Nos. 08-74443, 08-74439

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PUBLIC CITIZEN, INC., COLORADO OFFICE OF CONSUMER COUNSEL, and PUBLIC UTILITY LAW PROJECT OF NEW YORK, INC.,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

GEORGE JEPSEN, ATTORNEY GENERAL FOR THE STATE OF CONNECTICUT, LISA MADIGAN, ATTORNEY GENERAL OF THE STATE OF ILLINOIS, and PETER F. KILMARTIN, ATTORNEY GENERAL OF THE STATE OF RHODE ISLAND,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petition for Review of a Final Order of the Federal Energy Regulatory Commission

PETITIONERS' REPLY BRIEF

Lynn N. Hargis
Public Citizen, Inc.
215 Pennsylvania Avenue SE
Washington, DC 20003
(202) 454-5183

Scott L. Nelson
Public Citizen Litigation Group
1600 20th Street NW
Washington, DC 20009
(202) 588-1000

Attorneys for Petitioners in No. 08-74443 (Public Citizen, Inc., Colorado Office of Consumer Counsel, and Public Utility Law Project of New York, Inc.)

Additional Counsel Listed on Inside Front Cover

February 18, 2011

INSIDE FRONT COVER

Gerald A. Norlander
Public Utility Law Project of New York, Inc.
194 State Street, Suite 420
Albany, NY 12210
(518) 449-3375

Attorney for Petitioner Public Utility Law Project of New York, Inc., in No. 08-74443

John S. Wright
Michael C. Wertheimer
Assistant Attorneys General
Connecticut Office
of the Attorney General
10 Franklin Square
New Britain, CT 06051
(860) 827-2620

Peter F. Kilmartin, Attorney General
State of Rhode Island
150 South Main Street
Providence, RI 02903
(401) 274-4400

Lisa Madigan, Attorney General for the State of Illinois
By: Michael Scodro, Solicitor General
Janice A. Dale, Assistant Attorney General
Office of the Illinois Attorney General
100 West Randolph Street, 11th Floor
Chicago, IL 60601
(312) 814-3736

Counsel for Petitioners in No. 08-74439
(George Jepsen, Attorney General for the State of Connecticut,
Lisa Madigan, Attorney General of the State of Illinois, and
Peter F. Kilmartin, Attorney General of the State of Rhode Island)[*]

---

[*] In January 2011, George Jepsen succeeded Richard Blumenthal as Attorney General for the State of Connecticut, and Peter F. Kilmartin succeeded Patrick Lynch as Attorney General of the State of Rhode Island. Fed. R. App. P. 43(c)(2) provides that "[w]hen a public officer who is a party to an appeal or other proceeding in an official capacity dies, resigns, or otherwise ceases to hold office … [t]he public officer's successor is automatically substituted as a party."

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

Cases:

Statutes and Regulations:

Other:

INTRODUCTION

FERC's brief acknowledges that the lawfulness of its market-based rate (MBR) rulemaking is squarely at issue in this case, and that if petitioners' arguments concerning the Federal Power Act's (FPA's) filing requirements and its substantive command that rates be just and reasonable are correct, the MBR Rule cannot stand. FERC's defense of its rulemaking, however, fails to reconcile the MBR Rule with the FPA's clear commands.

With respect to what the Supreme Court labeled the FPA's "file-all-new-rates requirement," *NRG Power Marketing, LLC v. Maine PUC*, 130 S. Ct. 693, 698 (2010), FERC's position rests on wordplay—the claim that the only change in rates under the MBR Rule is the grant of an MBR tariff—that FERC makes no effort to defend as a reasonable reading of the FPA's language. As for whether the MBR Rule complies with the requirement that all rates be just and reasonable, FERC relies on appellate decisions holding that market-based rates can be just and reasonable *if* FERC determines that markets are competitive and ensures that the rates actually charged are within the zone of reasonableness—conditions the MBR Rule does not satisfy.

Finally, FERC makes the remarkable assertion that Congress ratified its MBR regime in the Energy Policy Act (EPAct) of 2005, a 550-page statute containing a few references to electricity "markets," which neither amends the

FPA provisions the MBR Rule contravenes nor otherwise provides any authorization, implicit or explicit, for FERC to substitute market-based rates for rates regulated under the FPA. FERC's reliance on the EPAct only underscores the absence of statutory authorization for its project of replacing the regulatory system Congress enacted with a market-based scheme of its own devising.

ARGUMENT

I. FERC Has Discarded Its Statutory Obligation to Require Advance Filing of Changes in Rates.

FERC relegates its defense of the MBR Rule's noncompliance with the FPA's file-all-new-rates requirement to a secondary position in its brief, contending that petitioners' argument on that point "begin[s] from the premise … that market-based rates are inconsistent with the Federal Power Act …." FERC Br. 35-36. On the contrary, the claim that the MBR Rule conflicts with the FPA's file-all-new-rates requirement is premised only on the statute's clear language, and is independent of the argument that market-based rates as implemented by FERC violate the substantive statutory mandate that all rates be just and reasonable. To the extent that FERC attempts to answer the argument on its own terms, FERC fails to justify its disregard of the FPA's clear filing requirements for all changes in rates and charges.

