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No. 08-674

IN THE
Supreme Court of the United States

NRG POWER MARKETING, LLC, *ET AL.*,
Petitioners,
v.

MAINE PUBLIC UTILITIES COMMISSION, *ET AL.*,
Respondents.

On a Writ of Certiorari
to the United States Court of Appeals
for the District of Columbia Circuit

**BRIEF OF THE
PUBLIC UTILTIES COMMISSION OF THE
STATE OF CALIFORNIA
AS *AMICUS CURIAE*
IN SUPPORT OF RESPONDENTS**

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QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission is required, as a matter of law, to presume that all contract rates are just and reasonable, and therefore are lawful, absent "extraordinary circumstances," regardless of the identity of the challenger.

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INTEREST OF *AMICUS CURIAE*[1]

The California Public Utilities Commission (CPUC) is charged, under the Constitution of the State of California, with the regulation of public utilities, including retail electricity service providers, operating within the State of California. When necessary to protect consumers in California, the CPUC exercises its statutory right under the Federal Power Act, 16 U.S.C. § 791a *et seq.*, to participate in Commission proceedings and to challenge the lawfulness of wholesale energy contract rates, the cost of which affects the retail prices regulated by the CPUC. The question presented in this case may affect the standard of review applied in those federal proceedings and in any subsequent court challenge to the resulting wholesale rate.

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[1] Pursuant to Rule 37.6, counsel for *amicus* states that no counsel for a party authored this brief in whole or in part, and that no person other than *amicus*, its members, or its counsel made a monetary contribution to the preparation or submission of this brief. Petitioners and respondents have filed letters of consent with the Clerk of the Court.

SUMMARY OF ARGUMENT

Petitioners insist that the *Mobile-Sierra* doctrine[2] restricts the authority of the Federal Energy Regulatory Commission by requiring it to presume that a wholesale power contract is just and reasonable whenever that rate is challenged, whether the rate is contested by a party to the contract, a retail consumer, a state public utilities commission, or the Commission itself. They further insist that when *Mobile-Sierra* applies, the Commission must not only limit its review to considerations of the public interest, but must also presume, "absent extraordinary circumstances," that contract rates are consistent with the public interest and, therefore, lawful. *See* Petr. Br. 22-23 (citation omitted). Petitioners are in effect asking the Court to erect a "practically insurmountable" barrier, *Papago Tribal Util. Auth. v. FERC*, 723 F.2d 950, 954 (D.C. Cir. 1983) (Scalia, J.), that would prevent the Commission from modifying contract rates except in extraordinary circumstances. The Court should reject petitioners' request.

Petitioners misread this Court's cases. *Mobile* and *Sierra* are part of a line of decisions, culminating in *Morgan Stanley Capital Group Inc. v. Public Utilities District No. 1 of Snohomish County, Washington*, 128 S. Ct. 2733 (2008), that establish that buyer's or seller's remorse is no basis for the

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[2] *See United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956); *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956).

Commission to alter the terms of a wholesale energy contract. That is, they stand for the simple proposition, recognized throughout this Court's cases, that the purpose of federal energy regulation is not to relieve a party of "its improvident bargain," *Sierra,* 350 U.S. at 355, or to "extricate [it] from a bed it made for itself," *Transcon. Gas Pipe Line Corp. v. State Oil & Gas Bd. of Miss.*, 474 U.S. 409, 425 (1986) (Rehnquist, J., dissenting). To be sure, in these cases the Court has also emphasized the importance of contract stability. But the Court has affirmed that this interest does not trump all others under the Act and that "*Mobile* recognized that there were two sources of price and supply stability inherent in the regulatory system . . . – the provisions of private contracts and the public regulatory power." *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137, 155-56 (1960).

Petitioners' argument also is fundamentally at odds with the purposes and premises of the Federal Power Act. Wholesale electricity prices are largely set by contracts. As a result, accepting petitioners' argument that the Commission lacks the authority to modify contract rates except in extraordinary circumstances would result in substantial deregulation of the wholesale electricity market. But Congress did not enact the Federal Power Act simply to restrain the occasional aberrant contract. To the contrary, it subjected power sales to federal supervision because it believed that if left to their own devices, energy producers and utilities would negotiate rates inconsistent with the public interest. Petitioners' arguments for a contrary presumption are based on a fundamental disagreement with that

view. They insist that wholesale electricity markets can be expected to produce rates that are not only fair to the parties, but also consistent with the public interest. That Congress did not accept these assertions is plain and dispositive.

In fact, Congress's skepticism of energy markets' ability to produce prices consistent with the public interest is well-founded. Wholesale purchasers have limited incentives to bargain hard for low prices because under the filed rate doctrine, state regulators generally may not prevent them from passing the full cost of their wholesale contracts on to consumers. Moreover, because many utilities also have a state-imposed obligation to serve their retail consumers, they cannot simply walk away from a deal when confronted by excessive wholesale prices, conditions of market power, or limited available supply.

Petitioners nonetheless argue that without a guarantee that contract rates will almost never be modified, producers and utilities will not invest sufficiently in the nation's energy infrastructure. But the Act already gives substantial protection against unwarranted contract modification. As enacted, the statute permits and encourages challenges before rates go into effect and decisions are made in reliance on the contract. When challenges are brought later, the challenger bears the burden of demonstrating that the rate is unlawful. And, perhaps most importantly, Congress gave the Commission ample authority to reject such challenges when necessary to promote the public interest in contract stability and investor confidence.

Petitioners' request for the further protection of a strong presumption that all contract rates are just

and reasonable is inconsistent with Congress's decision to delegate principal rate review authority to an expert commission, rather than the courts. There is no reason to believe that Congress shared petitioners' distrust of the Commission's ability to determine how strongly adherence to contract prices is required to achieve the just and reasonable rates the statute commands.

