No.

IN THE

Supreme Court of the United States

SEMPRA GENERATION ET AL.,

PETITIONERS,

v.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA ET AL.,

RESPONDENTS.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Ninth Circuit misapplied the Federal Power Act, failed to adhere to this Court's holdings in *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956) ("*Mobile*"), and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) ("*Sierra*"), and created conflicts with other circuits, when it held that the Federal Energy Regulatory Commission ("FERC") may abrogate valid, freely negotiated wholesale energy contracts absent any proof that undoing them is necessary to protect the public interest.

2. Whether the Ninth Circuit erred, and created conflicts with the First and D.C. Circuits, when it held that FERC must eschew the deferential "public interest" test articulated by this Court in *Mobile* and *Sierra* and instead apply a searching "zone of reasonableness" analysis whenever a contract rate is challenged as being too high rather than too low.

3. Whether the Ninth Circuit exceeded its legitimate scope of review by ignoring the Commission's findings and deciding issues based on arguments and evidence not presented to FERC.

PARTIES TO THE PROCEEDING BELOW

Pursuant to Rule 14.1(b) of the Rules of this Court, petitioners Coral Power, L.L.C. ("Coral"), PPM Energy, Inc. ("PPM"), and Sempra Generation ("Sempra") (collectively, "Petitioners"), state as follows:

Petitioners before the Ninth Circuit were the Public Utilities Commission of the State of California and California Electricity Oversight Board.

Respondent was the Federal Energy Regulatory Commission.

Intervenors were Pacific Gas & Electric Company; Nevada Power Company; Southern California Edison Co.; Southern California Water Co.; Department of Water and Power of the City of Los Angeles; Public Service Department of the City of Burbank; Public Service Department of the City of Glendale; Water and Power Department of the City of Pasadena; Sempra Generation, Mirant Americas Energy Marketing, L.P., Coral Power, L.L.C.; PPM Energy, Inc.; Public Utility District No. 1 of Snohomish County, Washington; and Dynegy Power Marketing, Inc.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of the Rules of this Court, Petitioners state as follows:

Coral Power, L.L.C. is owned by Coral Energy Holding, L.P., which is owned indirectly by Shell Oil Company. Shell Oil Company is owned indirectly by Royal Dutch Petroleum Company, which in turn is owned by Royal Dutch Shell plc, a publicly held corporation. Royal Dutch Shell plc has no parent company, and no publicly held company owns 10% or more of its stock.

PPM Energy, Inc., formerly known as PacifiCorp Power Marketing, Inc., is an Oregon corporation. PPM is a wholly owned subsidiary of ScottishPower Holdings, Inc., a Delaware corporation. ScottishPower Holdings, Inc. is owned by ScottishPower NA2, which is wholly owned by ScottishPower plc. ScottishPower plc is wholly owned by Iberdrola, S.A., a publicly held entity with shares listed on the Madrid stock exchange. Prior to April 23, 2007, the date upon which Iberdrola S.A.'s acquisition of ScottishPower plc closed, ACS, ACTIVIDADES DE CONSTRUCCION Y SERVICIOS, S.A., a publicly held company (which is also traded on the Madrid stock exchange) indirectly owned 10% of Iberdrola, S.A.'s stock. Calculation of ACS, ACTIVIDADES DE CONSTRUCCION Y SERVICIOS's share of the enlarged Iberdrola Group with the acquisition of ScottishPower plc is uncertain.

Sempra Generation, which was formerly named Sempra Energy Resources, is a California corporation and an indirect wholly-owned subsidiary of Sempra Energy, a publicly held corporation. No publicly held company owns more than 10% of Sempra Energy's stock.

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OPINIONS AND ORDERS BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit (Pet. App. 1a–15a) is reported at 474 F.3d 587. The order of the Federal Energy Regulatory Commission (the "Commission" or "FERC") setting Respondents' complaints for hearing (Pet. App. 16a–48a) is reported at 99 FERC ¶ 61,087, *reh'g denied*, 100 FERC ¶ 61,098 (2002) (Pet. App. 49a–65a). FERC's order denying the complaints (Pet. App. 91a–214a) is reported at 103 FERC ¶ 61,354, *reh'g denied*, 105 FERC ¶ 61,182 (2003) (Pet. App. 215a–67a).

JURISDICTION

The judgment of the Ninth Circuit was entered on December 19, 2006. On March 6, 2007, Justice Kennedy extended the time for filing a petition for a writ of certiorari to and including May 3, 2007. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Relevant provisions of the Federal Power Act, 16 U.S.C. §§ 791a *et seq.* ("FPA"), are set forth at Pet. App. 330a–51a.

STATEMENT OF THE CASE

Introduction

Congress enacted the FPA to ensure a sufficient, stable, and reasonably priced supply of wholesale electricity. To advance these goals, the FPA gives FERC authority to protect the public interest, but otherwise leaves parties free to set rates by contract. This Court recognized as much in 1956 when, in a pair of unanimous decisions, it announced the straightforward rule that the FPA requires valid contracts to be enforced except in extraordinary circumstances where the contracts are contrary to the "public interest." *United Gas Pipeline Co. v. Mobile Gas Serv. Co.*, 350 U.S. 332, 344 (1956) ("*Mobile*"); *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348, 354–55 (1956) ("*Sierra*"). Ever since, courts have taken FERC to task whenever it has failed to provide valid contracts that level of deference and respect.