Despite asserting throughout its brief that courts have repeatedly sustained its MBR regime, FERC points to no decision of any court holding that FERC's

MBR regime satisfies 16 U.S.C. § 824d(d)'s requirement that changes in rates and charges be filed with FERC before they take effect. FERC abandons the position it took in Order 697-A that this Court's decision in *California ex rel. Lockyer v. FERC*, 383 F.3d 1006 (9th Cir. 2004), endorsed its refusal to require advance filing of changes in rates under MBR tariffs: FERC's brief does not contest our demonstration (Pet. Br. 24-28) that *Lockyer* did not address § 824d(d).[2] And FERC completely ignores the Supreme Court's recent emphasis on the file-all-new-rates requirement in *NRG Power Marketing* and the Court's skeptical observation in *Morgan Stanley Capital Group Inc. v. Public Util. Dist. No. 1*, 554 U.S. 527, 542 (2008), that FERC's position that the filing of an MBR tariff satisfies that requirement is "metaphysical."[3]

---

[2] FERC likewise does not contest that the D.C. Circuit in *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866 (D.C. Cir. 1993), did not address statutory filing requirements. *Id*. at 871.

[3] The industry intervenors (but not FERC) contend that this Court has resolved the question of an MBR tariff's compliance with § 824d(d) in cases holding that the "filed rate" doctrine bars lawsuits against MBR sellers claiming that market rates are unreasonable. *See Wah Chang v. Duke Energy Trading & Mktg., LLC*, 507 F.3d 1222 (9th Cir. 2007); *E. & J. Gallo Winery v. EnCana Corp.*, 503 F.3d 1027 (9th Cir. 2007); *Public Util. Dist. No. 1 of Grays Harbor v. IDACORP, Inc.*, 379 F.3d 641 (9th Cir. 2004). But as *Gallo* makes clear, those decisions do not address the lawfulness of FERC's MBR tariffs or rates charged under them, but merely hold that that question is one that cannot be resolved collaterally, as opposed to in proceedings like this one directly challenging FERC's actions. *Gallo*, 503 F.3d at 1039 & n.11.

FERC now asserts that § 824d(d) gives it "broad discretion to waive the advance filing requirement." FERC Br. 38. The statute provides that FERC "for good cause shown, may allow changes to take effect without requiring the sixty days' notice … by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published." 16 U.S.C. § 824d(d). FERC's reliance on its waiver authority, however, is misplaced. Section 824d(d) provides FERC significant discretion as to what constitutes good cause, but it allows no discretion with respect to how FERC may exercise its waiver authority: FERC may only do so through an order that specifies the rate changes to be made and when they shall go into effect. FERC's MBR tariffs do no such thing. They do not say what future changes in rates will occur in market transactions or when changes will go into effect, nor could they unless the agency had the gift of precognition. FERC's MBR tariffs thus do not genuinely comply with the principle that "[e]xcept when the Commission permits a waiver, no regulated seller . . . may collect a rate other than the one filed with the Commission." *Ark. La. Gas Co. v. Hall*, 453 U.S. 571, 577 (1981).

FERC's reliance in its brief on its limited waiver authority under § 824d(d) is also unavailing for a more fundamental reason: In the orders at issue, FERC did not invoke that authority. FERC did not assert that MBR tariffs reflect a *waiver* of the advance filing requirement of § 824d(d); rather, it said MBR tariffs *satisfy* the

advance filing requirement because the only "change" in rates that ever occurs under the MBR Rule is the initial adoption of market-based-rates. Order 697, at ¶ 962; Order 697-A, at ¶ 456. FERC's new argument that § 824d(d)'s waiver authority can be stretched to encompass an MBR tariff is a post-hoc rationalization that, under *SEC v. Chenery Corp.*, 318 U.S. 80, 95 (1943), this Court must disregard, as it "may only sustain an agency's action on the grounds actually considered by the agency." *Nw. Envtl. Def. Ctr. v. Bonneville Power Admin.*, 477 F.3d 668, 686 (9th Cir. 2007).

As to the ground on which the agency actually relied—that no "changes" in rates occur once an MBR tariff is issued—FERC says little more than that it "has reasonably concluded that '[t]he market-based rate tariff, with its appurtenant conditions and requirement for filing transaction-specific data in [electric quarterly reports], *is* the filed rate.'" FERC Br. 37 (quoting Order 697 at § 961 (emphasis added in FERC Br.)). Thus, FERC "construes the rate change to be when a seller applies for market-based rate authority—*not* when it subsequently enters into transactions at market rates under its existing authority." FERC Br. 39. Absent from FERC's argument is any explanation of how it is possible, let alone reasonable, to "construe" the statutory language, which triggers the advance-filing requirement by a change in *rates and charges*, not changes in "rate authority," in the way FERC has done. FERC offers no response to our demonstration that its

position cannot be squared with the clear statutory language requiring advance filing (absent a waiver meeting the statutory requirements) whenever there is a "change" in a "rate" or "charge," and that the advance filing must "stat[e] plainly the change or changes to be made." *See* Pet. Br. 29-39. FERC simply asks the Court to defer to its metaphysical "construction" of the statute without even bothering to claim any ambiguity in the statutory language—the threshold requirement for any such deference. *See Amalgamated Sugar Co. v. Vilsack*, 563 F.3d 822, 831-33 (9th Cir. 2009).[4]