The Commission's acquiescence to petitioners' proposed limitation of its authority is no reason to depart from the statutory scheme Congress enacted. While the Commission has expertise in setting utility rates, it has no special claim to deference for its interpretation of this Court's decisions in *Mobile*, *Sierra*, and *Morgan Stanley*. Moreover, its current view is of recent vintage and inconsistent with its prior position that the *Mobile-Sierra* presumption applies only to challenges by parties to the contract.

At the very least, no presumption should apply when the rate is challenged by a state public utility commission. State commissions have special expertise and legal responsibility for ensuring that utility rates are consistent with the public's competing interests in reasonable prices and the reliable supply that contract stability encourages. As a result, any general presumption that contract negotiations produce rates consistent with the public interest is more than overcome when an expert agency charged with protecting consumers determines that a particular rate has defied that expectation. The same should be true when the Commission itself initiates a rate review based on reasonable suspicions that the rate is unlawful.

ARGUMENT

Petitioners concede, as they must, that the Federal Energy Regulatory Commission has statutory authority to modify contracts when necessary to protect the public interest. Petr. Br. 4-5; *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332, 344 (1956). They contend, however, that the *Mobile-Sierra* doctrine requires the Commission to presume that rates in wholesale power contracts *are* in the public interest, and therefore just and reasonable, whenever a contract rate is challenged, regardless of the identity of the challenger. Petr. Br. 35. They contend further that under the *Mobile-Sierra* doctrine the Commission may find harm to the public interest sufficient to warrant contract modification "only in circumstances of *unequivocal public necessity*," which will occur only in "*extraordinary circumstances*." Petr. Br. 22-23 (citations omitted) (emphasis added).

These assertions are based on a fundamental misreading of this Court's cases, which simply hold that the Commission may not relieve disappointed buyers and sellers of their contractual obligations except in light of the broader public interest. Accepting petitioners' further assertion that the Commission is generally precluded from altering contract rates, even when they are challenged by third parties seeking to promote the public interest, would effectively deregulate much of the wholesale energy market, contrary to the basic purposes of the Federal Power Act.

I. This Court Has Never Held That The Commission Must Always Presume That Contract Rates Are Just and Reasonable.

Petitioners' claim that contract rates must be presumed just and reasonable and preserved absent extraordinary circumstances in all rate challenges has no support in this Court's cases.

A. The *Mobile-Sierra* Presumption Is Limited To Cases Of Buyer's Or Seller's Remorse.

1. In *Mobile* and *Sierra*, this Court recognized that by "requiring contracts to be filed with the Commission," the Federal Power Act "expressly recognizes that rates to particular customers may be set by individual contracts." *Mobile*, 350 U.S. at 338. At the same time, however, Congress obviously intended to permit the Commission to alter agreed-upon rates in appropriate circumstances, to protect the public. *See, e.g.*, 16 U.S.C. § 824e(a). The principal question in *Mobile* and *Sierra* was whether a seller may unilaterally abrogate a contract rate previously accepted by the Commission simply by filing a new rate schedule. *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332, 337-38 (1956); *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348, 352-53 (1956). The Court held that it may not. The Act was not intended, the Court explained, to relieve parties of "improvident bargain[s]." *Sierra*, 350 U.S. at 355. Instead, the "purpose of the power given the Commission by [the Federal Power Act] is the protection of the public interest, as distinguished from the private interests of the utilities." *Id*.

Accordingly, *Mobile* and *Sierra* established nothing more than the principle that in reviewing challenges by parties to a contract, the Commission lacks the power to alter contract rates solely to protect the interests of a party. Instead, "[i]n such circumstances the sole concern of the Commission would seem to be whether the rate . . . adversely affect[s] the public interest." *Sierra*, 350 U.S. at 355. By limiting parties' abilities to use the statute to avoid their contract obligations, yet preserving the Commission's authority to modify rates in the public interest, this Court explained, the Act "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.

Nothing in these decisions suggests, much less holds, that maintaining the Act's intended balance requires equating a contracting party's attempt to evade its own improvident bargain with a third-party's request to modify a rate in order to protect the public interest. It is one thing to view with skepticism a contracting party's claim that the rate change it seeks is in the public interest. *See Mobile*, 350 U.S. at 344-45 (noting that contracting parties "are understandably not given the same explicit standing to complain of their own contracts as are those who represent the public interest or those who might be discriminated against"). Requiring especially convincing proof of harm to the public interest in challenges by contracting parties may well make sense in that context, for it does not unduly limit the Commission's "indefeasible right" to alter rates to protect the public interest, *Papago Tribal*

Util. Auth. v. FERC, 723 F.2d 950, 953 (D.C. Cir. 1983) (citing *Sierra*, 350 U.S. at 355), in response to challenges by non-parties to the contract or on its own initiative.

It is quite a different proposition, however, to say that the Commission must view all requests to modify contract rates with skepticism, regardless of who is seeking relief, and deny relief in all but extraordinary circumstances. As discussed below, imposing such a presumption in *every* contract rate challenge would be inconsistent not only with this Court's decisions in *Mobile* and *Sierra,* but with the basic purposes and design of the Federal Power Act.

2. Contrary to petitioners' suggestions, nothing in this Court's recent decision in *Morgan Stanley Capital Group Inc. v. Public Utilities District No. 1 of Snohomish County, Washington*, 128 S. Ct. 2733 (2008), is to the contrary.

As in *Mobile* and *Sierra*, the party challenging the contract rate was itself a party to the contract. This Court recounted that the respondents in the case had agreed to long-term contracts in the midst of unprecedented turmoil in the western energy markets. *Id*. at 2743. But "[a]fter the crisis had passed, buyer's remorse set in and respondents asked FERC to modify the contracts." *Id*. That factual context limited the Court's consideration to two questions relating to party-challenges to contract rate: "First, does the presumption apply only when FERC has had an initial opportunity to review a contract rate without the presumption? Second, does the presumption impose as high a bar to challenges by *purchasers* of wholesale electricity as it does to challenges by *sellers*?" *Id*. at 2737 (emphasis added).

