[12] that it would make such "just and reasonable" determinations concerning "market-based" rates, FERC has since changed its mind and only looks at whether sellers are "competitive."[13] Further, FERC has eliminated the concept of rate "increases" under its MBR regime, claiming that under an MBR "tariff," no rate ever "changes" because the rates always remain whatever the seller and buyer agree, a concept that *de facto* eliminates all the protections for consumers against rate *increases* that Congress enacted in FPA sections 205(d) and (e).

In light of these substantial arguments that FERC's MBR regime does not comport with the FPA, the Court should take care to avoid deciding, or appearing to decide, the question of the regime's lawfulness in a case that does not directly present the issue.

Second, an understanding of how FERC's current scheme of rate deregulation differs from the traditional system of FPA rate regulation that was in effect when the *Mobile-Sierra* doctrines were devised by this Court is important to the resolution of the issues that are actually presented: whether and how those doctrines should apply to contracts entered into in the very different regulatory environment FERC has devised. After all, the *Mobile-Sierra* doctrines are judge-made doctrines that cannot be divorced from the regulatory context in which they were issued, where the FPC was actually complying with the statutory

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[12] *E.g.*, FERC Br. 27-28.

[13] "Here, … the FERC has made it clear that it will exercise its § 5 authority (upon its own motion or upon that of a complainant) to assure that a market (i.e., negotiated) rate is just and reasonable." *Elizabethtown Gas*, 10 F.3d at 870.

mandates of the FPA and requiring public utilities to file all rates in advance for agency and public review under a "just and reasonable" standard. Even if the Court assumes for the purpose of its decision that FERC's MBR regime is not unlawful, the very different nature of regulatory oversight of rates under that regime is obviously relevant to whether contractually established rates should receive the extremely heavy presumption of lawfulness that petitioners advocate. The premise of *Mobile-Sierra* that a presumption of lawfulness may attach to a rate properly filed under the FPA, whose lawfulness the Commission and the public had a full opportunity to review before it went into effect, has no application once the statutory filing and review procedures (not to mention the underlying substantive standard of justness and reasonableness) have been dispensed with by the Commission.

The contrary position of FERC and the petitioners that the *Mobile-Sierra* doctrines reflect a presumption that the market can be trusted to establish wholesale electric rates is based to a significant degree on *dictum* in *Verizon Communications v. FCC*, 535 U.S. 467 (2002), a case decided under the Telecommunications Act of 1966. The *Verizon dictum*, which purports in passing to describe the history of the FPA and NGA, is inconsistent with a long line of cases of this Court decided under those statutes. It is particularly mistaken in suggesting that Congress believed that wholesale contracts were negotiated by "sophisticated parties" with equal bargaining power, who could be relied on to negotiate "just and reasonable" rates.

In fact, the paramount concern of Congress in enacting the FPA was to protect consumers. It is therefore not surprising, that, as the Ninth Circuit concluded, the *Sierra* doctrine, properly understood, is asymmetrical, with its stringent "public interest" standard applicable to efforts by sellers to raise rates that they agreed to, not to rates that consumers contend are unjust and unreasonable (and that have never been subject to review for reasonableness by FERC). Indeed, the FPA itself is asymmetrical because it regulates only one of the parties to a wholesale contract, the public utility seller, and was enacted to provide a "complete, permanent and effective bond of protection against excessive rates" to *consumers*, not to suppliers. *Atlantic Refining Co. v. Pub. Serv. Comm'n of State of N.Y.*, 360 U.S. 378, 388 (1959).

The petitioners' expansive conception of the *Mobile-Sierra* doctrines stands the FPA on its head. Indeed, if the view of *Mobile-Sierra* advanced by petitioners and FERC were correct, there would have been no need for FERC to create its MBR regime, because *all* negotiated contracts would *always* have been presumed to be "just and reasonable" under the FPA, whether or not the sellers had "market power"; and no negotiated contract could ever be changed unless some undefined, extraordinary, public necessity required it. *Mobile* and *Sierra* were never intended to go that far, nor could they without dispensing with the FPA's system of rate regulation in the interest of consumers.