Beyond its plea for deference, FERC argues that MBR tariffs must satisfy § 824d(d)'s file-all-new-rates requirement because courts have held that tariffs setting forth "formula rates" satisfy § 824d(d). FERC Br. 40-41. But there is a critical difference between a formula-rate tariff and an MBR tariff: A formula-rate tariff sets forth objectively defined criteria—a formula—by which the actual rate can be calculated. An MBR tariff, by contrast, provides no determinate indication of the rates that will actually be charged. The acceptance of formula rates under the FPA thus does not in any way legitimize an MBR tariff that just leaves rates and charges to be determined later. Far more analogous to an MBR tariff is the tariff

[4] FERC's position also contradicts what it told this Court in *Lockyer*, which was that an MBR tariff without actual rates (filed later) would not satisfy the rate-filing requirements of § 824d(c). *See* 383 F.3d at 1013. Now, addressing § 824d(d), which requires *advance* filing, FERC changes its tune and contends that the MBR tariff itself satisfies the requirement that changed rates be filed.

setting forth a range of possible rates that the D.C. Circuit held impermissible in *Southwestern Bell Corp. v. FCC*, 43 F.3d 1515, 1516 (D.C. Cir. 1995). FERC concedes that such a tariff does not set forth a rate. FERC Br. 45. If that is so, then an MBR tariff, which does not even define the range within which rates will fall, cannot possibly satisfy the statutory requirement that changes in rates be plainly stated in an advance filing.

FERC also invokes its use of "umbrella tariffs." FERC Br. 41-42. But as the case FERC cites, *Xcel Energy Servs. Inc. v. FERC*, 510 F.3d 314 (D.C. Cir. 2007), makes clear, FERC does not consider an "umbrella tariff" to substitute for advance filing under § 824d(d) of subsequent changes in service falling under that umbrella; the agency merely considers the existence of an umbrella tariff to be a factor favoring the grant of a waiver of the 60-day requirement if the change in service is filed before it goes into effect or soon thereafter. Because FERC's orders promulgating the MBR Rule did not rely on its waiver authority (and could not plausibly do so given the express limits on that authority) FERC's policies regarding waivers in cases involving umbrella tariffs do not support its decision to bypass § 824d(d)'s advance filing requirement in the MBR Rule. If anything, FERC's recognition that changes in service under "umbrella tariffs" *are* changes requiring advance filing or waiver under § 824d(d) contradicts its position on MBR tariffs.

FERC acknowledges that the Supreme Court in *Maislin Industries, U.S., Inc. v. Primary Steel, Inc.*, 497 U.S. 116 (1990), and *MCI Telecommunications Corp. v. AT&T Co.*, 512 U.S. 218 (1994), and the D.C. Circuit in *MCI Telecommunications Corp. v. FCC*, 765 F.2d 1186 (1985), *Regular Common Carrier Conference v. United States*, 793 F.2d 376 (D.C. Cir. 1986), and *Southwestern Bell*, 43 F.3d 1515, repeatedly rejected attempts by agencies to forgo regulation by eliminating statutory rate-filing requirements. FERC contends, however, that those decisions are inapplicable because in those cases agencies attempted to allow regulated entities to charge rates that were *never* filed, whereas FERC still requires after-the-fact reporting of actual rates charged under MBR tariffs. FERC Br. 43-45. But that contention is hardly an answer when the statute requires *advance* filing of changes in rates. What made the agencies' actions unlawful in *Maislin, MCI, Regular Common Carrier Conference*, and *Southwestern Bell* was not that they failed to require any form of rate filing, but that they failed to require *the form of rate filing commanded by statute*, with the accompanying opportunity for public and agency scrutiny of rates before they take effect. As the Supreme Court put it in *MCI*, both the agency and the court "are bound, not only by the ultimate purposes Congress has selected, but by the means it has deemed appropriate, and prescribed, for the pursuit of those purposes." 512 U.S. at 231 n.4. When the means prescribed is advance filing, after-the-fact filing is no more lawful than no filing at all.

FERC also contends that *Maislin*, *MCI*, and other cases holding that agencies may not "detariff" industries in violation of statutory rate-filing requirements are irrelevant because the FPA does not require that all rates be set forth in tariffs, but also allows them to be established by contracts. That is true as far as it goes, but it does not go very far toward supporting FERC's elimination of § 824d(d)'s file-all-new-rates requirement, because the filing requirements of § 824d apply not just to rates set forth in "tariffs" (indeed, that word is not even mentioned in the provision), but also—expressly—to "contracts" and changes in rates and charges made through them. 16 U.S.C. § 824d(c), (d).

FERC's assertion that *Morgan Stanley*'s holding that contract rates are subject to the *Mobile-Sierra* doctrine even on initial review somehow establishes that it is no longer necessary to file rate-changing contracts before they go into effect is even more outlandish. The Supreme Court in *Morgan Stanley* expressly refused to endorse the legitimacy of FERC's MBR regime and went out of its way to raise questions about its lawfulness. *See* 554 U.S. at 542, 548. And the Supreme Court's reference in *NRG Power Marketing* to the FPA's "file-all-new-rates requirement" hardly suggests that the Court sees some incompatibility between the statutory filing requirement and the *Mobile-Sierra* standard of review. 130 S. Ct. at 698. Indeed, the standard of review FERC uses when applying the just-and-reasonable requirement to a new rate is, logically, an entirely separate matter from

when the rate or contract must be filed. Nor is the *Mobile-Sierra* standard so toothless that filing of rates, and their review for lawfulness, can be dispensed with as superfluous or meaningless.

