NOS. 06-1457, 06-1462

In the Supreme Court of the United States

MORGAN STANLEY CAPITAL GROUP INC., *Petitioners,*
v. PUBLIC UTIL. DIST. NO. 1 OF SNOHOMISH COUNTY, WA,
et al., Respondents.

CALPINE ENERGY SERVICES, L.P., *et al., Petitioners,*
v. PUBLIC UTIL. DIST. NO. 1 OF SNOHOMISH COUNTY, WA,
et al., Respondents.

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

BRIEF OF AARP AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

STACY CANAN
AARP Foundation Litigation

MICHAEL SCHUSTER
AARP

601 E Street, NW
Washington, DC 20049
(202) 434-2060

BARBARA JONES
Counsel of Record
AARP Foundation Litigation
200 So. Los Robles, Suite 400
Pasadena, CA 91101
(626) 585-2628

WILLIAM JULIAN II
43556 Almond Lane
Davis, CA 95618
(916) 758-8882

Attorneys for AARP

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

AGENCY DECISIONS

STATUTES

OTHER AUTHORITIES

INTEREST OF *AMICUS CURIAE* AARP[1]

AARP is a nonprofit, nonpartisan organization that helps people over the age of 50 to have independence, choice and control in ways that are beneficial to them and society as a whole. AARP has close to 40 million members nationwide. As the largest membership organization representing the interests of Americans aged 50 and older AARP is greatly concerned about the threats to health and safety of America's most vulnerable citizens caused by the recent sharp rise in energy costs. Because of regulatory decisions like the one in this case below many low to middle-income families and older Americans must now choose between paying their energy bills for heating and cooling and paying for other essentials such as food and medicine.

The Federal Energy Regulatory Commission (FERC) regulates "the business of selling electric energy for ultimate distribution to the public"[2] under the Federal Power Act (FPA). All AARP members *are* included in the "public," the retail end-use electricity consumers whose utility bills are affected by the activities of wholesale sellers regulated by

---

[1] All parties have consented to the filing of this brief. The parties' blanket consents have been lodged with the Clerk of the Court. Pursuant to Rule 37.6, *amicus curiae* states that no counsel for a party has written this brief in whole or in part and that no person or entity other than *amicus curiae* or their counsel has made a monetary contribution to the preparation or submission of this brief.

[2] FPA § 201(a), 16 U.S.C. § 824(a) (2005).

FERC, like the Petitioners in this case, and their interest *is* "the public interest" protected by the FPA. They are, as the DC Circuit has noted, FERC's "...prime constituency – the consumers whom the [statute] was designed to protect against exploitation...."[3] As consumers, AARP members depend upon the "...complete, permanent and effective bond of protection from excessive rates and charges"[4] afforded them by the FPA when it is effectively administered by the FERC. That protection is founded on the bedrock requirement of the FPA that "all rates and charges made, demanded or received by public utilities ... shall be just and reasonable...." FPA § 205(a). FERC's failure in this case to modify unlawful rates has had devastating consequences for consumers. The Ninth Circuit decision in this case gives them some redress.

SUMMARY OF ARGUMENT

This case is about FERC's responsibility under the Federal Power Act to protect consumers. FERC has refused to find unlawful, or to modify, the rates contained in the Petitioners' exorbitantly high cost contracts. The higher percentage that consumers pay for electricity as a result of the contracts that are at issue here translate into serious family and social problems that affect consumers either directly or in the form of increased

---

[3] *Maryland People's Counsel v. FERC*, 761 F.2d 780, 781 (D.C. Cir. 1985).

[4] *Id.* at 777.

government expenditures to address those problems.

FERC has substituted the statutory "just and reasonable" standard established by Congress in the Federal Power Act ("FPA") with an arbitrary new standard which they call a "public interest" standard. That standard does not in fact benefit the "public interest" and is derived from an erroneous reading of this Court's decisions in *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956) and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) [hereinafter *Mobile/Sierra*]. Those decisions are consumer protection decisions, not contract protection decisions. The "public interest" discussed in *Mobile/Sierra* is in fact very different from the "public interest" standard adopted by FERC. Both the text of the Federal Power Act and the decisions of the Supreme Court interpreting the Federal Power Act, including those in *Mobile/Sierra*, fully support the order of the Ninth Circuit.