The facts of the case did not pose, and this Court did not purport to decide, whether or how *Mobile-Sierra* would apply if the challenge were not brought by a party to the contract, much less whether the same analysis would apply to challenges brought by a state public utilities commission or the Commission itself. *See, e.g.*, *id*. at 2747 (making clear that opinion was limited to addressing the proper application of the public interest test to "buyer's" and "seller's challenge[s]").

Moreover, as in *Mobile* and *Sierra*, the Court's rationale in *Morgan Stanley* turned principally on its recognition that Congress did not intend the Federal Power Act to alter contract rates just because they are "unfair to one of the parties that voluntarily assented to the contract." 128 S. Ct at 2746; *see also id*. at 2747 (criticizing court of appeals for "enabling sophisticated *parties* who weathered market turmoil by entering long-term contracts to *renounce those contracts* once the storm has passed") (emphasis added). In this way, the Court adhered to the principle, running throughout this Court's cases, that the federal energy regulatory regime was not created to "extricate [a utility] from a bed it made for itself." *Transcon. Gas Pipe Line Corp. v. State Oil & Gas Bd. of Miss.*, 474 U.S. 409, 425 (1986) (Rehnquist, J., dissenting).

To be sure, the Court also emphasized the importance of contract stability. But the decision did not suggest that this interest trumps all others under the Act or that it intended to depart from its prior acknowledgment that "*Mobile* recognized that there were two sources of price and supply stability inherent in the regulatory system . . . – the provisions

of private contracts and the public regulatory power." *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137, 155-56 (1960). As discussed below, in asking the Court to declare that the Commission may not alter contract rates except in extraordinary circumstances, petitioners urge "an application of [the *Mobile* and *Sierra*] decision[s] that could make private contracts the only stabilizing factor under the Act." *Id.* at 155-56.

B. None Of This Court's Cases Preclude The Commission From Modifying Contract Rates Except In Extraordinary Circumstances.

Petitioners are also wrong in asserting that where it applies, the *Mobile-Sierra* doctrine prevents the Commission from altering contract rates at anyone's request absent "extraordinary circumstances." Petr. Br. 23 (citation omitted).

1. Although there may be grounds to presume that a contract rate negotiated by sophisticated utilities is just and reasonable "as between the two of them," *Morgan Stanley*, 128 S. Ct. at 2746 (citation omitted), there is no basis in this Court's decisions to require the Commission to presume that contract rates almost always serve the *public* interest and, therefore, are just and reasonable except in rare instances.

Certainly, the Court said nothing of the sort in *Mobile* or *Sierra*. To the contrary, the Court expressly recognized that denying 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*." *Mobile*, 350 U.S. at 344 (emphasis added). And the Court said nothing about restricting the Commission's discretion in making that decision. Instead, it simply stated that "if the Commission, after hearing, determines the contract rate to be so low as to conflict with the public interest, it may . . . authorize the natural gas company to file a schedule increasing the rate." *Id*. at 345.

Likewise, in *Sierra*, the Court described the question before the Commission as whether "the rate is so low as to adversely affect the public interest – as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory." 350 U.S. at 355. Whether any of those conditions arose, or there were other grounds to find that the rate had an "adverse effect on the public interest," were questions the Court left to the Commission's discretion.

2. Petitioners nonetheless point to statements made in three subsequent cases that, they say, transformed the *Mobile-Sierra* doctrine into a nearly conclusive presumption that contract rates are just and reasonable (and therefore lawful), a presumption that precludes the Commission from modifying contract rates in almost all cases. Petitioners' reliance on that dicta is misplaced.

Petitioners first quote a single statement from *In re Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), in which the Court described the Federal Power Act as "premised on contractual agreements voluntarily devised by the regulated companies" and

then stated in passing that the Act "contemplates abrogation of these agreements only in circumstances of *unequivocal public necessity*." *Id*. at 822 (emphasis added); *see* Petr. Br. 22. For this proposition, the Court cited *Mobile,* which, as shown above, imposed no such requirement. *See Permian Basin,* 390 U.S. at 822. Nor was the phrase "unequivocal necessity" necessary to the Court's decision in *Permian Basin* – the Court affirmed the Commission's refusal to set aside the contract rates in that case because there was "*no* evidence of financial or other difficulties" caused by the contract rate. *Id*. (emphasis added). And elsewhere in the opinion, the Court accurately described *Sierra* as holding only that the "Commission may not, absent evidence of *injury to the public interest*, relieve a regulated party of 'its improvident bargain.'" *Id*. at 821 (quoting *Sierra*, 350 U.S. at 355) (emphasis added). *See also id*. ("It follows that the Commission was here without authority to abrogate existing contract prices unless it first concluded that they '*adversely affect the public interest*.'") (emphasis added).

Next, petitioners cite *Arkansas Louisiana Gas Company v. Hall*, 453 U.S. 571 (1981), for the proposition that the Commission "lacks affirmative authority, absent *extraordinary circumstances*, to 'abrogate existing contractual arrangements.'" Petr. Br. 22-23 (quoting 453 U.S. at 582) (emphasis added). But again, the question of any presumption of lawfulness was not before the Court (the case did not involve a construction of *Mobile-Sierra*, but rather concerned an application of the filed rate doctrine, *see* 453 U.S. at 573). And the Court made the statement in the course of rejecting an interpretation of the

Natural Gas Act that – like petitioners' construction of the Federal Power Act – "would give inordinate importance to the role of contracts between buyers and sellers in the federal scheme for regulating the sale of natural gas" *Id*. at 582.