Indeed, FERC agrees that the purpose of filing rate changes is to allow review of their lawfulness. FERC Br. 39. But FERC now interprets § 824d(d) to frustrate that purpose. By postponing the filing of actual rates until after they have already gone into effect, FERC negates the operation of § 824d(e), under which rates can be suspended and/or allowed to go into effect subject to refund if they are found unreasonable, thus providing the complete protection for consumers against unreasonable rates and charges that the statute contemplates. Under an MBR tariff, the actual rates charged can only be challenged—once they are reported—through complaint proceedings under § 824e, which do not provide for refunds from the date an invalid rate went into effect. *See* 16 U.S.C. § 824e(b). Thus, under FERC's "construction" of the statute, the file-all-new-rates requirement no longer does its job of allowing advance review of the lawfulness of rates and utilization of the suspension and refund provisions of § 824d(e). FERC's position can no more be squared with the acknowledged statutory purpose than with the unambiguous statutory language.

Finally, FERC insists that it must be able to dispense with the advance filing of changes in actual rates under MBR tariffs, because otherwise it would be

impractical to allow market-based rates, especially rates established in day-ahead auctions. According to FERC, the statute should not be read to "hamstring" its ability to implement market-based rates in ways incompatible with the advance-filing requirements. FERC Br. 42. In fact, sellers can, using filed contracts or filed rates, establish prices or price formulas for sales of ten minutes' or ten years' duration, and FERC's limited waiver formula can be invoked where there is good cause for waiving the 60-day-advance-filing requirement. In any event, FERC's job is not to bend clear statutory language to suit its policy preferences. If the FPA's file-all-new-rates requirement and its MBR Rule are incompatible, it is the MBR Rule that must go, not the statutory requirement—unless and until Congress says otherwise.[5]

II. FERC Has Failed to Demonstrate That Its MBR System Yields "Just and Reasonable" Rates.

FERC contends that courts, including this Court, have repeatedly upheld its authority to approve market-based rates. But the decisions on which FERC relies either did not reach the question, or approved market-based rates on the premise

[5] As the example of the telecommunications industry that was the subject of the *MCI* decisions indicates, Congress is fully capable of enacting new regulatory structures (with new consumer protections adapted to them) when it determines that continued enforcement of the regulatory regimes created by existing statutes is no longer warranted.

that FERC had made findings and would provide additional protections that the MBR Rule and FERC's brief defending it expressly disclaim.

FERC argues that the D.C. Circuit "upheld the Commission's approval of market-based electricity rates under the Federal Power Act" in *Louisiana Energy & Power Authority v. FERC*, 141 F.3d 364 (D.C. Cir. 1998) (*LEPA*). FERC Br. 25. The court in *LEPA*, however, did *not* consider whether approving market-based rates based on a showing that a seller lacked market power was consistent with the FPA's command that rates be just and reasonable. As the court explicitly noted, "LEPA [did] not challenge FERC's general policy of permitting market-based rates in the absence of market power." 141 F.3d at 366 n.2. The narrow issue in *LEPA* was only whether FERC properly found the seller lacked market power within the meaning of the MBR policy.

Other decisions discussed by FERC either approved market-based rates if accompanied by protections lacking under FERC's MBR Rule or disapproved market-based rates where such protections were absent. [6] In particular, this Court's decision in *Lockyer* was based in part on the Court's understanding that FERC

[6] The industry intervenors (but not FERC) rely on the D.C. Circuit's decision in *Colorado Office of Consumer Counsel v. FERC*, 490 F.3d 954 (D.C. Cir. 2007), claiming that it rejected petitioners' challenges to FERC's MBR regime on the merits. But that decision did not reach the issue, but held instead only that FERC was not required to reconsider the lawfulness of MBR tariffs in an investigation into a discrete issue of unreasonable rates under 16 U.S.C. § 824e.

would analyze a seller's market power three times a year so FERC could "determine ... whether market forces were truly determining the price." 383 F.3d at 1014. FERC in fact does so only "triennially"—once every three years—under the MBR Rule, and it now acknowledges that this Court's understanding in *Lockyer* was erroneous. FERC Br. 30.[7]

Equally importantly, *Lockyer* stressed that FERC could not rely on market forces alone to produce just and reasonable rates even in "highly competitive markets," *id*. at 1013, and thus *Lockyer* was premised on the understanding that FERC would vigorously review actual rates to ensure that they were in fact just and reasonable, not just that sellers lacked market power. As the Court put it, "[i]f the ability to ... gauge the 'just and reasonable' nature of the rates is eliminated, then effective federal regulation is removed altogether." *Id.* at 1015.

FERC invokes *Lockyer* while disclaiming the very review of the justness and reasonableness of rates that *Lockyer* deemed essential to the lawfulness of an MBR system. To be sure, as FERC points out, FERC requires after-the-fact reporting of sales prices, but as its brief makes clear, its review of that data, like its triennial review of sellers' market power, is aimed only at determining whether individual sellers possess market power or have violated conduct rules, not on considering

[7] FERC's MBR Rule excuses many sellers from even a once-every-three-years review of market power.

whether the rates themselves are just, reasonable, nondiscriminatory, and nonpreferential. *See* FERC Br. 30. Indeed, FERC's MBR Rule does not provide it with any criteria to judge whether market-based rates are just, reasonable, and neither preferential nor discriminatory (other than that they were produced by the market), so its much-vaunted oversight amounts to nothing when viewed from the standpoint of the statute's requirement that all rates and charges be just and reasonable. Moreover, FERC's after-the-fact review cannot provide the full refund remedies available when rates are reviewed before they go into effect.