The FPA protects consumers of electric energy from exploitation and abuse by the public utility sellers regulated by the Act. It places the burden of regulation on sellers – defined as "public utilities" under the Act. The text of the FPA establishes a single legal standard – just and reasonable -- for assessing the lawfulness of wholesale rates demanded or received by utility sellers. That a rate has been established by contract, rather than a FERC order, does not confer special status or insulate it from application of the "just and reasonable" standard as it has been defined by this Court.

The *Mobile/Sierra* decisions protect consumers by resisting sellers' attempts to unilaterally raise rates above the previously contracted level; a seller cannot unilaterally raise its price if its contract does not permit it. The Court's conclusions in *Mobile/Sierra* rest on both the language and the structure of the rate-setting provisions of the FPA, which afford sellers the initiative in proposing rates and rate changes. Under *Mobile/Sierra* the circumstances justifying a seller's unilateral rate increase above contracted levels (where the seller has not contractually reserved the power to change rates) are limited to situations where the contract rate is below the lower bound of the zone of reasonableness that defines statutory "just and reasonable," thereby jeopardizing service to the consuming public. This "public interest" standard applies only to sellers. The *Mobile/Sierra* decisions themselves explicitly affirm the authority of FERC to change rates asserted by consumer representatives, including wholesale buyers, to be unlawful because the rates are excessive.

Decisions of the Court and federal appeals courts that follow *Mobile/Sierra* do not depart from these holdings. FERC and Petitioners misinterpret the language of both the FPA and the very cases on which they purport to rely.

Under long-settled precedents of this Court, the "just and reasonable" legal standard requires FERC to assess the "end result" of the rate demanded or received relative to a "zone of reasonableness" based on the costs of suppliers. The

contract rate is never the test. Under the decisions of this Court, in applying the "just and reasonable" standard FERC must take into account of the economic context and consumer impacts of rates charged by statutory public utilities – the interests of the "public" to whom electric energy is distributed. The significant departure of the Petitioners' rate demands in Spring 2001 from the benchmark contract rate identified by FERC in December 2000 should have triggered "just and reasonable" rate review by FERC, as the Ninth Circuit ordered.

ARGUMENT

I. THE NINTH CIRCUIT'S HOLDING THAT FERC MUST GIVE PREDOMINANT WEIGHT TO THE IMPACT OF A CHALLENGED CONTRACT ON RATES PAID BY THE CONSUMING PUBLIC MUST BE UPHELD.

The Ninth Circuit's holding that FERC did not properly assess the public interest in any of the contracts before it is a correct reading of not only the FPA, but also the *Mobile/Sierra* decisions. Under California and other state laws, as well as decisions of this Court,[5] consumers must pay directly for the cost of these contracts even though they were not parties to the contracts. *See, e.g.*, Cal. Water Code § 80104. The energy crisis in 2000-2001 resulted in extreme power shortages and price volatility in the

---

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

western states. *Pub. Util. Dist. No. 1 of Snohomish County of Wash. v. FERC,* 471 F.3d 1053, 1056 (9th Cir. 2006). FERC's failure to address unlawful rates in this case has had devastating consequences for consumers. Respondents and retail consumers were victimized by wholesale sellers including Petitioners in the Western Energy Crisis.[6] Under the multi-year contracts at issue in this case, wholesale contract costs substantially exceeded the benchmark "reference" price of $74 per megawatt hour identified by FERC in December 2000 to address concerns about potential unjust and unreasonable prices.[7] Petitioners (and others) succeeded in locking in unlawful excessive rates[8] for many years into the

---

[6] The factual context of the Western Energy Crisis of 2000-01 is outlined in a long series of Ninth Circuit decisions listed in the decision below. *Snohomish*, 471 F.3d at 1067; see particularly *Lockyer v. FERC*, 383 F.3d 1006 (9th Cir. 2004). FERC's Western Energy Crisis archive is found at http://www.ferc.gov/industries/electric/indus-act/wec.asp. Particularly important is the *Final Report on Price Manipulation in Western Markets – Fact Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, issued March 2003 by the FERC Staff [hereinafter FERC STAFF REPORT]. The summary of findings, *Staff Report, Price Manipulations in Western Markets, Findings at a Glance*, is available at http://www.ferc.gov/industries/electric/indus-act/wec/enron/ summary-findings.pdf. This report is referenced throughout the *Snohomish* decision. It details pervasive manipulation of both electricity and gas supplies and prices during the Western Energy Crisis.

[7] *Snohomish*, 471 F.3d at 1069.

[8] FERC determined in December 2000 a benchmark price of $74 per megawatt hour for term contracts like the ones at bar. Petitioners demanded prices up to triple the FERC-declared

future through the device of making unlawful demands during a brief period of acute crisis in Spring 2001.