ARGUMENT

I. FERC's MBR Regime Does Not Square with the FPA.

This Court has not addressed whether FERC's novel MBR regime can be reconciled with the FPA's requirements. The D.C. Circuit, while issuing *dicta* in a number of opinions that FERC has relied on as support for market-based rates, has consistently sidestepped the question, most recently in *Colorado Office of Consumer Council v. FERC*, 490 F.3d 954 (D.C. Cir. 2007).[14] The Ninth Circuit, in *California ex rel. Lockyer v. FERC*, 383 F.3d 1006 (9th Cir. 2004), *cert. denied*, 127 S.Ct. 2972 (2007), relied on the D.C. Circuit's *dicta* in holding the market-based rates were not unlawful "per se," but the court recognized that the MBR regime rendered parts of the FPA essentially meaningless and held that the regime could only be squared with the FPA if FERC were given remedial authority it did not even claim to possess.

Although the question of the lawfulness of the MBR regime is not directly presented by this case,[15] it remains very much a live issue. It has been placed before FERC by consumer advocates in their comments on a pending rulemaking concerning MBR authorizations and is likely to be presented to the courts upon judicial review of that rulemaking.[16] Because the briefs of petitioners and FERC are replete with assertions that the MBR regime is lawful, and the assumption of its lawfulness is even more pervasive in their arguments, it is important that the Court understand

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[14] Certain parties in that case, including some of the amici joining in this brief, have filed a petition for certiorari, No. 07-385, which raises the issue of the MBR regime's lawfulness.

[15] As the Ninth Circuit noted, the lawfulness of the MBR regime was not at issue in the administrative proceedings in this case, 471 F.3d at 1072, and the Ninth Circuit did not address them other than insofar as it noted that *Lockyer* established the law of the circuit on that point.

[16] *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities, Order No. 697*, 72 Fed. Reg. 39,904 (July 20, 2007), 119 FERC ¶ 61,295 (2007).

the degree to which the MBR regime in fact departs from the terms of the FPA, so that the Court does not pretermit the issue without the benefit of a full adversary presentation of it. We therefore provide a brief summary of the principal legal flaws in FERC's MBR scheme.

- The FPA requires the filing of *all* rates and charges for Commission and public review to determine whether they appear to be just and reasonable or should be set for hearing under Sections 205(e) or 206(a). This Court has called rate filings the "basic duty" of the regulated entities under the NGA and FPA. *Mobile*, 350 U.S. at 341. Nonetheless, FERC's MBR regime eliminates advance rate filings and even prohibits its contracts from being filed for review.

- This Court has repeatedly held that neither the courts nor agencies have authority to change the goals of regulatory statutes or the means that the Congress chose to meet them. *MCI*, 512 U.S.at 234; *Maislin*, 497 U.S. at 135. Specifically, the Court has repeatedly held that only Congress may deregulate and detariff under a filed-rate statute. *Id.*

- Congress has never deregulated wholesale electric rates or changed the "just and reasonable" standard for sales for resale, and this Court has held that "the marketplace cannot be the final measure of 'just and reasonable' rates." *Texaco*, 417 U.S. at 400. Moreover, as then-Judge Scalia noted, *without* rate filings it is difficult to determine just and reasonable rates "and virtually impossible for the public to assert its right to challenge the lawfulness of existing or proposed rates." *Regular Common*

Carrier Conf. v. United States, 793 F.2d 376, 379 (D.C. Cir. 1986).

- Even the principal court decision that FERC relies on as supporting its MBR regime states that elimination of the section 205(e) consumer protections is contrary to "both the text and the goals" of the FPA. *Lockyer*, 383 F.3d at 1017. The *Lockyer* court appeared to find that it is nonetheless permissible for FERC to gut the FPA's consumer protections—by *de facto* eliminating rate suspension, hearings where the seller bears the burden of proof for increased rates, and refund protection—as long as the agency requires after-the-fact "reporting" of rates and "substitute remedies." *Id.* at 1016.

- FPA section 205(a) [16 U.S.C. 824d(a)] states that all electric rates for sale for resale by "public utilities" in interstate commerce must not only be reasonable, but must also be "just," and that rates that are not "just and reasonable" are *unlawful.*

- Petitioners argue that the "zone of reasonableness" is an elusive, undefined concept, but this is not correct; it has often been defined as a zone below which the seller earns an inadequate return on investment, and above which the investor earns an excessive return and rates are excessive to consumers. *Elizabethtown Gas*, 10 F.3d at 870; *Farmers Union*, 734 F.2d at 1502-03.