FERC also places great weight on the D.C. Circuit's decision in *Elizabethtown Gas*, 10 F.3d 866. It neglects, however, that that decision rested both on FERC's finding that there was a competitive market and on the court's understanding that FERC would continue to review rates to "assure that a market (i.e., negotiated) rate is just and reasonable." *Id*. at 870.[8] The same court, as FERC itself acknowledges, rejected FERC's reliance on market forces in *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486 (D.C. Cir. 1984), in the absence of empirical evidence that market forces would drive prices into the zone of

[8] FERC suggests (FERC Br. 34) that it is a figment of petitioners' imagination that *Elizabethtown Gas* relied on FERC's finding that there was a competitive market. In fact, the court expressly stated that a competitive market was a necessary precondition to market-based rates ("when there is a competitive market the FERC may rely upon market-based prices," 10 F.3d at 870), and stated, "Here the Commission specifically found that 'Transco's markets are sufficiently competitive ….'" *Id*.

reasonableness, or of any regulatory mechanism to ensure that rates actually charged fell within that zone. *See* FERC Br. 24-25 (quoting extensively from *Farmers Union*); *see also Tejas Power Corp. v. FERC*, 908 F.2d 998, 1005 (D.C. Cir. 1990) (likewise rejecting market rates without "substantial evidence upon the basis of which the Commission could conclude that market forces will keep ... prices in reasonable check."). [9]

Even while claiming that FERC's MBR Rule satisfies the requirements of these decisions and corrects deficiencies in prior attempts to rely on market-based rates, FERC's brief makes clear that the MBR Rule falls short of satisfying the standards established by the case law. In particular, FERC acknowledges it did not act on the basis of a finding that the electricity *markets* in which it allows sellers to exercise MBR authority are competitive. FERC Br. 33-34. FERC also concedes it did not rely on empirical evidence that its MBR Rule would result in actual rates and charges that are just and reasonable. FERC Br. 30-31. And again, FERC's MBR Rule does not provide for, or even allow the possibility of, meaningful review of after-the-fact filings to determine that rates are actually reasonable, as

[9] FERC also relies on *Blumenthal v. FERC*, 552 F.3d 875 (D.C. Cir. 2009), a case involving a challenge to a unique interim regulatory scheme in New England, for the proposition that it may approve market rates without finding a competitive market, but *Blumenthal* gave only cursory attention to that question and relied primarily on *LEPA*, which, as explained above, did not even address whether FERC's actions complied with the FPA.

FERC has disclaimed any standard of reasonableness other than that rates reflect market prices and that individual sellers lack market power and have not engaged in manipulative conduct.

Ultimately, FERC seeks to excuse its noncompliance with the requirements even of its own favored precedents with naked pleas for deference to its expertise and judgment. Thus, FERC asks the Court to overlook the absence of empirical evidence that market-based rates will in fact be within the zone of reasonableness because it believes market rates are reasonable based upon its "substantive expertise and decades of experience with energy markets, and in particular on more than 20 years of experience with developing its market-based rate program." FERC Br. 32. But FERC points to nothing in those years of experience to demonstrate that market rates have in fact been just and reasonable. Instead, FERC relies solely on economic theory (*see id*.), exactly what the courts in the precedents it purports to rely on have said is not good enough (including this Court in *Lockyer*, *see* 383 F.3d at 1013).

Similarly, FERC seeks to avoid the holdings of *Elizabethtown Gas*, *Farmers Union*, and *Lockyer* (383 F.3d at 1012) that approval of market-based rates depends upon a finding that the *markets* themselves are competitive, not just that individual sellers in them lack market power, by mere ipse dixit. FERC's brief states that "[i]n this rulemaking proceeding, the Commission explained that … its

approach in the electric area since the mid-1980s 'has been primarily to rely on an analysis of individual seller market power …'" FERC Br. 34 (quoting Order 697-A, at § 425). To be sure, that statement *describes* what FERC has done, but it hardly explains *why* FERC has done so, or how FERC's position makes sense as a matter of economic theory or real-world experience. On that score, FERC says no more than that "the Commission (and the industry) has over two decades of experience in using (and improving) that existing test [focusing on individual sellers rather than the existence of competitive markets], is comfortable with its analysis and with the results it yields, and has chosen not to alter its focus." FERC Br. 35.

However comfortable FERC may be, that statement falls far short of a reasoned explanation of how market-based rates may be trusted to be just and reasonable (or even, what is a different matter, to reflect competitive market forces) if the market that determines them is not competitive as a whole. FERC's statement provides no reason for this Court to abandon the requirement, set forth in *Lockyer* and *Elizabethtown Gas*, that approval of market-based rates must at least be based on the existence of a competitive market.