During the energy crisis some consumers observed that their electric bills "tripled", others saw their electric bills exceed $300. Mark Grossi, *No Heat or Food or Funds Many Seek Relief from Valley Social Agencies*, FRESNO BEE, Feb. 15, 2001, *available at* 2001 WLNR 1648598. In the midst of the energy crisis, this article summarized the effects on California's most vulnerable citizens: "Indeed, for jobless, working poor, elderly and other people on fixed incomes, the biggest decision during the state's energy crisis boils down to this: Pay the utility bill and run out of food money; or buy food and run the risk of having the power turned off." *Id.*

In one month, electricity prices rose 9% after the California Public Utilities Commission approved the increase to help the state's major utilities cover "part of spiking whole sale prices" and unfortunately energy assistance for low-income consumers was limited and exhausted before all who needed help received the help they needed. *Id.* Several years after the energy crisis was supposedly over, consumers still feel the "economic pain and personal traumas" that the contracts that are the subject of this action caused: "Consumers, particularly those on fixed incomes, couldn't pay electric bills that kept going up by leaps and bounds, even as they turned

---

benchmark, and received prices 40 percent to 120 percent higher. *Snohomish*, 471 F.3d at 1069-72.

off every light and cut back air conditioning to the bare minimum. A 65-year-old summed it up; I thought I was working so that I could retire; now I'm working to pay the electric bill." Bob Finkelstein & Michael Shames, *Yes. San Diegans Understand Need for Electricity Reforms,* SAN DIEGO TRIB., Oct. 12, 2005 *available at* http://www.signonsandiego.com/uniontrib/20051012/ news_lz1e12prop80.html.

Californians are not the only consumers to feel the effects of the contracts at issue here. "In 2000 the average Nevada Power Co. residential customer...was paying $84.29 a month" by 2005 that rate had increased to $127.88, an increase of almost 52 percent." Kevin Rademacher, *Utility Bills Burning up Residents' Cash,* LAS VEGAS SUN, Oct. 16,2005, *available at* http://www.lasvegassun.com/sunbin/stories/text/2005/oct/16/519515668.html. Nevada energy experts explained the effect of rising energy prices and on consumers. "[E]ven small increases in monthly expenses can have disastrous implications for consumers on the brink of poverty." *Id.* Given Nevada's extreme temperatures, it's no wonder that thousands of Nevadans sometimes struggle to pay their utility bills.

Unfortunately, nationwide electricity discounts for the poor are often reduced or "eliminated" due to state or local budget deficits. *See, e.g.*, Kim Horner, *Electricity Discount for Poor Eliminated: Some Residents Might Have To Make Choice Between Power, Food,* DALLAS MORNING NEWS, Sept. 1, 2005, *available at* 2005 WLNR 24675874 (noting that the Texas stopped giving the 10 percent break on

electricity costs "to 391,000 low-income households through the LITE-UP Texas program" and opted instead to "use the money...to help balance the state budget."). Consumer electricity costs during spot markets similar to those at issue here have doubled in some locations. Ron Scherer, *Cost of Electricity Rising Like Summer Heat,* CHRISTIAN SCI. MONITOR, July 27, 2005, *available at* http://www.csmonitor .com/ 2005/0727/p01s03-usec.html.

The higher percentage that consumers pay for electricity as a result of the contracts that are at issue here translate into serious family and social problems that affect consumers either directly or in the form of increased government expenditures to address those problems. Because retirees live on fixed incomes even small increases in expenses create financial hardship and emotional distress. The Federal Power Act was designed to provide consumers a "complete, effective and permanent and effective bond of protection from excessive rates." *Atl. Ref. Co. v. Pub. Serv. Comm'n of N.Y.*, 360 U.S. 378, 388 (1959).

The FERC Commissioners' fundamental error is hiding behind the contract status of the rates to avoid making the judgments they were appointed to make. An examination of the statutes and court precedents they relied on has demonstrated that there is no basis for their posture.[9] Under these

---

[9] Compare, *Jersey Central Power & Light Co. v. FERC,* 810 F.2d 1168, 1170 (D.C. Cir. 1985) ("...The explanation for what has taken place in these convoluted proceedings appears to be that the Commission resists 'end result' examination at the

precedents, the sharp departure of the contract prices demanded and received by Petitioners from FERC's December 2000 $74/mwh benchmark could and should have been reviewed by FERC on its own under FPA § 206, without resort to a complaint. The Ninth Circuit in this case has done no more than address FERC's refusal to perform its basic responsibility to assess whether the rates at issue were just and reasonable based on the cost-based zone of reasonableness.