In this case, the Ninth Circuit bucked 50 years of settled precedent and held that FERC is *required* at California's behest to undo approximately $12 billion of long-term power contracts the State executed during the "Western Energy Crisis" of 2000–01 if, in hindsight, FERC finds that the contract rates are unjust and unreasonable—regardless of the enduring harm that unsettling contractual expectations will cause to energy markets and consumers.

FERC had found that the challenged contracts were negotiated on behalf of California by sophisticated agents and counsel who used the State's purchasing power to force valuable concessions from the sellers. The State had agreed that no contracting party would have the right unilaterally to change the rates based on subsequent changes in market conditions. To the extent volatility in spot market prices influenced the long-term contract rates, the parties knowingly and voluntarily accepted the risks: The sellers had to supply electricity at the agreed rates regardless of whether market prices rose, and California committed to purchase at the agreed rates regardless of whether market prices fell. As it turned out, prices fell. Rather than keeping its bargain, California reneged and sought to undo the contracts, claiming that the rates to which it had freely agreed were, in hindsight, unjust and unreasonable.

The Ninth Circuit sided with California and concluded that new conditions on the application of *Mobile* and *Sierra* are necessary to protect today's consumers. Specifically, it held that FERC may apply the deferential *Mobile-Sierra* "public interest" standard to a market-based rate contract only if FERC (i) had an initial opportunity to examine the justness and reasonableness of a contract's rates before they went into effect and (ii) is willing to entertain after-the-fact challenges to contract rates based on later-discovered evidence. And it further gutted the respect that the "public interest" standard affords voluntary agreements by interpreting *Mobile* and *Sierra* asymmetrically to hold that a remorseful buyer complaining of rates that are too high can undo a valid contract whenever, in hindsight, the contract rate seems unreasonable and undoing the contract would lower consumer energy bills, regardless of the adverse effects that rule will have on the price and supply of power in the long run.

The Ninth Circuit's holdings are flatly at odds with this Court's decisions in *Mobile* and *Sierra*, and those of other circuits, which embrace the fundamental principle that a party may not set aside an otherwise valid contract just because it later questions the providence of the bargain. The decision also conflicts with holdings of the D.C. Circuit recognizing that FERC's market-based regulatory framework satisfies any need for an initial "just and reasonable" evaluation of contract rates under the FPA. And the Ninth Circuit's insistence that FERC should have been more concerned about current consumer bills than about the long-term cost and reliability of supply is irreconcilable with *Mobile* and *Sierra*, decisions of other circuits, and longstanding principles of agency deference.

The Ninth Circuit's decision is not only profoundly unfair to Petitioners, who were sellers in this case, but disastrous to this Nation's electricity markets—the most capital intensive sector of our economy. More than $900 billion in capital has been invested in this sector, and estimates suggest that an additional $400 billion will be needed over the next 15 years for power generation. Investors depend fundamentally on the enforceability of valid contracts. If not reversed, the Ninth Circuit's abandonment of that principle will pose an immediate and significant threat to this industry, gravely undermine FERC's decades-long movement towards market-based regulation, and could cost consumers tens of billions of dollars. Moreover, the damage will likely spread to the natural gas industry, which involves a nearly identical regulatory framework. This Court should grant review to prevent those harms from occurring.

Regulatory Background

When Congress enacted FPA §§ 205 and 206 in 1935, it recognized that many transactions for wholesale electricity are ill-suited to traditional common carrier regulation, under which an agency accepts generally applicable tariffed rates so long as they are "just and reasonable." Electricity is not transmitted or sold on a one-size-fits-all basis. As with natural gas, the transmission and sale of electricity "typically require[s] substantial investment in capacity and facilities for the service of a particular distributor," and market participants often need to make "individualized arrangements" that would not conform to broadly applicable tariffs. *Mobile*, 350 U.S. at 339. At the same time, some level of regulatory oversight was considered necessary because of concentration within the industry. *See FPC v. Texaco Inc.*, 417 U.S. 380, 397–98 (1974).

To accommodate the competing concerns of "contract stability on the one hand and public regulation on the other," *Mobile*, 350 U.S. at 344, "Congress departed from the [traditional] scheme of purely tariff-based regulation" and allowed parties to set rates through privately negotiated contracts. *Verizon Commc'ns, Inc. v. FCC*, 535 U.S. 467, 479 (2002); *see also Mobile*, 350 U.S. at 338 (noting "marked contrast" between Natural Gas Act ("NGA"), which is materially identical to FPA, and tariff-based regulatory schemes). In wholesale power markets, contracting parties are "often sophisticated businesses enjoying presumptively equal bargaining power, who c[an] be expected to negotiate a 'just and reasonable' rate as between the two of them." *Verizon*, 535 U.S. at 479. Thus, absent fraud, duress, or any other traditional contract principle justifying contract avoidance, the FPA assumes that contracting parties can protect their own interests, and FERC may not declare a contract rate to be "'unjust' or 'unreasonable' simply because it is unprofitable to the public utility." *Sierra*, 350 U.S. at 355. FERC may interfere with valid contracts only when necessary to protect the public interest.