- Nonetheless, FERC now contends that it need not determine whether competition in fact drives rates down into a "zone of reasonableness" as the courts require and as FERC originally assured the D.C. Circuit it would do under its MBR regime. *See Elizabethtown Gas*, 10 F.3d at 870.

- In any event, the court in *Elizabethtown Gas* was confused about what constituted a competitive market outcome, conflating a reasonable rate of return on capital for power plants *on the margin* with a just and reasonable rate for all power sold in the same market; in fact, this may entail extremely high rates of return on equity for all the other power plants not on the margin, because all plants get the same market clearing price.
- This means that FERC has turned the 1956 *Hope Natural Gas Co.* "end result" ratemaking test,[17] on which the agency purports to rely in support its MBR regime, on its head: FERC doesn't care about the "end result" of ratemaking—whether consumers are protected from excessive rates—as long as FERC is happy with its ratemaking *methodology*, reliance on a "competitive" market. However, the FPA does not require FERC to ensure that a ratemaking *theory* is defensible, but that the resulting rates and charges to consumers are "just and reasonable."
- FERC claims that there are never any "rate increases" or "changes" under its MBR regime because the "rate"—a statement that rates will be whatever the seller and buyer agree—*never changes*. As a result, none of the FPA's con-

[17] *See* 320 U.S. at 602. ("It is not theory but the impact of the rate order which counts.")

sumer protections in sections 205(d) and (e) can ever be implemented for increased MBR charges, because such "increases" have been *defined out of existence* by FERC.

- Even Section 206 refund-effective-dates cannot be implemented for initial rates until long *after* excessive MBR rates have been charged because FERC no longer requires (or allows) advance filing of initial MBR rates;
- FERC has no standard for determining whether rates are "unduly preferential or discriminatory," which the FPA prohibits, because sellers and buyers are free to negotiate *any* rate for *any* service, so FERC has no standard for comparison. Although FERC continues to claim that its standard is whether sellers charge different rates for similar services, this standard that has no meaning under FERC's MBR regime.
- Consumers no longer receive refunds, as the FPA anticipates, when FERC determines that they paid excessive charges, even though the Act was designed "to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges." *Atlantic Refining Co.*, 360 U.S. at 388; instead, FERC has abandoned the statutory remedy for consumers and created its own remedy whereby only bad actors are required to "disgorge" excess profits, while consumers paying excessive rates in the market that was skewed by their actions are left unprotected.
- The Courts have long held that FERC may not abdicate its *independent responsibility* to en-

sure lawful rates by simply relying on wholesale buyers to negotiate "just and reasonable" rates, because: (1) such buyers may not only lack equal bargaining power, but (2) they may lack adequate incentive to bargain strongly, because the Supremacy Clause requires that buyers must in most circumstances be allowed to pass their negotiated prices along to retail consumers. *Tejas Power v. FERC*, 908 F.2d 998, 1003 (D.C. Cir. 1990) (citing *Nantahala Power & Light Co. v Thornburg*, 476 US 953 (1986).

- FERC's MBR regime nonetheless relies completely on wholesale buyers to determine by negotiation whether rates are "lawful," yet the D.C. Circuit case which FERC and petitioners cite as supporting "market rates," *Tejas Power*, actually held that agreement of buyers alone is not enough; buyers must *both* lack market power *and* have interests that "are sufficiently likely to be congruent with those of ultimate consumers," who "presumably, will bear the costs of the agreed-upon rates." *Id.* at 1003-4. *Cf. Missouri Pub. Serv. Comm'n v. FERC*, 337 F.3d 1066, 1076 (D.C. Cir. 2003), *Atlantic Refining*, 360 U.S. at 390.
- FERC attempts to justify its elimination of the FPA-mandated rate filings and review by claiming that its MBR regime avoids "the costs and practical difficulties that would be associated with prior review of a large number of transactions, many of which are of short duration." FERC Br. 8. Not only does "lack of time" not authorize FERC to depart from statutory requirments, but FERC has never given any reason why *long-term contracts*, such as those in

this case, could not be filed and reviewed, even under a "market rate" regime.