II. THE FEDERAL POWER ACT PROTECTS CONSUMERS BY REQUIRING THAT ALL RATES BE JUST AND REASONABLE.

A. FERC's "public interest" standard violates the FPA.

FERC concedes in their Opening Brief that the Ninth Circuit was correct in its holding that "there is but one statutory standard addressing the lawfulness of wholesale electricity rates," and "[t]hat standard requires that *all* rates be 'just and reasonable'." FERC Br. On Writ of Cert., p. 21. However as the record reflects in this case, the FPA's statutory "just and reasonable" standard has been improperly modified by FERC and replaced with FERC's so-called (and misnamed) "public interest" standard. FERC's "public interest" standard bears little resemblance to the public interest criteria discussed by this Court in *Mobile/Sierra.*

---

agency level, and is deeply antagonistic to court review of ratemaking under the guidelines laid down by *Hope.*").

An example and clarification of FERC's own public interest standard is discussed in *Pub. Utils. Comm'n of Cal. v. Sellers of Long-Term Contracts to the Cal. Dep't of Water Res.,*101 FERC ¶ 61,293, 62, 175 (Dec. 17 2002).[10] In that case FERC specifically holds that unjust and unreasonable contracts can pass their public interest test:

> ...the burden of showing that a contract is contrary to the public interest is a higher burden than showing that a contract is not just and reasonable...The fact that a contract may be found to be unjust and unreasonable under Sections 205 or 206 of the Federal Power Act does not in and of itself demonstrate that the contract is contrary to the public interest under the Supreme Court cases....

Id. See also, PaciCorp. v. Reliant Energy Servs. Inc. 105 FERC ¶ 61,184 (2003) ("...if rates subsequently become unjust and unreasonable and the contract at issue is subject to a *Mobile-Sierra* standard of review, the Commission under court precedent may not change a contract simply because it is no longer just and reasonable.") *Id.* at ¶ 31. FERC's "public

---

[10] Cited with approval in *Pub. Utils. Comm'n v. Sellers of Long Term Contracts,* 103 FERC ¶ 61,354 (2003), *review granted and remanded in Pub. Utils. Comm'n of State of Cal. v. FERC,* 474 F.3d 587 (9th Cir. 2006) *pet'n for cert. filed,* 75 USLW 3610 (May 03, 2007) (06-1454).

interest standard" which permits high rate, unjust and unreasonable contracts clearly violates the FPA.

B. There is only one legal standard for lawful rates under the Federal Power Act – the "just and reasonable" standard contained in section 205(a).

The FPA places the burden of regulation directly on sellers. The activity regulated by Congress is the business of selling electricity for ultimate distribution to the public.[11] It applies price restraint -- the "just and reasonable" requirement found in FPA § 205(a) -- to all rates and charges demanded and received by public utilities subject to the jurisdiction of the FERC:

> All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall

---

[11] FPA § 201(a) declares that "[T]he business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation of ... that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest,..." 16 U.S.C. § 824(a). "Public utilities" are entities that own or control facilities for engaging in sales under FPA § 201(e), 16 U.S.C. § 824(e). Electric utilities are defined as sellers of electricity by FPA § 3(22), 16 U.S.C. § 796(22).

> be just and reasonable, and *any such rate or charge that is not just and reasonable is hereby declared to be unlawful.*

FPA § 205(a), 16 U.S.C. § 824d(a) (emphasis added).

The statute makes no reference to the manner in which rates have been established, demanded or received. It makes no distinction between rates and charges initially established by contract or by FERC order. It covers all "demands" such as bids or offers that invoke sophisticated strategies for raising prices such as the economic withholding described in the FERC STAFF REPORT, *supra* note 6.[12] As the Supreme Court noted in *Mobile*, ratemaking under the identical provisions of the Federal Power Act and the Natural Gas Act involves a "...single statutory scheme under which all rates are established initially by the [sellers], by contract or otherwise, and all rates are subject to being modified by the Commission upon a finding they are unlawful." *Mobile*, 350 U.S. at 341; *accord*, *United Gas Pipe Line Co. v. Memphis Light, Gas and Water Div.*, 358 U.S. 103, 113 (1958).

The *Mobile* Court's use of the precise term "unlawful", where the word has been given the specific meaning of "not just and reasonable" by

---

[12] FERC STAFF REPORT, *supra* note 6, at pp. VI-45 et seq. contains a description and discussion of economic and physical withholding of electricity supply during the Energy Crisis.