As this Court has long understood, the public interest in a sufficient and stable power supply necessitates a strong presumption in favor of upholding otherwise valid contracts. In *Permian Basin Area Rate Cases*, 390 U.S. 747, 822

(1968), this Court held that the FPA's "regulatory system ... contemplates abrogation of these agreements only in circumstances of unequivocal public necessity," such as where the rate "might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory." *Sierra*, 350 U.S. at 355. For decades, FERC effectively applied that presumption within its centralized, cost-based regulatory scheme. It is even more essential under FERC's modern market-based regulatory framework.

Beginning in the late 1980s, technological advances and changes in the regulatory landscape had stimulated competition to the point that FERC concluded it could effectively ensure that wholesale electricity rates are just and reasonable through indirect methods of oversight.[1] In the early 1990s, FERC implemented an approach under which sellers can seek advance approval to sell wholesale power at negotiated, market-based rates without having to submit each contract rate for agency review. *See, e.g., Sw. Pub. Serv. Co.*, 72 FERC ¶ 61,208, at 61,966 (1995). A seller can obtain FERC's authorization to sell at market rates by demonstrating that "it, and its affiliates, either do not have, or have adequately mitigated, market power in both generation and transmission," that "it cannot erect barriers to entry," and that "there is no evidence of other behavior perceived as anticompetitive, such as affiliate abuse or reciprocal dealing." *Grand Council of the Crees v. FERC*, 198 F.3d 950, 953 (D.C. Cir. 2000). A seller's application for market-based rate authority is subject to public review and comment, and aggrieved parties may seek judicial review of

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[1] *See* Electric Energy Market Competition Task Force, *Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy* at 19–22 (Apr. 2007) ("*Report on Competition*"), *available at* http://www.ferc.gov/legal/maj-ord-reg/fed-sta/ene-pol-act/epact-final-rpt.pdf (describing regulatory reforms); *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000) (affirming FERC's regulatory reforms), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002).

FERC's determination. *See, e.g., La. Energy & Power Auth. v. FERC*, 141 F.3d 364, 366–67 (D.C. Cir. 1998). This framework is based on the premise that, "[i]n a competitive market, where neither buyer nor seller has significant market power, it is rational to assume that the terms of their voluntary exchange are reasonable" within the meaning of § 205. *Tejas Power Corp. v. FERC*, 908 F.2d 998, 1004 (D.C. Cir. 1990).

FERC continually monitors this system by requiring market-based rate sellers to file triennial reports containing updated market power analyses and quarterly reports summarizing the terms of all sales, as well as notice of any changes to the facts on which the Commission relied in granting market-based rate authority. *See, e.g., Hinson Power Co.*, 72 FERC ¶ 61,190, at 61,912 (1995); *Louisville Gas & Elec. Co.*, 85 FERC ¶ 61,215, at 61,884–85 (1998).[2] FERC retains authority under FPA § 206 to revoke a seller's market-based rate authorization if a seller fails to comply with these reporting requirements, or if FERC later determines that the seller has market power.

Factual Background

1. California's Failed Restructuring Experiment

Ironically, the "dysfunctional" market conditions of which California complains were caused primarily by its own "aggressive market experiment." *Cal. ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831, 835 (9th Cir. 2004), *cert. denied*, 125 S. Ct. 1836 (2005). In 1996, the California legislature required the State's three vertically integrated investor-owned utilities ("IOUs") to divest most of their electric generating assets and sell their remaining output into newly established, centralized auction "spot" markets (for electricity to be delivered immediately). Instead of using self-

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[2] Under FERC's market-based regulatory regime, power marketers like Petitioners were not required or expected to file their individual contracts with the Commission and instead reported their market-based rate transactions in their quarterly reports. *See, e.g., PacifiCorp Power Mktg., Inc.*, 97 FERC ¶ 61,105, at 61,551 (2001).

generated power to serve their customers, the IOUs were required to purchase power from these spot markets and were also forbidden from entering "forward" contracts (for electricity to be delivered in the future) that would have hedged them against spot market volatility. *See Econ. Report of the President* at 166 (Feb. 2003).[3]

California's experiment proved to be fundamentally flawed. By the summer of 2000, in what has been dubbed the "Western Energy Crisis," spot market prices rose dramatically. *FERC Report* at 1. In August 2000, FERC began investigating the situation. It found the high spot market prices were largely attributable to "market fundamentals" (*i.e.*, inadequate supply to meet rising demand) and California's "seriously flawed" market design. *San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.*, 93 FERC ¶ 61,121, at 61,349, 61,358 (2000). FERC promptly implemented several structural reforms in the California spot markets beginning in December 2000—imposing price caps, modifying the rules governing market operations, and eliminating the requirement that IOUs purchase all of their power from spot markets. *See FERC Report* at 3–4. FERC also began investigating allegations of market manipulation by various sellers. *See id.* at 6.

2. Negotiation and Execution of Forward Contracts

In early 2001, Governor Gray Davis authorized the California Department of Water Resources ("CDWR") to negotiate long-term power contracts on behalf of the State to "'stabilize the market and drive the price of electricity down.'" Pet. App. 111a (citation omitted). CDWR issued two requests for bids and received 213 responses from a range of entities, including Petitioners Sempra and Coral, which intended to build generation facilities to serve California's expanding demand. *Id.* at 113a. CDWR then

[3] *Available at* http://www.gpoaccess.gov/usbudget/fy04/pdf/2003_erp.pdf; *see also* FERC, *The Western Energy Crisis, the Enron Bankruptcy, and FERC's Response* at 1 (*"FERC Report"*), *available at* http://www.ferc.gov/industries/electric/indus-act/wec/chron/chronology.pdf.