- Despite the fact that no actual rates and charges are filed with, much less reviewed by, FERC or the public, FERC and the regulated entities and their lenders still claim, as they do in these cases, that MBR rates are entitled to the protection of the "filed rate doctrine." This extraordinary claim has actually been accepted by some courts. *See Pub. Util. Dist. No. 1 v. Idacorp Inc. (Grays Harbor)*, 379 F.3d 641, 651-52 (9th Cir.2004); *Town of Norwood*, *Mass. v. New England Power Co.*, 202 F.3d 408, 419 (1st Cir. 2000).

II. The *Mobile-Sierra* Doctrines Cannot Be Divorced from the Regulatory Context in Which They Were Issued, When the FPC Was Actually Complying with the Requirements of FPA Sections 205 and 206 as They Were Enacted.

There are really two *Mobile-Sierra* doctrines, which often are conflated, but which are different. In *Mobile*, this Court rejected an attempt *by a regulated seller* to breach a fixed-rate contract by claiming that the NGA's requirement that natural gas companies file all rate *increases* allows them to file such increases whenever they choose, despite the terms of any contract with customers. This judge-made doctrine—that the contract between the parties limits the seller's ability to file for rate increases—has little meaning in an MBR regime where no rate increases are required to be filed at all, because FERC says rate increases no longer occur once MBR authorizations are granted.

In *Sierra*, this Court rejected an attempt *by a regulated seller* to breach a fixed-rate contract by claiming that the contract rate had become so low that it did not recover a "fair return" on investment and thus was no longer "just and reasonable." The Court held that the seller could not escape the rate it had agreed to (and filed with the Commission) without a showing that the public interest demanded an increase. It is the *Sierra* doctrine, rather than *Mobile's* holding, that petitioners seek to invoke here.

In both *Mobile* and *Sierra*, the Court noted that the rates that the sellers sought to change had been "duly filed" with the Commission, which had had a full opportunity to review them under Section 205 or 206 when they were first filed and before they went into effect. *Mobile* at 336; *Sierra* at 352. In interpreting the filing and review provisions of both statutes, this Court very clearly stated that the fact that the rates were set by contract made no difference to the powers of the Commission to review the rates in the first instance:

> [A]ll rates are established initially by the natural gas companies, *by contract or otherwise*, and *all* rates are subject to being modified by the Commission upon a finding that they are *unlawful.*

Mobile, 350 U.S. at 341 (emphasis added).

> The basic power of the Commission is that given it by § 5(a) to set aside and modify any rate *or contract* which it determines, after hearing, to be "unjust, unreasonable, unduly discriminatory, or preferential."

Id. (emphasis added).

Recognizing that the FPA and NGA declare unjust and unreasonable rates to be "unlawful," this Court stated:

> [FERC's power] is simply the power to review rates and *contracts* made in the first instance by natural gas companies and, if they are determined to be *unlawful*, to remedy them. Section 5(a) would of its own force apply to *all* the rates of a natural gas company, *whether long-established* or newly changed, but in the latter case the power is further implemented by sec. 4(e).

Id. (emphasis added).

Four years after *Mobile-Sierra*, this Court summarily disposed of the argument that *Mobile* requires the Commission to blindly honor the "integrity" of contracts:

> The short of the matter is that *Mobile* recognized that there were *two* sources of price and supply stability inherent in the regulatory system established by the Natural Gas Act—the provisions of private contracts *and* the public regulatory power. See 350 U.S. at p. 344. Petitioner now urges an application of that decision that could make private contracts the *only* stabilizing factor under the Act.

Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. 137, 155-56 (1960) (emphasis added).