Ultimately, FERC's brief conveys not much more than that it trusts markets, and that the Court, in turn, should trust FERC. That is precious little to go on as a basis for concluding that the MBR Rule satisfies Congress's command that FERC

ensure that all rates and charges are just and reasonable. As the Supreme Court held a generation ago in *FPC v. Texaco, Inc.*, 417 U.S. 380, 398 (1974), "the prevailing price in the marketplace cannot be the final measure of 'just and reasonable' rates mandated by the Act." FERC's MBR Rule offers no other measure.

III. Congress Has Not "Ratified" FERC's Disregard of the Fundamental Statutory Limits of Its Authority.

FERC's argument that Congress has "ratified" its MBR regime—including both its elimination of the requirement of advance filing of rate-changes and its presumption that market rates are just and reasonable as long as sellers lack market power and do not engage in prohibited conduct—rests on isolated snippets from the EPAct of 2005 that fall far short of demonstrating congressional acquiescence in FERC's abandonment of fundamental requirements of the FPA. None of the provisions on which FERC relies amended or repealed, expressly or by implication, the key provisions of the FPA at issue here—§ 824d(d)'s advance-filing requirement for rate changes, and the basic command of both § 824d(a) and § 824e(a) that all rates be just and reasonable. FERC's reliance on bits and pieces of the EPAct as evidence that Congress approved FERC's fundamental reshaping of the FPA runs afoul of the principle that "Congress … does not alter the fundamental details of a regulatory scheme in vague terms or ancillary

provisions—it does not, one might say, hide elephants in mouseholes." *Whitman v. American Trucking Ass'ns*, 531 U.S. 457, 468 (2001).

The mouseholes on which FERC relies are small ones indeed. FERC points to the use of the term "markets" in a handful of provisions of the EPAct (and in some of the EPAct's headings), including references to "price transparency in markets," protection of "consumers and competitive markets," and sales of electricity "through an organized market." FERC Br. 47-48.[10] Such references to "markets" fall far short of endorsing *market-based rates* or FERC's elimination of statutory filing requirements. FERC does not argue that these provisions say anything about rates or filing requirements; it relies on their use of the word "market," as if that alone were enough to signify endorsement of FERC's MBR system. But a "market" is merely "the course of commercial activity by which the exchange of commodities is effected." Merriam Webster's Online Dictionary, http://www.merriamwebster.com/dictionary/market. Wholesale electricity markets existed before FERC adopted its MBR regime, and will continue to exist if it is cast aside. The EPAct's use of the word "market" to describe the buying and

[10] In citing the latter provision, codified at 16 U.S.C. § 824e(e)(2), FERC omits to quote the critical statutory language that limits its applicability to an entity that "makes a short-term sale of electric energy through an organized market *in which the rates for the sale are established by Commission-approved tariff*" (emphasis added). Because FERC's MBR tariffs do not establish rates for any sale, the provision implies no approval of MBR tariffs.

selling of wholesale power thus cannot be read to imply approval of FERC's adoption of a particular market paradigm as the basis for its replacement of just and reasonable rates with market-based rates, and still less for FERC's disregard of express statutory requirements concerning the filing of changes in wholesale electric rates.[11]

FERC also points to the EPAct's amendment of the Public Utility Regulatory Policies Act (PURPA), 16 U.S.C. § 824a-3, to provide that electric utilities no longer have an obligation to purchase power from a cogeneration or small power production facility (generally referred to as a "qualifying facility" or "QF") if the QF has access to one of a number of types of markets for the sale of its power. 16 U.S.C. § 824a-3(m)(1)(A)-(C). As FERC acknowledges, PURPA is a "separate statute" from the FPA, FERC Br. 48, and an obscure provision in a different statute concerning the terms under which utilities must buy power from QFs would be an odd place to look to find congressional repeal of basic requirements of the FPA.

Moreover, FERC itself has taken the position that the references to "markets" in the amendments to PURPA do not necessarily refer to "competitive

[11] One of the provisions FERC cites, which enacted 16 U.S.C. § 824t's requirement that FERC promote "price transparency," would be an extremely unusual place to find implicit approval of FERC's deviation from the FPA's public-filing requirements for rate changes, which hardly enhances "transparency."

markets," and the D.C. Circuit has agreed with FERC on this point. *Am. Forest & Paper Ass'n v. FERC*, 550 F.3d 1179 (D.C. Cir. 2008). As that court put it, "FERC's interpretation—that the markets in [PURPA] can be competitive or non-competitive—is consistent with the common usage of the word 'markets.' Indeed, this Court has often referred to non-competitive markets or monopolistic markets." *Id*. at 1181-82. The various subsections of the provision refer to a number of different kinds of markets, which, if accessible to a QF, excuse utilities from their obligation to purchase power from the QF, and do not mandate that any of them exist or suggest that the existence of any of them would necessarily comply with other provisions of federal law. In short, the EPAct's amendment of PURPA, which the court in *American Forest & Paper Association* agreed was "not … a masterpiece of legislative draftsmanship," *id.* at 1183, reflects neither congressional approval of any particular scheme of market regulation adopted by FERC nor an intention to repeal, replace or alter the FPA's requirements of advance filing of rate changes and just and reasonable rates.