Finally, petitioners rely on *Morgan Stanley*, in which the Court repeated the dicta from *Permian Basin* and *Arkansas Louisiana Gas*, *see* 128 S. Ct. at 2748, and stated that "only when the mutually agreed-upon contract rate *seriously* harms the consuming public may the Commission declare it not to be just and reasonable," *id*. at 2746 (emphasis added); *see also id*. at 2747, 2750 (repeating the "seriously harms" formulation). The language of "serious harm" can be read simply to exclude insignificant effects on the public interest, which is a far cry from adopting a court-made rule restricting the Commission from modifying contracts except in "extraordinary circumstances," or upon a showing of "unequivocal necessity." That construction is consistent with *Mobile* and *Sierra*. In any event, the Court's mention in *Morgan Stanley* of "serious" harm was unnecessary to its rejection of the claim that a contract rate is inconsistent with the public interest whenever it is "above marginal cost." *Id*. at 2748-49.

II. To Require The Commission To Presume That Contract Rates Are Just And Reasonable, Except In Extraordinary Circumstances, Would Be Contrary To The Basic Premises Of The Federal Power Act.

Congress enacted the Federal Power Act to regulate what it saw as a heavily monopolistic market in which unregulated transactions routinely

risked serious harm to consumers and the broader economy. *See New York v. FERC*, 535 U.S. 1, 5-7 (2002); *see also FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 609-10 (1944). Petitioners' strained construction of this Court's decisions reflects a fundamental disagreement with that policy choice, and the rule they propose would go far toward dismantling the regulatory regime Congress intended.

A. Petitioners' Proposed Standard Would Effectively Deregulate Much Of The Wholesale Electricity Market.

1. Effective regulation cannot "turn on the desire of the regulated enterprise to be subject to it." *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137, 151 (1960) (discussing regulation under Natural Gas Act). Yet accepting petitioners' arguments in this case would have that effect in many places. For example, in California, a market that serves over 33 million consumers, and other regions of the United States, the vast majority of wholesale electricity prices are set by bilateral contract. *See, e.g.*, *Pub. Utils. Comm'n of Cal. v. FERC*, 462 F.3d 1027, 1039 (9th Cir. 2006) (noting that in "most . . . electricity markets . . . more than 80% of transactions are made through long term forward contracts"). Accordingly, requiring the Commission to presume that contract rates are just and reasonable, except in extraordinary circumstances, is to effectively deregulate markets Congress intended the Federal Power Act to regulate.

When Congress has directed an agency to regulate a market, the agency may not simply presume that the results the market produces meet

the applicable statutory standard, except in extraordinary circumstances. *See FPC v. Texaco, Inc.*, 417 U.S. 380, 394 (1974). No one would think, for example, that the courts have authority to require the Food and Drug Administration to presume, absent extraordinary circumstances, that drugs are safe and effective, 21 U.S.C. § 355(d), so long as they were produced in a competitive market. Congress adopted the Food, Drug, and Cosmetics Act, 21 U.S.C. §§ 301 *et seq*., because it did not believe that market forces and the deterrent effect of tort law were sufficient to protect the public. Congress thus required the FDA to exercise its own independent judgment as to the actual safety and effectiveness of the drugs subject to its jurisdiction. It is not enough for the agency to ensure that drugs are produced in a context that one might *expect* to produce safe and effective drugs; the *actual* safety and effectiveness of the drug must be determined by the agency. This, even though drug companies must invest enormous amounts of money into the development of new drugs, and could argue that minimizing regulatory oversight by requiring the regulator to presume that market-produced drugs are safe and effective would lead to greater investment to the benefit of the general public.

So, too, in the context of utility regulation. In *FPC v. Texaco, Inc.*, 417 U.S. 380 (1974), the Court overturned a Commission order to the extent that it exempted small natural gas producers from the Act's rate-filing requirements. The Court explained that any presumption that "current contract prices in an area approximate closely . . . the just and reasonable rate. . . . would contradict the basic assumption that

has caused natural gas production to be subjected to regulation" in the first place. *Id*. at 398 (quoting *FPC v. Sunray DX Oil Co.*, 391 U.S. 9, 25 (1968)). "In subjecting producers to regulation because of anticompetitive 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 399.[3] *See also Wis. Gas Co. v. FERC*, 770 F.2d 1144, 1158 (D.C. Cir. 1985) (reliance on economic theory is no substitute for a reasoned exercise of the Commission's discretion).

To be sure, petitioners do not argue for a completely conclusive presumption. But a standard that permits alteration of contract rates only in extraordinary circumstances is no more consistent with congressional intent than one that regulates rates not at all. Congress did not enact the Federal Power Act to correct an occasional aberrant contract, leaving consumers in all other cases to pay the prices agreed to by utilities. Instead, Congress gave the Commission the responsibility to review utility rates

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[3] In *Morgan Stanley* the Court noted that while *Texaco* precludes the Commission from "implement[ing] a scheme of *total deregulation* by applying no standard of review at all to small producer rates," the decision said nothing to prevent the Commission from reviewing rates under the *Mobile-Sierra* doctrine. *Morgan Stanley Capital Group Inc. v. Pub. Util. Dist. No. 1 of Snohomish County, Wash.*, 128 S. Ct. 2733, 2746 (2008) (emphasis in original). We agree. Our point is simply that *Texaco*, and *Morgan Stanley*'s reaffirmation of it, precludes construing *Mobile-Sierra* in a way that effectively abdicates the Commission's regulatory responsibility, as petitioners would have the Court do here.

in order "to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges." *Atl. Refining Co. v. Pub. Serv. Comm'n of N.Y.*, 360 U.S. 378, 388-89 (1959) (discussing Natural Gas Act). Congress believed that excesses were common in the natural gas and electricity industries and intended the Commission to exercise its powers vigorously in the protection of the public interest. *See*, *e.g.*, *Sunray Mid-Continent Oil Co.*, 364 U.S. at 143; *NAACP v. FPC*, 520 F.2d 432, 438 (D.C. Cir. 1975). Petitioners' proposed presumption is fundamentally inconsistent with that intent.