In short, the premise of *Mobile*, and particularly, of *Sierra*, was that the rates that the sellers were seeking to change, to the buyers' disadvantage, had already been subject to the protections provided by the Act by means of filing and review. It was only in that context that the Court in *Sierra* erected a heightened presumption that the duly filed and reviewed rates were lawful and could only be increased where the seller's private interest in higher rates happened to "coincide with the public interest." 350 U.S. at 344. As FERC itself recently told the D.C. Circuit, "there is no expectation of contract stability when a contract is submitted to FERC for the first time, has yet to be approved by FERC, and has not yet gone into effect." *Maine PUC v. FERC*, 454 F.3d 278, 284 (D.C. Cir. 2006). Absent compliance with the requirement that rates be filed for review before they are effective, providing the Commission and public with a meaningful opportunity to review them to determine in the first instance whether they comply with the statutory standard of justness and reasonableness, there is no basis for applying a presumption of lawfulness to a contract rate. Under FERC's MBR scheme, those prerequisites for application of the *Mobile/Sierra* presumption are absent.

The petitioners,' FERC's and amici's concerns about contract stability for power supplies could be managed as they have been since 1935, if FERC were to follow the mandates of the FPA and review contracts for lawfulness *before* they become effective. FERC argues that there is no time for the FPA-required review where there are many rates, some of short duration, but has not been able to offer even this unacceptable excuse for ignoring the statutory filing requirements in the case of long-term contracts. FERC Br. 8.

III. Contrary to the *Verizon Dictum*, the FPA Did Not Reflect a Presumption that Private Contracts Would Yield "Just and Reasonable" Rates.

In Jane Austen's *Pride and Prejudice*, Elizabeth Bennett is told by her father that she must choose between her parents because her mother will never speak to her again if she does not marry Mr. Collins, and her father will never speak to her again if she does. This Court faces a similar dilemma; it cannot accept both the history of the NGA and FPA set out in passing in *dictum* in *Verizon Communications v. FCC*, 535 U.S. at 479-81—relied on by petitioners here—and also accept the history of these statutes found in such cases as *Hope Natural Gas*, *Mobile-Sierra*, *Gulf States Utilities Co. v. FPC*,[18] *Atlantic Refining*, and *Sunray Oil*, because the two are contradictory. *Verizon* was a case brought under the Telecommunications Act of 1996. Nonetheless, its *dictum* purports to give a sweeping history of the passage of the FPA and NGA, although often without citations to sources. Several parts of this history are incorrect or incomplete.

Although the *Verizon* Court referred to the FPA as the "Federal Power Act of 1920," all the provisions regulating wholesale power transactions were added to the FPA in the Public Utilities Act of 1935, together with PUHCA. In passing PUHCA at the same time as the relevant provisions of the FPA, Congress clearly recognized that on one side were giant power trusts,

[18] 411 U.S. 747 (1973) (The FPA was enacted "to provide effective federal regulation of the expanding business of transmitting and selling electric power in interstate commerce.").

covering many states and with enormous financial and political power, and on the other were municipalities, many quite small, and the brand-new REA-financed rural electric cooperatives (the REA was created in early 1935). This Court has described the situation: "[S]tate commissions and communities were becoming increasingly helpless before huge utility combinations."[19] This Court has also noted:

> [T]he primary practical problem that led to the passage of the [NGA] was the great economic power of the pipeline companies as compared with that of communities seeking natural gas service.

Sunray, 364 U.S. at 143, citing *Hope Natural Gas*, 320 U.S. at 610.

It is therefore clear that Congress did *not* view natural gas and electric sales for resale in interstate commerce as being between "sophisticated [commercial] parties with equal bargaining power" who could be relied on to negotiate just and reasonable rates, as the *Verizon dictum* suggests**.** Petitioners' reliance on this dictum is therefore ill-placed.

In addition to the fact that huge utility holding companies on one side and municipalities and new rural coops on the other hardly had equal bargaining power, the utilities were usually also trying to run municipalities and coops out of business. *See, e.g., City of Mishawaka, Indiana v. American Electric Power Co.*, 616 F.2d 976, 985 (7th Cir. 1980) (affirming trial court's finding of "specific utility intent to serve its monopolistic purposes at municipal expense," by engaging in monopolistic practices that would harm

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[19] *Hope Natural Gas*, 320 U.S. at 610.

the municipality and perhaps allow the utility to acquire the municipal system). The *Mishawaka* court found that AEP deserved no credit for originality in these maneuvers, noting two law journal commentators who found "it is not an uncommon practice" for a private electric company to refuse to sell bulk power to a municipality or otherwise try to harm it economically. *Id.* at 983. Indeed, the *Sierra* decision itself was an example of the anticompetitive supplier practices of the utilities which, large as they were, like Oliver Twist, still wanted "more," in this case the customers of municipalities.