"negotiated with the sellers on an individual basis," gaining "negotiating leverage with each agreement that it reached." *Id.* at 113a–14a. CDWR had the advantage of being "'essentially a single purchaser'" in the forward market with an appreciation that "its actions would affect market prices," and effectively used its considerable bargaining power. *Id.* at 115a. Indeed, some sellers, including Coral and Sempra, agreed to sell power initially at a substantial loss in hopes of recovering those losses over the life of the contracts. *Id.* at 116a. Before entering these contracts, Petitioners had each demonstrated that they lacked market power and received FERC's authorization to sell at market rates. No one filed a FPA § 206 complaint asking FERC to reconsider or revoke their market-based rate authority.

Ultimately, CDWR assembled a diversified portfolio of contracts for 12,000 MW of power, *id.* at 113a–14a, which included approximately $10 billion of long-term contracts entered into with Petitioners between May 4, 2001 and July 6, 2001. This portfolio allowed California "to remedy its dependence on the spot market ... for terms of ten years or more," while also encouraging sellers to build new generating facilities in a State that had long experienced a shortfall of supply. *Id.* at 118a; *see also San Diego*, 93 FERC ¶ 61,121, at 61,367. The Sempra, Coral, and PPM contracts alone made possible the construction and operation of thousands of megawatts of new generation in and around California—enough to supply millions of homes. The same benefits would not have been achieved without the long-term contracts.

When these deals were struck, California was fully aware of prevailing market conditions, including allegations that some suppliers had manipulated the spot markets. It voluntarily chose to avoid exposure to the continued volatility of the spot markets in favor of the stability of longer-term transactions. The State knowingly accepted the risk that, if spot prices fell, the rates it agreed to in its long-term contracts might later seem too costly. That risk was far from academic, since FERC had already taken steps to address structural problems in the spot markets when these contracts were executed; indeed, when California entered the PPM agreement, FERC had already imposed specific market mitigation measures in spot markets throughout the West. Yet California's negotiators lauded these long-term contracts as "fair, negotiated, hard-fought deals,'" where "'[f]requently, sellers had to concede numerous points.'" Pet. App. 256a (citation omitted).

Procedural Background

1. Underlying Agency Proceedings

During the summer of 2001, California reaped the benefits of the below-spot-market rates CDWR had secured in its long-term contracts. However, by fall, spot market prices had fallen, and shortly thereafter, CDWR's sister agencies, Respondents California Public Utilities Commission ("CPUC") and California Electric Oversight Board ("CEOB") filed complaints with FERC seeking to undo the same contracts the State had praised only months before.

FERC summarily dismissed the complaints with respect to all contracts (including PPM's) entered into after June 20, 2001, the date FERC had implemented effective mitigation measures to correct problems in the Western spot markets. Pet. App. 34a, 62a. With respect to all remaining contracts, FERC concluded that the parties intended *Mobile-Sierra*'s deferential public interest test to apply. *Id.* at 92a.[4] FERC held that market-based rate contracts are protected by the public interest standard, even though it does not engage in a particularized review of each such contract before it becomes effective, because FERC's regulatory regime provides sufficient alternative "mechanisms for ensuring that market-based rates are just and reasonable." *Id.* at 130a. Essentially, FERC explained, its finding that Petitioners lacked market power predetermined that the

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[4] Respondents did not challenge that determination before the Ninth Circuit. *See* Pet. App. 9a–10a ("[I]t is undisputed that the contracts at issue either explicitly call for *Mobile-Sierra* review or do not preclude it.").

rates Petitioners charged would be just and reasonable. FERC stated that if it were to examine every market-based rate contract before it took effect, "the original grant of market-based rate authority" would become "a pointless exercise of no value to anyone." *Id.* And in that event, "no contract made under market-based authority would protect the parties' contractual expectations as envisioned by [this Court] in *Mobile-Sierra*." *Id.*

After examining the "totality of the circumstances," including evidence adduced in its other investigations of the Western Energy Crisis, FERC held that Respondents had failed to meet the high burden of proof necessary to overturn valid contracts under the *Mobile-Sierra* public interest test. *Id.* at 224a. The Commission found neither "market manipulation specific to the long-term contract negotiations resulting in prices and terms being challenged here," nor "evidence of unfairness, bad faith, or duress." *Id.* at 119a. Rather, "the contracts at issue were the result of choices voluntarily made by CDWR." *Id.* FERC further concluded that the contracts did not threaten the financial ability of any public utility to continue service or impose an excessive burden on consumers; to the contrary, CDWR had achieved its goal of obtaining a contract portfolio with an average price of no more than $70 per megawatt-hour, which would cause no increase in retail rates. *Id.* at 110a. FERC concluded that even if—as a Commission 2003 staff report suggested—spot market dysfunctions had affected forward prices, that would not justify undoing forward contracts, particularly given Respondents' failure "to demonstrate that the contracts were priced above long-run competitive prices" or otherwise show that the contract rates exceeded just and reasonable levels. *Id.* at 111a, 256a.