2. Petitioners' plea for strict limits on the Commission's power to alter contract rates is particularly inappropriate given the lengths to which the Commission has already gone to relax regulatory review of market-based rates. Under its "market tariff system," the Commission has abandoned its obligation under Section 205, 16 U.S.C. § 824d, to review all rate changes before they are put into effect, instead permitting many sellers of wholesale power to file "market-based rate tariffs" that contain no rates but simply state that the utility intends to negotiate rates with purchasers in the future. *See Morgan Stanley Capital Group Inc. v. Pub. Util. Dist. No. 1 of Snohomish County, Wash.*, 128 S. Ct. 2733, 2741 (2008). At the same time, the Commission has precluded pre-implementation challenges under Section 205, 16 U.S.C. § 824d, under which the utility bears the burden of proving that the rate is just and reasonable. *See GWF Energy, LLC*, 97 FERC ¶ 61,297, at 62,391 (2001). Instead, the Commission will hear challenges to contract rates only under Section 206, where the challenger bears the burden of

proof and the Commission's power to order refunds is limited. *See* 16 U.S.C. § 824e(b); *see generally* Br. of Amici Curiae Col. Office of Consumer Counsel, *et. al.* at 13-20, *Morgan Stanley Capital Group, Inc. v. Pub. Util. Dist. No. 1 of Snohomish County, Wash.*, 128 S. Ct. 2733 (2008).

This Court has not passed on the legality of the Commission's market-based tariff regime, *see Morgan Stanley*, 128 S. Ct. at 2747, and has no occasion to do so here. But the Court should consider that the combined effect of the Commission's diminished review of rates and the presumption petitioners advocate would be the virtual elimination of any meaningful review for contract rates either before *or* after they are implemented, contrary to the manifest directives of the Act.

B. Congress Rejected The Premises Underlying Petitioners' Argument When It Enacted The Federal Power Act.

Petitioners' argument not only runs contrary to Congress's intent to subject wholesale electricity rates to significant regulatory review, but also is founded upon premises Congress rejected when it enacted the Federal Power Act. *See, e.g.*, *Texaco*, 417 U.S. at 399.

1. In Enacting The Federal Power Act, Congress Rejected The View That Electricity Markets Can Be Counted On To Produce Rates Consistent With The Public Interest.

At bottom, the arguments in favor of a presumption that contract rates are just and reasonable except in extraordinary circumstances are arguments against subjecting contract rates to regulatory oversight in the first place. Petitioners and their amici argue that contract rates should be presumed lawful in almost all circumstances because "contract rates negotiated by sophisticated parties can be expected to be reasonable even insofar as they affect third parties," Petr. Br. 35, as "the efficiency of private bargaining" leads "buyers and sellers . . . to negotiate contracts that maximize gains not only for themselves but also for society as a whole." Br. of Blaydon, *et al*. 10.

But Congress enacted public utility rate regulation because it disagreed with those assumptions.[4] Congress concluded that left unregulated, electricity market participants would not necessarily act in the interests of consumers and the broader economy. In *Sunray Mid-Continent Oil*, this Court explained that "the basic assumption that has caused natural gas production to be subjected to

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[4] The appropriate degree of government regulation of markets – be it markets for wholesale electricity, stocks, or mortgage-backed securities – is a topic of perennial debate among politicians and economists alike. *See* Paul Krugman, *How Did Economists Get It So Wrong?*, N.Y. TIMES, Sep. 6, 2009.

regulation" was that a utility "whose cost of purchase is a current operating expense which the [utility] is entitled to pass on its customers as part of its rates, lacks sufficient incentive to bargain prices down." 391 U.S. at 25-26. So, too, the Federal Power Act is premised on Congress's recognition that, for several reasons, the usual dynamics of supply and demand cannot discipline prices in the wholesale electricity market.

First, utilities generally can pass on the full cost of power purchases to their retail customers.[5] Because Congress gave the Commission exclusive authority over wholesale rates, the Supremacy Clause (implemented by the filed rate doctrine) requires that "a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate." *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953, 970 (1986).

Second, utility purchasers often have a monopoly at the retail level, particularly in the market for service to residential customers. In such markets, there is little or no competitive pressure to keep retail prices low. *See, e.g.*, U.S. ENERGY INFORMATION ADMINISTRATION, THE CHANGING STRUCTURE OF THE ELECTRIC POWER INDUSTRY 2000: AN UPDATE 15, 41 (Oct. 2000) (explaining that retail service has historically been a monopoly and that only a few

[5] By definition, wholesale electricity is purchased for *resale*. *See* 16 U.S.C. § 824(d).

states have begun to allow retail competition);[6] REPORT TO CONGRESS ON COMPETITION IN WHOLESALE AND RETAIL MARKETS FOR ELECTRIC ENERGY PURSUANT TO SECTION 1815 OF THE ENERGY POLICY ACT OF 2005 (as of 2006, 20 states and the District of Columbia allow retail competition but in most of them competition has been slow to develop, particularly for residential customers).[7]

Third, utilities do not necessarily increase their profits by negotiating lower wholesale prices. In many states, under a traditional "rate of return" regime, utility profits are regulated by a state commission, and lower wholesale costs may lead to lower retail prices, but not necessarily higher profits. *See, e.g.*, *Entergy La., Inc. v. La. Pub. Serv. Comm'n*, 539 U.S. 39, 42 (2003).

Fourth, many wholesale purchasers are unable to walk away from a deal simply because the price demanded is too high. A monopoly franchise for retail service brings with it a state law "obligation to serve" all customers who want electricity in the service territory. These utilities must procure enough power to provide reliable, adequate service to all those customers, regardless of wholesale prices. *See, e.g.*, Cal. Pub. Utils. Code § 451 (West 2009).[8]

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[6] Available at http://www.ferc.gov/legal/fed-sta/ene-pol-act/epact-final-rpt.pdf.

[7] Available at http://www.ferc.gov/legal/fed-sta/ene-pol-act/epact-final-rpt.pdf.