In short, Congress in 1935 was well aware that the FPC would *not* be regulating contracts between "sophisticated" parties with equal bargaining strength, but between the operating companies of huge utility combinations and much smaller and weaker municipalities that the FPA-regulated sellers would be happy to run out of business. And even where the buyer was in fact a sophisticated fellow-utility, it lacked incentives to bargain strongly because it was able in most cases to pass along its "negotiated" prices under federal preemption doctrines.[20]

Equally unfounded is petitioners' reliance on the *Verizon* dictum to imply that contracts were allowed under the NGA and FPA *because* Congress thought parties were sophisticated and had equal bargaining power. Rather, this Court said in *Mobile* that contracts, instead of uniform tariffs, were allowed under the NGA and FPA because of the need for individualized arrangements by natural gas and electricity cus-

[20] See, *Nantahala*, 476 U.S. at 964, 973.

tomers—a very different proposition from reliance on sophistication of the parties. This Court said:

> Recognizing the need these circumstances create for *individualized arrangements* between natural gas companies and distributors, the [NGA] permits the relations between the parties to be established *initially by contract*, the protection of the public interest being afforded *by supervision of the individual contacts*, which to that end *must be filed with the Commission and made public.*

Mobile, 350 at 338-39(emphases added).

Finally, the *Verizon dictum* says that while state utility commissions were concerned with "just and reasonable" retail rates, the chief concern of federal agencies regulating wholesale transactions was discrimination, citing a judicial reference to the Interstate Commerce Act. *Verizon*, 535 U.S. at 479. While this may have been true under the ICA, the chief concern of the FPA and NGA has always been that rates should be "just and reasonable." This Court early on described "the fixing of 'just and reasonable' rates" as the heart of the new regulatory system." *Hope Nat. Gas*, 320 U.S. at 611.

Undue preference and discrimination are prohibited by section 205(b) of the FPA, but section 205(a) declares that all rates that are not just and reasonable are unlawful. In addition, because states must allow power retailers to pass federally-sanctioned prices through to retail consumers under the Supremacy Clause in most cases, the major part of retail electricity bills, the power supply portion (about 65%), will effectively be regulated only by FERC under the FPA wherever states have allowed or ordered their state utilities to sell off their power plants. In such "deregulated" states, the distributing utilities are completely dependent on the wholesale "market" that FERC "regulates." *See Nantahala*, *supra*.[21]

IV. The *Mobile-Sierra* Doctrines, Like the FPA Itself, Are Predominantly Intended to Protect Consumers.

Even if this Court were to find that the judge-made law of *Mobile-Sierra*, decided under a totally different regulatory scheme in which the FPA mandates were adhered to and actual rates and charges were both filed and reviewed, remains fully applicable to contracts entered into under the MBR regime, the Court should nonetheless find that the standard for contract review under a "public interest" standard is asymmetrical, emphasizing protection of consumers rather than power marketers.

This Court "declared as early as the *Hope Natural Gas* case that the primary aim of" the congruent provisions of the NGA and FPA was "'to protect consumers against exploitation ….' 320 U.S. 591, 610." *Sunray*, 364 U.S. at 147. In short, although this appears to be a fact the current FERC has missed, the FPA was *not* enacted to protect power wholesalers from their customers. Although FERC, petitioners, and *amici* supporting them all imply that *Sierra* and *Mobile* refer to *any party* to a contract, *Mobile* and *Sierra* in fact never address "any party" but only the *regulated* party

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[21] Although *Nantahala* suggests that there may be an exception for state determinations that a contract was entered into "imprudently," such a showing may be hard or impossible to make under an MBR regime where the entire "market" is subject to negotiated rates.

to the contract, either the natural gas company or the public utility.

In discussing the "sanctity of contracts," this Court clearly explained in *Mobile* what it meant by the "stability of supply arrangements" necessary for a healthy natural gas industry:

> Conversion by *consumers*, particularly industrial users, to the use of natural gas may frequently require substantial investments which the *consumer* would be unwilling to make without long-term commitments from the distributor, and the distributor can hardly make such commitments if its supply contracts are subject to unilateral change by the natural gas company whenever its interests so dictate.