FERC's reliance on EPAct § 1290 is equally unconvincing. That provision applied only to FERC proceedings, pending when the EPAct was enacted, involving wholesale contracts entered into in the western United States before June 20, 2001 (i.e., contracts formed during the western energy crisis of 2000-2001). The provision allowed FERC to excuse buyers from making termination payments

under the contracts if FERC had both "found [the seller] to have manipulated the energy market resulting in unjust and unreasonable rates" and "revoked the seller's authority to sell any electricity at market-based rates." EPAct § 1290(a)(1)-(2), 119 Stat. 983-84. Far from constituting a general endorsement of FERC's MBR regime, § 1290's criteria were designed to identify specific proceedings, involving a particular seller: Enron, the only power marketer that satisfied the provision's criteria (finding of market manipulation and revocation of MBR authority) as of the EPAct's enactment. *See City of Vernon, Cal.*, 115 FERC ¶ 61,374 at P 11 n.20, P 33-35 (June 28, 2006). Congress's choice of criteria including FERC's revocation of MBR authority reflected only its awareness of the historical fact that FERC had taken this action with respect to Enron.[12]

Thus, the provision is not, as FERC's brief misleadingly suggests, "premised on the operation of FERC's market-based rate rules" (FERC Br. 49) in any ongoing sense. Still less can it be read to reflect endorsement of the lawfulness of market-based rates or of the particulars of FERC's MBR Rule. Even if it were the case, as FERC now suggests (contrary to the Commission's own decision in *City of Vernon*) that Congress meant to do something more than provide additional

[12] The provision, championed by Senators Cantwell, Murray, and Ensign, was specifically intended to benefit the Snohomish PUD and Nevada utilities that were affected by termination payments in contracts with Enron. *See* 151 Cong. Rec. S7271-72 (June 23, 2005).

remedial authority to FERC in a limited class of cases involving Enron, at most the provision might be read to suggest that FERC has the power to *prevent* sellers from charging market-based rates, not to affirm its power to *grant* market-based rate authority, and certainly not to grant it on terms that excuse clearly stated requirements of the FPA that remain in full force.

Finally, FERC cites the EPAct's addition of a provision to the *Natural Gas Act* that expressly authorizes FERC to allow certain natural gas companies to charge market-based rates for natural gas storage. 15 U.S.C. § 717c(f)(1). FERC does not explain how providing *expressly* for MBR authority for a limited category of services offered by *natural gas companies* constitutes implicit acceptance of an across-the-board MBR program for *electricity* wholesalers. If the provision has any relevance here, it only illustrates that Congress can grant FERC limited MBR authority when it chooses to do so. The EPAct's silence with respect to any comparable grant of MBR authority for electricity wholesalers is deafening.

Moreover, the EPAct's grant of MBR authority to FERC for natural gas storage transactions is notable in that Congress expressly conditioned it on follow-up review by FERC to ensure that market rates actually charged are "just, reasonable, and not unduly discriminatory or preferential," 15 U.S.C. § 717c(f)(3)—precisely the type of review that FERC does not perform with respect to market-based electricity rates. Because the provision allows market-

based rates to be charged even by sellers who have market power, it is clear that Congress's command in § 717c(f)(3) means that FERC must examine the fairness of the *rates themselves*, not just the market power and conduct of individual sellers. The provision thus underscores that Congress's use of the terms "just and reasonable" to describe rates in the FPA likewise refers to characteristics of the rates, not just of power marketers. And Congress's care to include this provision in the one part of the EPAct where it expressly authorized FERC to allow market-based rates suggests that it would *not* approve a system in which FERC abandons review of the justness and reasonableness of actual rates, and considers only whether sellers have market power and obey its conduct rules.

In sum, there is far less to FERC's ratification argument than meets the eye. FERC has scoured a 550-page statute and found a grand total of four provisions that refer generally to electricity "markets," one more that uses a reference to FERC's revocation of market-based rate authority only to identify a class consisting of one power marketer (Enron) with respect to which FERC was granted enhanced remedial authority, and another that provides express authority for limited use of market-based storage rates by certain gas companies—authority notably lacking with respect to electricity wholesalers. Those are weak reeds on which to rest the contention that Congress ratified FERC's MBR regime and implicitly repealed the still-extant FPA provisions that the MBR Rule flouts. This

Court, following principles long established by the Supreme Court, has emphasized that "repeals by implication are 'heavily disfavored,' and may be found only where two statutes are in irreconcilable conflict or where one statute entirely displaces another"—requirements as to which a "clear and manifest" showing is necessary. *Lujan-Armendariz v. INS*, 222 F.3d 728, 743 (9th Cir. 2000). FERC has pointed to nothing in the EPAct that displaces or conflicts with the FPA's file-all-new-rates requirement or its command that all rates be just and reasonable.

The circumstances are a far cry from those in *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120 (2000). There, the FDA reversed its decades-old position as to whether cigarettes were subject to regulation as drugs or medical devices. The Supreme Court found it clear that the agency's new position was fundamentally incompatible with the limits of its authority under longstanding provisions of the Food, Drug and Cosmetic Act. *Id.* at 131-43. The Court then went on to hold that, even if there were any doubt on the subject, Congress had made clear its acceptance of the FDA's former position that it lacked regulatory authority over cigarettes by enacting six separate statutes over a period of 35 years that, together, created a "distinct regulatory scheme" for cigarettes that "preclude[d] any role for the FDA." *Id.* at 144.