§ 205(a),[13] refutes any inference that the *Mobile* Court was creating a different standard than the one found in the statute for rates established by contract. There is no textual support in the Federal Power Act for creating a different and higher standard for review of rates established by contract.[14]

C. "Just and reasonable" rates protect consumers from excessive demands and charges by establishing a zone of reasonableness based on suppliers' costs.

The "just and reasonable" standard has from the very earliest decisions of the Supreme Court been understood to restrain the ability of utilities to exploit and abuse the public through excessive rates.[15] *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944); *FPC v. Memphis Light, Gas and Water*

---

[13] The counterpart provision of the Natural Gas Act, § 4(a), 15 U.S.C. § 717c(a) is identical to FPA § 205(a).

[14] *Snohomish*, 471 F.3d at 1058-60; *accord, Boston Edison Co. v. FERC*, 233 F.3d 60, 65 (1st Cir. 2000). This is one of several reasons for asserting that there is no conflict between the Ninth Circuit and First Circuit.

[15] Indeed, the "public interest" considerations in electric and gas ratemaking were understood to refer to impacts on the consuming public prior to the enactment of the Federal Power Act and the Natural Gas Act. *Union Dry Goods Co. v. Georgia Pub. Serv. Co.*, 248 U.S. 372 (1919); *Cf., Arkansas Gas Co. v. Arkansas R.R. Comm'n,* 261 U.S. 379 (1923) (cited approvingly in *Sierra*, 350 U.S. 348 at 355).

Div., 411 U.S. 458, 465 (1973); *NAACP v. FPC*, 425 U.S. 662, 670 (1976). *See also*, *Verizon Inc. v. FCC*, 535 U.S. 467, 481 (2002); STEPHEN G. BREYER REGULATION AND ITS REFORM, 15-16 (Harv. Univ. Press) (1982).

It is settled law that the essence of just and reasonable ratemaking under the Federal Power Act involves considering the "results" of a rate, the impact of the rate on the consuming public and on the regulated utility. *Hope*, 320 U.S. at 602; *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 315-316 (1989). In practice this means establishing a zone of reasonableness, defined by cost-based upper and lower bounds. *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 305-06 (1974); *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585 (1945); *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968).

The zone of reasonableness has consistently been established with reference to the utilities' cost of providing the service subject to regulation, *Hope*, 320 U.S. at 602-03; *Permian Basin*, *supra*. FERC must also take non-cost factors and impacts into account when important consumer protection policies are implicated in rates demanded or charged by utilities. *FPC v. Conway Corp.*, 426 U.S. 271 (1976); *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581 (1924); *Panhandle Eastern Pipe Line Co. v. FPC*, 324 U.S. 635 (1945). However, when it departs from producers' costs in setting rates "...each deviation from cost-based pricing [must be] found not to be unreasonable and to be consistent with the Commission's [statutory] responsibility." *Mobil Oil*

Corp., 417 U.S. at 308, quoted in *Farmers Union Cent. Exchange v. FERC*, 734 F.2d 1486, 1502 (D.C. Cir. 1984).

The consumer protection objective is the basis for price ceilings in systems that depart from strict cost-of-service pricing. *Permian Basin*, 390 U.S. at 793-95, 822; *FPC v. Texaco, Inc.*, 417 U.S. 380, 399 (1974). Under those cases even price ceilings – the upper end of the zone of reasonableness -- must have some demonstrable relationship to the costs of the utilities demanding or receiving the rate for the regulated service.

The statutory "just and reasonable" standard also establishes a lower bound for rates. *Hope*, 320 U.S. at 603; *Natural Gas Pipeline Co.*, 315 U.S. at 585. Rates below the lower bound must be raised. The purpose for the lower bound is to preserve the financial integrity of the seller's enterprise, so that continued service to the public is not jeopardized. *Hope, supra*; *Memphis, supra*. The purpose is not to afford sellers opportunities for speculative profit or to guarantee them any profit at all but rather to establish a "most favored customer test." *Cf. Colorado Interstate*, 324 U.S. at 612 (Jackson, J., concurring) ("most favored customer test"). As this Court noted in *Duquesne Light Co.*, 488 U.S. at 310, quoting *Hope*, 320 U.S. at 605: "Rates which enable [a] company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risk assumed certainly cannot be condemned as invalid, even though they might produce only a meager return on

the so called 'fair value' rate base." This expresses the notion that the consuming public has a stake in the financial viability of the regulated seller. *Cf.*, *Memphis*, 358 U.S. at 113. It is the consuming public's interest that defines the lower bound for the statutory "just and reasonable" determination. The public's interest in receiving service at just and reasonable rates – the public interest -- includes a reciprocal interest in the seller's financial viability but does not encompass profit-maximizing seller behavior.