350 U.S. at 344.

The Court found that the FPA and NGA had *not* been enacted to protect *regulated sellers* from filing and charging rates that later proved to be inadequate. Petitioners, and unfortunately FERC, have tried to flip this doctrine on its head to claim that customers cannot be protected from *excessive* rates once they have signed a contract, even though they will pass these prices through to retail ratepayers.

Immediately after the *Mobile/Sierra* decisions were issued, utilities similarly attempted to crop language from the cases to argue that the FPC lacked power under the FPA to set aside a rate fixed by a contract negotiated at arm's length and supposedly advantageous to both parties, and to substitute a lower rate based upon the cost of service. *South Carolina Generating Company v. FPC*, 249 F.2d 755, 759 (1957), *cert denied*, 356 U.S. 912 (1957). Both the buyer and seller argued that the contract was beneficial to the South Carolina area so that it did not adversely affect the public interest, claiming that the *Sierra* test thus deprived the FPC of power to change the contract rate on a cost-of-service basis. *Id.* at 761. The Fourth Circuit found that this argument was:

> [A]n attempt to generalize from a particular situation without recognizing the significant difference in the facts in the pending case. The Supreme Court [in *Sierra*] was dealing with rates, too low to permit an adequate return according to accepted standards…The practical effect of the decision is to compel contracting *utilities* to abide by their agreements unless it is shown that the agreed rate is so low [as to meet the *Sierra* test]. … In the pending case, to the contrary, we are dealing with a rate that was *too high* according to accepted standards of rate regulations.

249 F.2d at 761(emphasis supplied).

The Fourth Circuit concluded:

> We do not think that the Supreme Court denounced this accustomed procedure [of limiting contract rates to an adequate return on investment] in the *Mobile* and *Sierra* cases when it concluded that the unusually low rates which the utilities had voluntarily set up to serve their own interests were not unjust or unreasonable; and hence the Commission in the pending case, bearing in mind that its duty is to protect the public interest as distinguished from the private interest of the utilities, and finding that the *contract rate* is unreasonably high was justified in fixing a lower rate *for the benefit of the retail consumers* in Georgia after providing a reasonable return on the moneys invested by the utilities.

Id. (emphasis supplied.)

The Fourth Circuit recognized that the fact that this Court had held the selling utilities to unusually low rates "which the utilities had voluntarily set up to serve their own interests" did not imply that the Commission lacked power to modify an unjustly high rate for the benefit of the retail consumers who would pay the negotiated rates.

Interestingly, the selling utility and its holding company argued that the contract was in the "public interest" because:

> It enabled the corporate system, composed of E & G and the Generating Company, to secure a needed source of additional power and to sell at wholesale a portion of the product at substantial profit….

249 F.2d at 759. Indeed, it appears that the retail consumers who would actually pay for these passed-along "substantial profits" were the only ones that didn't like the contract. Happily for the retail ratepayers, the FPC and the Fourth Circuit recognized that they were exactly the parties that the Commission had been created by the Congress to protect. One year after its landmark decisions in *Mobile* and *Sierra*, this Court denied a petition for certiorari.

Petitioners argue that they are entitled to the "protections" of *Mobile-Sierra*, but as the contemporaneous *South Carolina* decision reflects, both doctrines were clearly designed to protect *customers*, not regulated "utilities" under a rate-filing, regulatory statute. *Mobile*'s language regarding "sanctity of contract" said that the regulated *sellers* could not abuse statutory filing procedures to get out of their contractual commitments to their customers.

Thirty years after *Mobile-Sierra*, in a dissent on other grounds, then-Judge Ginsburg eloquently dismissed a similar attempt by a selling utility to claim that *Mobile* prevented the Commission from challenging the lawfulness of initial rates set by contract :

> Petitioner stated that, in contrast to the rate uniformity required under the ICA, private contract plays a key role in rate setting governed by the FPA.… In developing this heated argument, petitioner cropped lines from [*Mobile*] and sought to portray dictum in that opinion as the Court's holding. Petitioner's "contact autonomy/*Mobile*" argument distorts precedent to no avail.