The Commission ultimately concluded that Respondents' "dissatisfaction with the bargain," *id.*, was insufficient to justify abrogating valid contracts under the public interest standard. It explained that "'[c]ompetitive power markets simply cannot attract the capital needed to build adequate generating infrastructure without regulatory certainty,'" and that "sanctity of contracts remains vitally important whether the regulatory system is cost-based or market-based." *Id.* at 243a (citation omitted).

2. The Ninth Circuit's Decisions

In this case and a companion case decided the same day, *Public Utility District No. 1 of Snohomish County, Washington v. FERC*, 471 F.3d 1053 (9th Cir. 2006) ("*PUD*") (Pet. App. 268a–329a), the Ninth Circuit held that "FERC erred both in its procedural reliance on *Mobile-Sierra* and in the substantive standard it used in determining that the contracts at issue did not affect the public interest." Pet. App. 270a (footnote omitted). It proclaimed that the *Mobile-Sierra* public interest standard is anachronistic and should now be applied only in limited circumstances when FERC has already had the chance to conduct a "plenary, 'just and reasonable' agency review." *Id.* at 305a. And where, as here, FERC has relied on the sellers' lack of market power to ensure that rates are just and reasonable, the Ninth Circuit held that FERC must also allow *post hoc* challenges based on later-discovered evidence suggesting there was market "dysfunction." *Id.* at 322a.

Applying its newly modified version of the *Mobile-Sierra* doctrine, the Ninth Circuit held that FERC erred in applying the deferential public interest standard to the challenged contracts, because FERC's market-based framework had not provided an "opportunity for initial review of the contracted rate." *Id.* at 303a. According to the Ninth Circuit, FERC's finding that sellers lacked market power did not justify applying the deferential *Mobile-Sierra* public interest standard to their contracts because "the basis for [sellers'] market-based rate authority" may have become "so atrophied" by the time the contracts were entered that FERC could not reasonably assume that the contract rates were just and reasonable. *Id.* at 316a. In so holding, the court ignored that FERC approved Sempra's application for market-based rate authority only three weeks before Sempra signed its contract—and no one has ever suggested that market conditions changed in that three-week interim.

The court also summarily rejected Petitioners' contention that Respondents should have raised any concerns about Petitioners' market-based rate authority *before* agreeing to the long-term contracts. *Id.* at 317a–18a. It simply neglected FERC's findings that Petitioners had not exercised market power nor engaged in market manipulation with respect to the contracts at issue, and it ignored Respondents' inability to prove that the contract rates exceeded long-run competitive prices. *See id.* at 224a–25a.

Although FERC had evaluated all of the evidence and found no fraud, duress, or any other basis to undo valid contracts, the Ninth Circuit faulted FERC for failing to consider after-the-fact evidence that forward market prices were affected by "dysfunction" in the spot markets. *Id.* at 317a–18a. The Ninth Circuit ordered FERC on remand to reconsider, with the benefit of hindsight, the entire "context" in which those agreements were made. *Id.* With respect to PPM's contract, which had been reached *after* FERC implemented corrective measures in spot markets throughout the West, the Ninth Circuit directed FERC on remand to "consider[] the possibility that ill effects remained" even after these measures took effect, based on evidence not in existence when FERC dismissed the complaints against PPM. *Id.* at 14a–15a.

Finally, the Ninth Circuit held that, even if the *Mobile-Sierra* test could apply here, the Commission "fundamentally misunderst[ood]" what the "public interest" is in this setting. *Id.* at 13a. The Ninth Circuit held that FERC had committed reversible error by applying the factors articulated in *Sierra*, which involved a seller's complaint about low contract rates (a "low-rate challenge"), to a buyer's complaint about high contract rates (a "high-rate challenge"). *Id.* (citation omitted). The Ninth Circuit explained its view that "the key 'public interest' in a high-rate challenge ... is assuring that the consuming public pays fair rates...." *Id.* at 325a. Although the Ninth Circuit acknowledged that the uncertainty caused by abrogating "high-rate" contracts may affect the price and supply of power over the long run, it declared that FERC's responsibility to protect present consumers from "unjustifiably high rates" must come first. *Id.* at 326a. Thus, the Ninth Circuit specifically instructed FERC that it must undo contracts under the public interest test if the contract rates are beyond "a zone of reasonableness" and retail rates would have been lower "had the wholesale contract rates been lower." *Id.* at 14a, 325a.

REASONS FOR GRANTING THE WRIT

For over 50 years since this Court unanimously decided *Mobile* and *Sierra*, it has been settled law that the FPA does not interfere with private contracts except in extraordinary circumstances of public necessity. That rule has provided the backdrop for every wholesale power contract in effect today, involving hundreds of billions of dollars of investments. Lower courts have given FERC considerable flexibility to discern and weigh the factors that affect the public interest, but they have resolutely forbidden FERC from undoing a valid contract simply because its rates, viewed in isolation, appeared unjust or unreasonable. The Ninth Circuit's decision ignores these foundational principles and precedents, and subverts the settled expectations of all market participants by dramatically narrowing the circumstances under which contracts are protected by the *Mobile-Sierra* public interest standard, and mandating the use in *buyer* challenges of a radically less deferential version of the public interest standard that ignores the FPA's long-term goal of ensuring a stable and sufficient supply of electric power. By inviting buyers and others to sue whenever, in hindsight, they believe a contract is a bad bargain, the Ninth Circuit's new rules destabilize all power contracts—particularly those made under FERC's market-based regulatory framework. Unless reversed, the decision will stifle investment, impede the development of energy markets, and harm consumers.