Here, by contrast, FERC claims that Congress has ratified the agency's *departure* from clear limits of its authority in the FPA's core provisions, which have existed since its enactment in the 1930s. And FERC points, not to a string of statutes premised on its MBR regime and (as in *Brown & Williamson*) "incompatible" with any other regulatory scheme, *id*. at 156, but only to a few isolated words in a single statute that by no means preclude the operation of the FPA's filing requirements and its substantive command that rates be just and reasonable.

The pertinent teaching of *Brown & Williamson* is the Supreme Court's recognition that, if Congress wanted to allow the agency to turn its statutory scheme upside down, "Congress could not have intended to delegate a decision of such economic and political significance to an agency in so cryptic a fashion." *Id.* at 160. In words directly relevant here, *Brown & Williamson* reiterated the Court's previous statement in *MCI v. AT&T* that "[i]t is highly unlikely that Congress would leave the determination of whether an industry will be entirely, or even substantially, rate-regulated to agency discretion …." *Id.* (quoting *MCI*, 512 U.S. at 231).

IV. A Desire to Avoid Disruption Cannot Justify Perpetuating an Unlawful Regulatory Scheme.

The industry intervenors (but, notably, not FERC) argue that the Court should consider what they assert would be disruptive economic effects of setting

aside FERC's MBR Rule. FERC and the industry would undoubtedly face challenges in responding to a decision striking down the MBR Rule. Whether the effects would be more disruptive and harmful to consumers than market-based rates have been is highly debatable, and there is more to be said on that subject than the intervenors' one-sided presentation of publications that support their policy preferences suggests. The other side of the argument has been summarized as follows:

> Over the past 15 years, federal and state policymakers have fundamentally restructured wholesale electricity markets and retail electric service in many parts of the country. These changes were predicated on the promise that increased "competition" would spur efficiencies, promote innovation, ensure an adequate infrastructure and, most importantly, result in lower rates for consumers. But the opposite has occurred—restructured markets are producing higher prices (and higher profits) than one would expect in a competitive market. Nor is new infrastructure being constructed. And the only "innovation" many consumers have seen is in the new and complex market mechanisms developed to extract more dollars from them for the same basic product—retail electric service.

American Public Power Association, *Consumers in Peril: Why RTO-Run Electricity Markets Fail to Produce Just and Reasonable Electric Rates* (2008), *available at* https://appanet.cms-plus.com/files/PDFs/ConsumersinPeril.pdf.

This policy debate is not for the Court to resolve. A regulatory structure that violates congressional commands is not lawful just because it would be inconvenient to dismantle it. Neither passage of time nor changes in the industry can alter the clear meaning of the words of the FPA. Congress long ago provided

for regulated wholesale electricity markets, in which all changes in rates and charges must be filed with FERC before taking effect, and rates and charges are subject to review to ensure that they are just and reasonable. FERC has taken upon itself to substitute its version of a market-based system. Whether FERC's system is preferable to the one Congress enacted, however, is not up to FERC to decide or this Court to consider in reviewing the lawfulness of FERC's actions.

CONCLUSION

For the foregoing reasons, this Court should set aside FERC's MBR Rule.

Respectfully submitted,

/s/ Scott L. Nelson
Scott L. Nelson
Public Citizen Litigation Group
1600 20th Street NW
Washington, DC 20009
(202) 588-1000

Lynn N. Hargis
Public Citizen, Inc.
215 Pennsylvania Avenue SE
Washington, DC 20003
(202) 454-5183

Attorneys for Petitioners in No. 08-74443 (Public Citizen, Inc., Colorado Office of Consumer Counsel, and Public Utility Law Project of New York, Inc.)

Gerald A. Norlander
Public Utility Law Project
of New York, Inc.
194 State Street, Suite 420
Albany, NY 12210
(518) 449-3375

Attorney for Petitioner Public Utility Law Project of New York, Inc., in No. 08-74443

John S. Wright
Michael C. Wertheimer
Assistant Attorneys General
Connecticut Office of the
Attorney General
10 Franklin Square
New Britain, CT 06051
(860) 827-2620

Lisa Madigan, Attorney General for
the State Of Illinois
By: Michael Scodro
Solicitor General
Janice A. Dale
Assistant Attorney General
Office of the Illinois Attorney General
100 West Randolph Street
11th Floor
Chicago, IL 60601
(312) 814-3736

Patrick C. Lynch, Attorney General
State of Rhode Island
150 South Main Street
Providence, RI 02903
(401) 274-4400

Counsel for Petitioners in No. 08-74439 (George Jepsen,

Attorney General for the State of Connecticut, Lisa Madigan, Attorney General of the State of Illinois, and Peter F. Kilmartin, Attorney General of the State of Rhode Island)

February 18, 2011

CERTIFICATE OF COMPLIANCE WITH RULE 32(a)(7)(C)

Pursuant to Federal Rule of Appellate Procedure 32(a)(7)(C), I certify that the foregoing brief is proportionally-spaced, has a type-face of 14 points, and, as calculated by my word processing software (Microsoft Office Word 2007), contains 6,844 words.

February 18, 2011

/s/Scott L. Nelson
Scott L. Nelson

CERTIFICATE OF SERVICE

I hereby certify that on February 18, 2011, I electronically filed the foregoing brief with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system. I certify that all parties participating in the case are represented by lawyers/law firms that are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

February 18, 2011

/s/ Scott L. Nelson
Scott L. Nelson