The determination of the upper and lower bounds within which the just and reasonable rate may fall is the crucial task of the FERC in making rates. It is in this way that the well-known "balancing" of investor and consumer interests occurs. *Hope, supra*; *Permian Basin*, 390 U.S. at 792. While the methods for relating the zone of reasonableness to supplier costs may vary widely in practice, the fundamental requirement of a grounding of rates in costs has been absolutely consistent and has been unchanged by Congress. The Supreme Court has consistently rejected attempts by the FERC and its predecessor Federal Power Commission to equate statutory "just and reasonable" with rates established simply by reference to the "market." *Texaco*, 417 U.S. at 394-97. In *Texaco*, this Court held that:

> ...[T]he prevailing price in the marketplace cannot be the final measure of "just and reasonable" rates mandated by the Act.... In subjecting

> producers to regulation because of anti-competitive conditions in the industry, Congress could not have assumed that "just and reasonable" rates could conclusively be determined by reference to market price...

Id. at 397-399.

III. THE *MOBILE* AND *SIERRA* DECISIONS APPLY THE "JUST AND REASONABLE" STANDARD TO LIMIT THE PRICE-SETTING POWERS OF SELLERS, AND THUS TO PROTECT THE CONSUMING PUBLIC.

FERC's refusal to invoke the "just and reasonable" standard in this case leads directly to a failure of that "permanent bond of protection" for consumers that this Court has placed at the core of the Federal Power Act. FERC's refusal is not supported by an accurate reading of the *Mobile/Sierra* decisions, which uphold the consumer protection objective of the FPA against unilateral seller-initiated rate increases.

A. The decisions in *Mobile/Sierra* do not restrict the power and responsibility of FERC to protect the interest of consumers from unjust contracts.

Mobile involved an attempt by a natural gas company, by statutory definition a seller,[16] unilaterally to increase a specific rate set by a contract with a gas distributor. *Sierra* involved an attempt by a public utility[17] seller unilaterally to increase a rate set by a contract with a purchaser for resale, using both the unilateral "filing and notice" procedure of FPA §§ 205(c) and 205(d) and the complaint procedure under FPA § 206.[18] The essential holding in Mobile was simply that: "the Natural Gas Act does not give natural gas companies the right to change their rate contracts by their own unilateral action. " *Mobile*, 350 U.S. at 337.

---

[16] The term "natural gas company" is defined by the Natural Gas Act (NGA) and refers to sellers in interstate commerce, NGA § 2(6), as that term is defined in the NGA, NGA § 2(7), 15 U.S.C. §§ 717a(6) and 717a(7). It does not refer to any business involved in a gas transaction as buyer.

[17] Defined by FPA§ 201(e), 16 U.S.C. § 824(e), as an entity that owns facilities subject to the jurisdiction of the Commission, which in turn is limited to facilities for wholesale sales in interstate commerce and for transmission in interstate commerce.

[18] 16 U.S.C. § 824e(a) provides in pertinent part: "Whenever the Commission, after a hearing held upon its own motion or upon complaint, shall find that any rate... demanded, ... charged, or collected by any public utility for any ... sale subject to the jurisdiction of the Commission, or that any ... practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, ... practice, or contract to be thereafter observed and in force, and shall fix the same by order."

Although utility companies set the rates initially, the Commission assures that the rates are lawful through active supervision of the outcomes.

> The basic power of the Commission is that given it by [statute] *to set aside and modify any rate or contract* which it determines, after hearing, to be "unjust, unreasonable, unduly discriminatory, or preferential." This is neither a "rate-making" nor a "rate-changing" procedure. *It 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. [The statute] would of its own force apply to all the rates of a natural gas company, whether long-established or newly changed.*

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

This language makes it clear that *Mobile* did not elevate rates set by "contract" to a higher status than other rates or preclude the modification of unjust and unreasonable contracts. All contracts are subject to the paramount authority of the Commission to assure that rates are lawful, which cannot be waived or compromised by contract. *Papago Tribal Util. Auth. v. FERC*, 723 F.2d 950, 954 (D.C. Cir.1983) [hereinafter *Papago II*]. This Court did not reject the Commission's ability to modify excessive and unjust rates set created in contracts. Specifically, this Court declared that:

> [D]enying to natural gas companies the power unilaterally to change their contracts in no way impairs the regulatory powers of the Commission, for *the contracts remain fully subject to the paramount power of the Commission to modify them when necessary in the public interest.* The Act thus affords a reasonable accommodation between the conflicting interests of contract stability on the one hand and public regulation on the other.