[8] Even in those states that have encouraged competition in the retail service sector, there is a designated "provider of last resort" that has a comparable obligation.

They do not have the option of reducing the level of service when costs soar, like commercial airlines do. Instead, these utilities have no option but to purchase whatever amount of electricity is required to meet their obligation to serve their customers, regardless of cost. *See Am. Gas. Ass'n v. FERC*, 912 F.2d 1496, 1516 (D.C. Cir. 1990) (wholesale sellers may extract monopoly profits because the retail provider must provide continuous service to its customers).

Fifth, transmission constraints limit the numbers of potential wholesale suppliers able to deliver power to specific "load pockets," or geographic areas where demand is high relative to available supply. *See*, *e.g.*, *PJM Interconnection*, 121 FERC ¶61,173, at 61,790, n. 32 (2007). In such situations, competition among suppliers able to serve that load may be limited or nonexistent.

Sixth, it is not uncommon that wholesale purchasers will obtain power from affiliated companies, thereby reducing their incentive to bargain for the best prices. As the Commission has explained, when affiliated companies are "on both sides of the bargaining table," ensuring just and reasonable rates requires that the Commission "carefully scrutinize the rates, terms and conditions of the contract." *Ne. Utils. Serv. Co.*, 66 FERC ¶ 61,332, at 62,078 (1994); *see also S. Co. Servs., Inc.*, 67 FERC ¶ 61,219 (1994).

For these reasons, "neither the Commission nor [the courts] may merely assume, without analysis, that the [utilities'] protection of their own interests . . . will inure to the benefit of consumers" because "as regulated utilities, [they] might not have

a sufficient incentive, in dealing with [sellers], to minimize their costs." *Tejas Power Corp. v. FERC*, 908 F.2d 998, 1003 (D.C. Cir. 1990).

2. *Congress Did Not Believe That Active Regulatory Oversight Of Contract Rates Impedes Private Investment.*

Nor is there any reason to think that Congress accepted petitioners' assertion that the public interest demands that utilities generally be allowed to charge each other whatever rates they agree to (and ultimately to pass those costs on to their retail customers), because otherwise energy companies will refuse to invest in needed improvements to the nation's energy infrastructure. *See* Petr. Br. 39-41.

It is worth recalling that the nation's electric power infrastructure has been built by an industry operating within a highly regulated framework for over a hundred years. Since 1935, under the Federal Power Act, all wholesale contracts have been subject to review and modification by the Commission. During that time, there has been extensive infrastructure investment even though petitioners have not identified any case prior to 2002 in which the Commission applied the *Mobile-Sierra* presumption to a third-party challenge. *See* Petr. Br. 31-32 & n.7.[9] And although for the last few decades

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[9] This Court has made clear that even when *Mobile-Sierra* does not apply, the Commission must consider a utility's ability to attract capital and return on investment along with other factors. *See, e.g.*, *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989).

the Commission has attempted to shift to a pro-market regulatory paradigm and away from traditional forms of regulation, that is a reason for confidence in, not skepticism about, the Commission's willingness to ensure that rate modifications will not unduly diminish market incentives for investment.

Petitioners and their amici present no evidence that without a guarantee of near inviolability for their contract rates, utilities will refuse to invest sufficiently in energy infrastructure improvements. Indeed, in this very case, petitioners agreed that challenges to rates brought within 45 days of the capacity auction would be reviewed by the Commission without any *Mobile-Sierra* presumption. *See* J.A. 118-19; Pet. App. 78a, 120a. And many other utilities voluntarily subject their contract rates to "ordinary" just and reasonable review through so-called "Memphis clauses." *See, e.g.*, *United Gas Pipe Line Co. v. Memphis Light, Gas, and Water Div.*, 358 U.S. 103, 113-14 (1958).

The Federal Power Act affords substantial protection of contract stability without the need to impose petitioners' generally insurmountable presumption. For one thing, the Act provides a mechanism for early challenges to rates through pre-implementation challenges under Section 205, 16 U.S.C. § 824d. This process allows the Commission to consider the lawfulness of a rate before parties to the contract have invested heavily in reliance on the proposed rate. To be sure, the Commission has rendered that protection largely ineffective by refusing to consider Section 205 challenges to market-based rates, but that is a reason to declare that practice unlawful, not to justify yet further

departures from the regulatory scheme Congress enacted. Moreover, once rates have gone into effect, Section 206, 16 U.S.C. § 824e, promotes contract stability by placing a "heavy burden" on any challenger to show that a rate is unjust and unreasonable. *Hope Natural Gas Co.*, 320 U.S. at 602. And, as discussed next, Congress has given the Commission ample authority to deny requests for rate changes when doing to would unduly undermine contract stability in conflict with the public's interest in encouraging long-term investment to ensure a stable supply of electricity.

C. Congress Delegated To The Commission, Not The Courts, The Responsibility To Decide How Much Weight To Give The Fact That A Rate Was Set By Contract.

Imposing greater restraint on the Commission's exercise of discretion also would be fundamentally inconsistent with the Act's allocation of power and responsibility between the Commission and the courts.

1. Congress has entrusted the regulation of wholesale electricity prices to the informed judgment of the Commission, not to the reviewing courts. *Mont.-Dakota Utils. Co. v. Nw. Pub. Serv. Co.*, 341 U.S. 246, 251 (1951); *see also In re Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968). For that reason, this Court has repeatedly emphasized that the Commission is "not bound to the use of any single formula or combination of formulae in determining rates," but rather has broad discretion to determine for itself what factors are relevant and how much

weight each should be given. *Hope Natural Gas Co.*, 320 U.S. at 602 (citing *Natural Gas Pipeline Co. of Am.*, 315 U.S. 575, 586 (1942)); *see also Mont.-Dakota Utils. Co.*, 341 U.S. at 251 ("Statutory reasonableness is an abstract quality represented by an area rather than a pinpoint. It allows a substantial spread between what is unreasonable because too low and what is unreasonable because too high.").