Middle South Energy v. FERC, 747 F.2d 763, 776 (1984).

In that case, the petitioner at least acknowledged that FERC could suspend contractually established rate increases, and that initial rates may be modified by FERC if they are not "just and reasonable." *Id.* Here, petitioners' and amici's "heated arguments", and even FERC's acquiescence, would completely set aside these historic principles derived from 70 years of FPA regulation.

Limiting *Mobile* and *Sierra* to the protection of customers is consistent with the overwhelming thrust of the FPA itself, which regulates only sellers for the protection of their customers. For example:

- Only sellers for resale, not buyers, are regulated as "public utilities" by the FPA. *See* Section 201(e), 16 U.S.C. 824e;
- Only "public utility" sellers are required to file their charges for review and to justify any rate increases;

- Only "public utility" sellers can have their rates suspended and made subject to refund while being prohibited from retroactively collecting undercharges;
- Only "public utility" sellers can unilaterally file new rates, if contracts allow such changes to be filed;
- Only "public utility" sellers would ever have to worry that a rate is "too low" and doesn't recover a "fair return" on investment as in the *Sierra* test;
- The FPA is only concerned about sellers charging *excessive* rates, not rates that are *too low*; thus, it is only where rates are claimed to be *too low* and that an *increase in rates is required* that the Commission must consider whether it is needed to protect the public interest; a decrease from excessive rates is *always* in the public interest and was the reason behind the FPA and NGA. This Court has explained that it is the policy of the Act that sellers "shoulder the hazards" of possibly unlawful rates. *Tennessee Gas Pipeline v. FPC*, 371 U.S. 145, 153 (1962).

V. If Petitioners and FERC Were Right About *Mobile-Sierra*, FERC's New MBR Regime Would Be Unnecessary, Because Contractually Established Rates Would Always Have Prevailed Under the FPA

Perhaps the best indication that petitioners' and FERC's claims about the scope of the *Mobile-Sierra* doctrine are unfounded is that—if they were true—FERC would not have needed to create (unlawfully in our view) its MBR regime to allow sellers to set their rates by negotiation. Under the theory of *Mobile-Sierra* proffered to this Court by petitioners, FERC, and their amici, *all* contracts negotiated by sellers and buyers *have always been* protected as automatically "just and reasonable," unless some extraordinary public necessity standard (not specified by the statute or any court) is met. If that is so, FERC may as well discard its "market power" tests and its entire MBR regime because—according to petitioners' view of *Mobile-Sierra*—if parties to a contract agree, that is the end of the matter and has been for fifty years. What their arguments boil down to is that *all contract rates, whether filed or unfiled*, must be treated as "just and reasonable" and be passed on to retail consumers (as well as being protected from court or other challenges under the "filed rate doctrine"), even though they have never been reviewed by FERC for lawfulness under the FPA.

FERC generally claims that such rates are *now* "just and reasonable" under its MBR regime because FERC requires an advance "market power" analysis of sellers. However, in its brief to this Court, FERC effectively asserts that *all contracts* negotiated by the parties *have always been* considered "just and reasonable" under the *Mobile-Sierra* doctrine, absent an extraordinary showing of public interest. FERC Br. 17, 19. If this were in fact the case, FERC would have no need to now review a seller's "market power," because *any* contract rate is deemed "just and reasonable" anyway.

The claims made for the *Mobile-Sierra* doctrine here would put an exclamation point on FERC's attempt, through its MBR regime, to transform the FPA from a regulatory statute into a scheme of deregulation. They amount to the extraordinary fiction that this has *always* been the intent behind the FPA, somehow discerned by this Court in *Mobile* and *Sierra* a generation before FERC even thought of market-based rates. This effort to rewrite not only the statute, but also history, cannot be permitted to succeed.

CONCLUSION

The Court should affirm the Ninth Circuit decision insofar as it requires the wholesale contracts below to be remanded to FERC for "just and reasonable" review under the FPA. Whatever decision this Court makes, it should be careful to avoid giving its approval to FERC's so-called "market-based rate" regime, which allows wholesale sellers and buyers to negotiate their own rates without notice to or review by FERC or the public, or any determination that such rates are in fact lawful, yet still grants them all the benefits of "filed rates."

Respectfully submitted,

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