I. THE NINTH CIRCUIT'S TREATMENT OF VALID WHOLESALE ENERGY CONTRACTS CONFLICTS WITH DECISIONS OF THIS COURT AND OTHER CIRCUITS

The Ninth Circuit held that private contracts are not protected by the deferential *Mobile-Sierra* public interest standard unless FERC has the opportunity to determine for itself that their rates are "just and reasonable" before they take effect. That conclusion finds no support in this Court's decisions, which make clear that the FPA was not intended to displace traditional contract principles except in rare circumstances of unequivocal public necessity. It also conflicts squarely with holdings of other circuits that an opportunity for initial agency review is not required to trigger *Mobile-Sierra* contract protection. Even if some initial agency review were necessary, moreover, FERC's regulatory framework for market-based rates provided it. The Ninth Circuit erred in holding, in direct conflict with decisions of the D.C. Circuit, that FERC's regulatory framework fails to satisfy the Commission's obligation under FPA § 205 to ensure "just and reasonable" rates.

A. The Ninth Circuit Misread *Mobile* and *Sierra* and Created a Circuit Split by Holding That Initial Agency Review Is a Prerequisite to Application of the Public Interest Standard

Unlike some other federal regulatory schemes, the FPA does not mandate tariffs as the exclusive method of establishing rates but "expressly recognizes that rates to particular customers may be set by individual contracts." *Mobile*, 350 U.S. at 338. And where rates are set by contract, FERC's role under the FPA is limited. The FPA was not designed to protect contracting parties from themselves. Congress presumed that the buyer and seller are capable of "negotiat[ing] a 'just and reasonable' rate as between the two of them." *Verizon*, 535 U.S. at 479. Thus, where a contract is valid under normal contract law principles, FERC's "sole concern" under the statute is whether the contract is contrary to the public interest. *Sierra*, 350 U.S. at 355.

It has accordingly long been settled that, except in extraordinary circumstances where upholding a wholesale electricity contract will adversely affect the public interest, FERC has no power under the FPA to abrogate or modify the contract. *See Ark. La. Gas Co. v. Hall*, 453 U.S. 571, 582 (1981) ("[T]he Commission itself lacks the affirmative authority, absent extraordinary circumstances, to 'abrogate existing contractual arrangements.'") (quoting *Permian Basin*, 390 U.S. at 820). Whenever FERC has strayed from this path and issued orders seeking to limit the applicability of the *Mobile-Sierra* doctrine, courts have vacated the orders and "remind[ed] the [Commission] that it is not free to ignore the doctrine." *Sam Rayburn Dam Elec. Coop. v. FPC*, 515 F.2d 998, 1005 (D.C. Cir. 1975).[5]

Although the contracts at issue in *Mobile* and *Sierra* were filed with the Commission and allowed to take effect, the agency had made no determination whether they were "just and reasonable," and this Court never suggested that an opportunity for initial, plenary review was a prerequisite to the deferential public interest standard. To the contrary, the Court explained in *Mobile* that utilities are free under the statute to set rates by contract, except that "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. And the Court's reasoning in *Sierra* confirms that, even had the Commission concluded on an initial review that the contract afforded the utility "less than a fair return," the agency lacked authority to "relieve[]" the utility "of its improvident bargain." *Sierra*, 350 U.S. at 355.

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[5] *See also, e.g., Boston Edison Co. v. FERC*, 233 F.3d 60, 68 (1st Cir. 2000) (remanding for FERC to apply public interest); *Ne. Utils. Serv. Co. v. FERC*, 993 F.2d 937, 961–62 (1st Cir. 1993) (same).

The Ninth Circuit purported to draw contrary support from FERC's order in *Northeast Utilities Service Co.*, 66 FERC ¶ 61,332 (1994), *see* Pet. App. 303a, but that precedent actually undercuts the Ninth Circuit's holding. In *Northeast Utilities*, a utility had filed several rate agreements contemporaneously with a proposed merger. *See Ne. Utils.*, 993 F.2d at 960. *On initial review of the contracts*, FERC modified the rates on the ground that they were not "just and reasonable." *Id.* The First Circuit reversed, holding that FERC "was bound to follow the *Mobile-Sierra* doctrine," and it instructed FERC to reevaluate the contract under the public interest standard. *Id.* at 962. On remand, FERC once again modified the contract rates, but this time it justified its decision by evaluating the public interest factors. *See Ne. Utils.*, 66 FERC ¶ 61,332, at 62,084–85. The First Circuit affirmed because "FERC ha[d] done more on remand than simply substitute the words 'public interest' for the forbidden phrase 'just and reasonable.'" *Ne. Utils. Serv. Co. v. FERC*, 55 F.3d 686, 692 (1st Cir. 1995). Thus, in direct conflict with the Ninth Circuit's decision, the First Circuit held that the public interest standard applies even when a contract is being reviewed for the first time.