Mobile, 350 U.S. at 344 (emphasis added).

The importance of contract stability is here explicitly described with reference to the interest of the consuming public, who are the end-use customers of the wholesale buyers. *Cf.*, *Memphis*, 358 U.S. at 113. Because the regulated utility seller has the initiative in demanding and setting rates, its business judgment – including making an "improvident bargain" -- stands as it would absent the existence of regulation. However, all contracts remain fully subject to the paramount power of the Commission to protect the consuming public from unlawful rates. Contract stability is merely one element – an important element but not a superior element -- in the regulatory scheme whose purpose is to protect the consuming public. Contract stability must be balanced against other concerns of public regulation such as protection from excessive rates.

B. The Sierra "public interest" language is a specific application of the statutory "just and reasonable" standard.

Sierra addresses precisely the seller's resort to the remedial powers of the Commission to raise its contract rate under FPA § 206. In *Sierra,* this Court rejected an attempt by the seller to end-run the *Mobile* decision barring a unilateral seller rate increase. This Court defined the purpose of the Commission in protecting the public interest. Specifically, this Court declared:

> That the purpose of the power given the Commission by 206 (a) is the protection of the public interest, as distinguished from the private interests of the utilities, is evidenced by the recital in 201 of the Act that the scheme of regulation imposed "is necessary in the public interest." When 206 (a) is read in the light of this purpose, it is clear that a contract may not be said to be either "unjust" or "unreasonable" simply because it is unprofitable to the public utility.

Sierra, 350 U.S. at 355.

The *Sierra* decision does not hold that a contract creates a presumption that its pricing is "just and reasonable." It does not hold that a contract waives resort to FERC's remedial powers under FPA § 206. Rather, *Sierra* holds that the rate

the seller demands and receives pursuant to contract is the lawful rate unless the contract rate is so low that service to the public is threatened, *i.e.* is not just and reasonable. Otherwise, the business decision of the utility seller – however "improvident" -- will stand. The D.C. Circuit has previously noted that this "public interest" standard is a difficult standard for a *seller* to meet,[19] because the interest served is truly that of the public in affordable service, not that of the seller in maximizing profit.

As the First Circuit has noted, the language connecting a seller's rate increase request to the "public interest" language is only in reference to rates asserted by the seller to be too low.[20] It arises only in the rate increase context. It is important to note that the *Sierra* Court's reluctance to improve the seller's "unprofitable" contract carries no reluctance to relieve buyers and the public from an unlawful excessive rate, however established.

This Court further confirmed the approach of restricting sellers to their contracted obligations in *Memphis.* In that case, the seller's contract permitted it to charge its going rate "under Seller's Rate Schedule [the appropriate rate schedule designation is inserted here], or any effective superseding rate schedules, on file with the Federal Power Commission." *Memphis,* 358 U.S. at 105.

---

[19] *Papago II*, 723 F.2d at 954.

[20] *Northeast Utils. Serv. Co. v. FERC*, 55 F.3d 686, 690 (1st Cir. 1995).

Upholding a change filed with the FPC and approved by it, this Court noted that:

> It seems plain that Congress, in so drafting the statute, was not only expressing its conviction that the public interest requires the protection of consumers from excessive prices for natural gas, but was also manifesting its concern for the legitimate interests of natural gas companies in whose financial stability the gas-consuming public has a vital stake.

Id. at 113.

Significantly, this Court did not intimate any limitation on the ability of buyers and other representatives of the public interest to resort to a § 206 proceeding to determine lawfulness. Buyers for resale and the consuming public who depend on the receipt of regulated service do not have the power enjoyed by sellers under the NGA and FPA, and affirmed by *Mobile* and *Sierra*, unilaterally to change rates in the absence of contract terms. They must resort to complaint under FPA § 206(a). The Ninth Circuit holding in this case that FERC has applied the wrong standard to review of rates asserted by the public to be excessive under § (206)(a) is mandated not only by the clear and unambiguous statutory "just and reasonable" language of the Federal Power Act but also by the *Mobile/Sierra* opinions.