Congress delegated to the Commission principal responsibility for reconciling the competing interests in ensuring both reasonable rates and adequate investment because the question requires expertise regarding exceedingly complicated and ever changing markets. *See, e.g.*, *Permian Basin*, 390 U.S. at 767. Here, petitioners have provided the Court no reason to think that Commission error is so inevitable that its discretion must be subject to the extraordinary discipline of a strong court-imposed presumption. To the contrary, in exercising its statutory authority to modify contracts, the Commission has not modified contracts lightly (and petitioners do not claim that the Commission has abused its discretion). In addition, petitioners' presumption would make a single factor (the existence of a contract), the nearly conclusive consideration in what ought to be a far more encompassing, and far less constrained, inquiry. *See, e.g.*, *Tejas*, 908 F.2d at 1003 (Commission accords "some weight" to the fact of a contract, but must exercise its independent judgment and consider other relevant factors).

2. This does not mean, however, that the Court should defer to the Commission's inexplicable acquiescence in petitioners' attempts to diminish its authority. While the Commission's special expertise

in utility regulation commands deference to its views on whether a particular rate is just and reasonable, that expertise has no bearing on the question of whether this Court's decisions in *Mobile*, *Sierra*, and *Morgan Stanley* extend to third-party challenges. *See* FERC Br. 17-22 (basing position on its construction of those decisions); *Ledbetter v. Goodyear Tire & Rubber Co., Inc.*, 550 U.S. 618, 642 n.11 (2007) ("Agencies have no special claim to deference in their interpretation of our decisions."). Moreover, as petitioners concede, the Commission's current position is of recent vintage and conflicts with the view it took prior to 2002 that *Mobile-Sierra* did not apply to third-party challenges. *See* Petr. Br. 32 n.7; *see also* Resps. Br. 32 & n.3 (collecting Commission opinions to that effect). The lack of consistency also diminishes any deference its interpretation would otherwise be due. *See, e.g.*, *United States v. Mead Corp.*, 533 U.S. 218, 228 (2001).

D. Any Further Restraints On The Commission's Authority Must Come From Congress.

If further constraints on the Commission's discretion are warranted in light of changes in energy technology and markets, *see generally Morgan Stanley*, 128 S. Ct. at 2740-41, they should come from Congress, not from a decision of this Court. "It may be, as some economists have persuasively argued, that the assumptions of the 1930's . . . if true then, are no longer true today." *Texaco*, 417 U.S. at 400. But responsibility for revising the Act in light of those changes lies with Congress. *Id*. ("It is not the Court's role, however, to overturn congressional

assumptions embedded into the framework of regulation established by the Act."); *see also New York v. FERC*, 535 U.S. 1, 24 (2002).

It is therefore notable that in 2005, Congress rejected a proposal that would have provided that the Commission "shall have no authority to abrogate or modify any provision of an executed contract . . . that has been entered into or taken effect, except upon a finding that failure to take such action would be contrary to the public interest." H.R. 6, 109th Cong. § 1286(a) (as passed by House, Apr. 21, 2005). This language would have extended the holding of *Mobile* and *Sierra* to third-party contract challenges, but would not have included the strong presumption of lawfulness petitioners seek. And even that more modest extension of the *Mobile-Sierra* doctrine to third-party challenges failed to pass. Whatever else may be read into that rejection, it demonstrates that the doors of Congress are open to those who would argue that the nation's approach to regulation of electricity service requires fundamental revision.

III. At The Very Least, No Presumption Should Apply When Contract Rates Are Challenged By State Public Utility Commissions Or The Federal Commission Itself.

Even if the Court concludes that contract rates ordinarily should be presumed just and reasonable in third-party challenges, the Court should not extend the presumption to challenges by state public utilities commissions or to investigations initiated by the Commission *sua sponte*.

1. As instrumentalities of co-equal sovereigns in an area subject to joint state and federal regulation,

the views of a state commission are entitled to a level of respect entirely unlike that owed to private citizens, interest groups, and corporations. *See Ark. Elec. Coop. Corp. v. Ark. Pub. Serv. Comm'n*, 461 U.S. 375, 377 (1983) (recognizing that the "regulation of utilities is one of the most important of the functions traditionally associated with the police power of the States"). State commissions bring to bear unique substantive expertise in the regulation of public utilities. Indeed, state commissions have been regulating electrical utilities for the public interest longer than the federal government. *See, e.g.*, *New York v. FERC*, 535 U.S. at 5-6. And they are charged, no less than the Commission, with the responsibility "to insure the public adequate service at reasonable rates without discrimination." *Pac. Tel. & Tel. Co. v. Pub. Util. Comm'n*, 62 Cal.2d 634, 647 (1965).

In this way, state commissions differ from other third parties who may focus principally on reducing short-term rates. Like the Commission itself, state commissions must attend to the important interests of contract stability, the economic well-being of utilities, and the maintenance of incentives for long-term investment. *Cf. Los Angeles v. Pub. Util. Comm'n*, 15 Cal.3d 680, 694 (1975) (noting the duty of the Public Utilities Commission of the State of California to consider "every element of public interest affected by" the operation of public utilities).

As a consequence, federal law grants state commissions special status in proceedings to determine whether wholesale rates are consistent with the public interest. Congress enacted Title II of the Federal Power Act to "supplement" state regulation, to "aid the State commissions in their

efforts to ascertain and fix reasonable charges," and to "assist the States in the exercise of their regulatory powers." *Conn. Light & Power Co. v. FPC*, 324 U.S. 515, 525-26 (1945).[10] The new provisions were "in no sense a usurpation of State regulatory authority and contain throughout directions to the Federal Power Commission to receive and consider the views of State Commissions." *Id*. at 526. State commissions thus have long played a critical role before the Commission in cases where the justness and reasonableness of wholesale electric rates is adjudicated. In fact, the Act specifically identifies state commissions as among those the Commission may allow to intervene as parties in federal rate proceedings 16 U.S.C. § 825g(a).[11] *See also id*. § 825*l* (same with respect to identifying parties entitled to petition for rehearing of Commission decisions); *Md. People's Counsel v. FERC*, 760 F.2d 318, 320-21 (D.C. Cir. 1985) (Scalia, J.) (noting that similar provisions of the Natural Gas Act "reflected" Congress's "special solicitude for states and state agencies . . . in protecting their citizens in this traditional governmental field of utility regulation").