The law in other circuits is consistent with the First Circuit and equally in conflict with the Ninth Circuit. For instance, in *Borough of Lansdale v. FPC*, 494 F.2d 1104 (D.C. Cir. 1974), the D.C. Circuit firmly established that FERC lacks authority to modify a contract for reasons besides public necessity—regardless of whether the contract has previously been subject to plenary review. The D.C. Circuit held unequivocally that "[t]he present case does not fall outside the confines of the *Sierra-Mobile* doctrine merely because the 1971 contract has never been filed with, or accepted by, the Commission." *Id.* at 1114; *see also Natural Gas Pipeline Co. of Am. v. Harrington*, 246 F.2d 915, 919 (5th Cir. 1957). The Ninth Circuit attempted to distinguish that holding by claiming that it "primarily reflected concern over a seller's abuse of the rate-filing requirement." Pet. App. 304a. But the D.C. Circuit did not rule so narrowly. The court flatly rejected the contention that the filing and acceptance of a contract is required for the public interest standard to apply, because that would "stand[] the *Sierra-Mobile* doctrine on its head." 494 F.2d at 1113. It recognized that the "regulatory force of a contract arises before, and survives in the absence of, the physical filing of the document." *Id.* at 1114. And in *Compania de Gas de Nuevo Laredo, S.A. v. FERC*, 606 F.2d 1024 (D.C. Cir. 1979), the D.C. Circuit confirmed that its *Lansdale* holding applies even where a utility "seek[s] to enforce, rather than to abrogate, the unfiled contract." *Id.* at 1029.[6]

As these decisions make clear, the FPA presumes that rates set by valid contracts are just and reasonable and must be enforced except in extraordinary circumstances of unequivocal public necessity. That presumption does not depend on initial agency review of the contract, as the Ninth Circuit held; instead, the presumption derives from Congress's recognition that, in the context of wholesale electricity markets, individualized arrangements are necessary, and privately negotiated rates will generally be "just and reasonable" because "the party charging the rate and the party charged [are] often sophisticated businesses enjoying presumptively equal bargaining power." *Verizon*, 535 U.S. at 479; *see also Mobile*, 350 U.S. at 338–39 (observing that natural gas industry is ill-suited for broadly applicable tariffs). Contrary to the Ninth Circuit's holding in this case, the *Mobile-Sierra* doctrine is premised upon the critical role of contractual arrangements in the regulatory scheme, not upon some notion of administrative collateral estoppel arising from FERC's opportunity for initial review.

[6] *See also Sam Rayburn Dam Elec. Coop.*, 515 F.2d at 1008 ("[T]here is not a scrap of language in [*Lansdale*] suggesting ... that the decision is limited to attempted abrogations of written contracts that have been tendered to and rejected by" the Commission.).

B. The Ninth Circuit Erred and Created Conflicts with Decisions of the D.C. Circuit When It Held That FERC's Market-Based Regulatory Approach Fails to Satisfy FPA § 205's Requirement That Rates Be Just and Reasonable

Even if the opportunity for an initial agency determination that contract rates are "just and reasonable" within the meaning of FPA § 205 were a precondition to the application of *Mobile-Sierra*'s deferential "public interest" standard, the Ninth Circuit erred in holding that FERC's market-based regulatory system is insufficient to satisfy that requirement. The Ninth Circuit concluded that FERC's approach fails to ensure just and reasonable rates because it does not permit "'timely consideration of sudden market changes and offers no protection to purchasers victimized by the abuses of sellers or dysfunctional market conditions that FERC itself only notices in hindsight.'" Pet. App. 10a (citation omitted). That holding conflicts with several D.C. Circuit decisions that have upheld FERC's market-based rate framework as providing sufficient oversight to satisfy § 205, and it creates a standard of perfect hindsight that would effectively bar FERC from implementing any workable market-based approach.

This Court has repeatedly observed that FERC is not bound to use any particular method to ensure that rates are just and reasonable. *See, e.g., FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944). When Congress passed the FPA in 1935, the Commission had little choice but to adopt a centralized, cost-based regulatory approach because the Nation's electricity industry was dominated by a handful of holding companies with monopoly power. But changes in the industry have opened the transmission and interstate sale of electricity to broad competition and led FERC sensibly to conclude that market-based regulation is equally effective and much more efficient. Under FERC's existing approach, wholesale sellers are free to negotiate rates so long as they demonstrate that they lack market power. The

D.C. Circuit has repeatedly held that this approach comports with the FPA. *See, e.g.*, *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870–71 (D.C. Cir. 1993); *Tejas Power Corp.*, 908 F.2d at 1004.[7]

Although the Ninth Circuit agreed with that general proposition, the court concluded that a market-based regulatory regime would be valid "*only* insofar as FERC implements and uses an effective oversight mechanism *after* the market-based rate authorization is initially granted." Pet. App. 312a. The court held that FERC's current regulatory regime fails that test for two reasons: first, FERC's initial market power analysis may have gone stale by the time that a challenged contract was executed (*see id.* at 316a; *id.* at 10a); second, FERC does not permit parties to challenge the justness and reasonableness of contract rates after-the-fact, based on later claims of market "dysfunction." *See id.* at 12a.