C. Decisions of the federal appellate courts following *Mobile* and *Sierra* reviewing proposed increases in contract rates uphold the interest of the consuming public under the just and reasonable standard.

Sellers initiate rate changes under the Federal Power Act. Accordingly the vast majority of cases invoking the rule of *Mobile/Sierra* to protect consumers from seller-initiated rate increases arise in rate increase filings under FPA § 205. Under the influence of Judge Scalia's opinion in *Papago II,* 723 F.2d 950, these cases emphasize the continuing viability of the concerns that animate traditional "just and reasonable" ratemaking. The rationale has been to protect the consuming public from exploitation and abuse, not contract preservation at all cost. Judge Scalia noted first that the right of a party to bring to the FERC's attention rates not in the public interest could not be waived or eliminated by contract. Specifically, he noted that:

> The limitation ... cannot abridge the right of the parties to bring to the attention of the Commission ... rates not in the public interest. The Commission's obligation to insure that rates do not violate that prescription is imposed for the benefit of the public at large... it therefore cannot be waived or eliminated by agreement of the latter. Even agreement not to bring a rate contrary to the public interest to the

> Commission's attention would be akin to a contract to suppress evidence and therefore void. [citation omitted].

Papago II, 723 F.2d at 954. Next he noted that reservation of a power to bring a § 206 action necessarily implied application of the "just and reasonable standard." He then proceeded to apply just and reasonable ratemaking principles, including noting that the rates being modified were below the "zone of reasonableness" as a justification for the rate increase.

The basic rule in the D.C. Circuit involving rate increase filings has been:

> The ability of contracting parties to determine for themselves whether and under what conditions rates may be altered – subject, of course, to the overriding regulatory power of the Commission to adjust rates in the public interest – has been delineated in three decisions of the Supreme Court....[I]n resolution of *the rate increase disputes*, the *Mobile-Sierra-Memphis* trilogy assigns the pre-eminent role to the intent of the contracting parties.

City of Oglesby v. FERC, 610 F.2d 897, 902-03 (D.C. Cir. 1979) (emphasis added). The D.C Circuit has consistently applied this rule to prevent seller rate

increases. This approach is entirely consistent with *Mobile/Sierra*.[21]

D. FERC's decision below is not entitled to deference.

FERC's so-called "public interest" standard undermines the Act's consumer protection objective. The unambiguous text of § 205(a) that all rates be "just and reasonable" is not ambiguous. FERC's current anti-consumer position is not a reasonable interpretation of the Federal Power Act. Further, since FERC's anti-consumer "public interest" contract rate standard rests on its reading of this Court's decisions in *Mobile/Sierra*, the rule of deference to agency statutory interpretation contained in *Chevron USA, Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984) and its progeny does not come into play. FERC is not free to disregard this Court's interpretations of any statute. *Nat'l Cable and Telecomms. Ass'n v. Brand-X Internet Servs.*, 545 U.S. 967 (2005) (Stevens, J., concurring).

---

[21] Unsupported dictum in *Texaco, Inc. v. FERC*, 148 F.3d 1091, 1096 (D.C. Cir. 1998), to the effect that "[t]he [*Papago* II] Court did not suggest that the parties' failure to explicitly foreclose the Commission's authority to replace rates would leave it intact" misses the point. FERC's authority derives from the statute and cannot be waived by private agreement. Even in the Texaco case, however, the Court looked to the substance of the consumer protection objective of FPA § 206, and found a "public interest" justification for a rate change initiated by FERC in a gas pipeline case. *Id.* at 1097.

CONCLUSION

The decision of the Ninth Circuit fully comports with the text of the Federal Power Act and its purpose to protect the consuming public. It is consistent with the leading Supreme Court precedents interpreting the requirement that all rates charged by public utilities be just and reasonable. FERC's reliance on *Mobile* and *Sierra* to avoid reviewing the contracts at issue here under the "just and reasonable" legal standard is erroneous. The judgment of the court of appeals should be affirmed.

January 18, 2008

Respectfully Submitted,

BARBARA JONES
Counsel of Record
AARP Foundation Litigation
200 So. Los Robles,
Suite 400
Pasadena, CA 91101
(626) 585-2628

STACY CANAN
AARP Foundation Litigation

MICHAEL SCHUSTER
AARP

601 E Street, NW
Washington, DC 20049
(202) 434-2060

WILLIAM JULIAN II
43556 Almond Lane
Davis, CA 95618
(916) 758-8882

Attorneys for AARP