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[10] The Act also declares that its provision shall "extend only to those matters which are not subject to regulation by the States," 16 U.S.C. § 824(a), and specifically preserves the authority of "a State or State commission" in certain traditional areas, including the retail sale of electricity. *Id*. § 824(b)(1).

[11] The Commission has likewise recognized the special status of state commissions by allowing them to intervene as a matter of right in Commission proceedings. 18 C.F.R. § 385.214(a)(2).

This Court has held that the Commission's similar combination of expertise and legal responsibilities warrant giving its views on the lawfulness of rates great deference. *See Texaco*, 417 U.S. at 389; *see also FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944) (Commission orders are "the product of expert judgment which carries a presumption of validity"). The views of the Commission's state counterparts are due deference for the same reason. When a state commission challenges a particular rate as inconsistent with the public interest, the deference owed to that expert view should more than overcome any general presumption that private contract negotiations produce just and reasonable rates consistent with the public interest.

2. For similar reasons, the Commission should be free of the burden of any presumption when it initiates an investigation of rates *sua sponte*, based on its informed view that they may conflict with the public interest.

While this Court has described the *Mobile-Sierra* presumption as a limitation on the powers of the Commission to set aside contract rates at the request of a party, it has done so in the context of cases in which the Commission itself had seen no reason to instigate an investigation on its own. When the Commission has seen no basis to doubt the lawfulness of a rate of its own accord, and when no third party representing the public interest has complained, there may be good reason to be reluctant to overturn a contract rate simply because a party to the contract would prefer a more profitable rate. But when the Commission itself takes the unusual step of

initiating a rate investigation, given the deference owed to the Commission's rate expertise, no presumption should constrain the Commission's exercise of its most basic statutory duties.

IV. Whether The Commission Could Lawfully Choose To Adopt A Stricter Standard Of Review Of Its Own Volition Is Not Before The Court.

This Court granted certiorari to decide a limited question: "Whether *Mobile-Sierra*'s public interest standard applies when a contract rate is challenged by an entity that was not a party to the contract." Petr. Br. i. For the reasons set forth above, and in the brief for respondents, the answer to that question is "no." Nothing in *Mobile*, *Sierra*, or this Court's other cases requires the Commission to presume that a contract rate challenged by a third party is just and reasonable, absent extraordinary circumstances.

The Commission agrees that it is not required by this Court's cases to apply the *Mobile-Sierra* presumption to the rate challenges at issue in this case, albeit for different reasons that those presented in this brief. *See* FERC Br. 28-32. But it nonetheless asserts that the decision below should be reversed on an alternative ground. It argues that even if it was not *required* to apply the *Mobile-Sierra* public interest standard as provided in the settlement agreement it approved, it nonetheless lawfully adopted that standard as a matter of discretion. FERC Br. 28-32. This Court should not decide that question in this case.

First, if the Commission intended to ask the Court to pass on the scope of its authority to impose a

Mobile-Sierra standard as a matter of discretion, it was required to seek certiorari on that question. *See* S. Ct. R. 14.1(a) ("Only the questions set out in the petition, or fairly included therein, will be considered by the Court."). But the Commission did not even hint at its present theory in its certiorari-stage brief. In fact, not only did the Commission decline to seek certiorari on the question it now asks the Court to decide, it affirmatively opposed plenary review of the decision below. FERC BIO 8.

Second, it does not appear that the court of appeals understood the Commission to be making the argument it now presses, or that the Commission made clear below the distinction it now draws between circumstances in which it is *required* to apply the *Mobile-Sierra* standard and the occasions on which it has discretion to adopt it. *See* Pet. App. 19a-24a; FERC CA Br. 53-58. This Court should not decide such an important and complicated question without the benefit of a lower court decision that squarely addresses it on the basis of adequate briefing from the Commission and the parties.

Third, there is no reason to think that affirming without considering the Commission's new argument will unduly prejudice the parties. There is no way to know whether anyone will ever challenge the results of the capacity auctions pursuant to the settlement. Nor is there any reason to assume that the difference in the standard of review would make a difference to any such challenge. *See* FERC BIO 10-12. Indeed, affirming here will not predetermine the weight the Commission may afford the public's interest in contract stability and greater investment in the New England capacity market in any future challenge.

See FERC BIO 10-12. And the Commission has made clear by its brief in this Court that it takes those interests very seriously, a position that should give investors substantial confidence that the rates established under the settlement will not lightly be modified.[12]

That said, if the Court were to excuse the Commission's waiver of its alternative grounds for reversal and accepted its position, the Court should resolve the case on that ground and leave for another day the broader question of whether *Mobile-Sierra* applies of its own force to all challenges to all bilateral contracts.

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[12] Even while insisting that the Question Presented is irrelevant to the proper disposition of this case – because, it says, this case does not involve the kind of contract to which the *Mobile-Sierra* presumption applies, *see* FERC Br. 28-32 – the Commission nonetheless claims that the Court should reverse the court of appeals for giving the wrong answer to that irrelevant question. FERC Br. 22. But if the Question Presented does not arise on the facts of this case, the proper resolution would be to dismiss the petition as improvidently granted or to affirm the decision below on the ground, supported by the Commission, that the court of appeals was right in concluding that the *Mobile-Sierra* doctrine does not apply.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted,

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