The Ninth Circuit's staleness contention conveniently ignores the facts of this case. Sempra filed its application seeking market-based rate authority on February 6, 2001. Respondent CPUC intervened in that proceeding but did not object to Sempra's request.[8] On April 10, 2001, FERC found that Sempra lacked market power and granted the company market-based rate authority. Sempra signed its contract with CDWR *only three weeks later*. Respondents have never suggested that market conditions changed in the interim. Yet under the Ninth Circuit's holding, FERC's conclusion that Sempra lacked market power was apparently still not timely enough to constitute sufficient oversight. The inescapable conclusion is that, as FERC presaged in its order, "the original grant of market-based

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[7] These conflicts with D.C. Circuit precedent are particularly important because the FPA always permits parties to seek review of FERC orders in the D.C. Circuit. *See* 16 U.S.C. § 825*l*(b). Thus, parties seeking to undo a contract will choose the Ninth Circuit whenever possible, and parties seeking to enforce a contract will petition the D.C. Circuit for review.

[8] *See* FERC Docket No. ER01-1178.

rate authority" has become "a pointless exercise of no value to anyone." Pet. App. 130a, 231a.

The Ninth Circuit's decision also ignored the mechanisms that FERC had in place in 2001 (and that remain in place today) to ensure that the market remains workably competitive after it has granted a seller market-based rate authority. For instance, sellers had to file quarterly reports summarizing all market transactions. And every three years, sellers had to submit to a full market-power analysis. The Ninth Circuit also attached no significance to California's right, based on this (or any other) information, to file a complaint under FPA § 206 seeking revocation of Petitioners' market-based rate authority *before* it executed the contracts, even though such a complaint would have enabled the challenger later to seek retroactive reformation of the contracts.

Perhaps most fundamentally, the Ninth Circuit erred in construing the FPA to require FERC to allow *post hoc* challenges to its market analyses based on hindsight. As the D.C. Circuit correctly acknowledged, FERC has always had to rely upon "[l]ong-range estimates" that are "admittedly imperfect." *Town of Norwood v. FERC*, 53 F.3d 377, 380 (D.C. Cir. 1995). Contrary to the Ninth Circuit's conclusion in this case, the D.C. Circuit has held that even if FERC's "sanguine predictions about market conduct ... turn out to be incorrect," *prospective* revocation of market-based authority "provides an appropriate safeguard against the uncertainties of FERC's prognostications." *La. Energy*, 141 F.3d at 370–71; *accord, Interstate Natural Gas Ass'n of Am. v. FERC*, 285 F.3d 18, 34–35 (D.C. Cir. 2002) ("*INGAA*"). This Court reached a similar conclusion in connection with the filed rate doctrine: retroactive ratemaking is forbidden under the FPA, even if the Commission accepted a cost-based rate that in hindsight falls outside the bounds of the zone of reasonableness. *See, e.g., FPC v. Tenn. Gas Transmission Co.*, 371 U.S. 145, 152–53 (1962).[9]

In ruling that the enforceability of market-based rate contracts must be subject to *post hoc* "just and reasonable" challenges, the Ninth Circuit ignored the fact that hindsight may equally illustrate the flaws in the assumptions underlying cost-based rates, as was the case in *Sierra*. Parties *always* contract in the absence of perfect information. And it is through contracts that they hedge and allocate the risks associated with that uncertainty. Here, the parties all recognized that, because of a confluence of many factors, spot market prices were unusually high. By executing the contracts at issue here, California immediately lowered its costs and escaped exposure to spot market volatility. At the same time, it accepted the risk that, if spot market prices declined, it would be bound to continue purchasing at higher, long-term rates. Allowing parties like California to mount *post hoc* challenges to freely negotiated agreements whenever risks they have knowingly accepted have come to roost will wreak havoc on the markets and long-term consumer interests.

C. By Undermining Contractual Certainty, the Ninth Circuit's Ruling Poses an Immediate and Grave Threat to the Nation's Energy Industry

If not reversed, the Ninth Circuit's holding will undermine any workable market-based rate system by destroying the contract certainty necessary to an efficient competitive market. As FERC has recognized, "[t]he certainty and stability which stems from contract

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[9] In *Permian Basin*, this Court held the Commission need not evaluate *every* filed rate for reasonableness, even if the consequence is that some rates fall outside the just and reasonable range. 390 U.S. at 777. FERC had adopted "area rates" because it lacked the resources to constantly monitor every wholesale energy transaction. The Court affirmed FERC's order, recognizing that "'[c]onsiderations of feasibility and practicality are certainly germane' to the issues before us." *Id.* (citation omitted).

performance and enforcement is essential to an orderly bulk power market. If the integrity of contracts is undermined ... the market, the industry and ultimately the consumer would suffer." *Pub. Serv. Co. of N.M.*, 43 FERC ¶ 61,469, at 62,153 (1988), *aff'd sub nom. San Diego Gas & Elec. Co. v. FERC*, 904 F.2d 727, 730 (D.C. Cir. 1990); *see also Mobile*, 350 U.S. at 344 ("[T]he stability of supply arrangements ... is essential to the health of the natural gas industry."). Contract certainty has become even more essential in today's regulatory environment because market participants such as independent generators and power marketers are no longer guaranteed recovery of their costs but must instead rely on an interdependent web of contractual commitments to secure funding and mitigate their risks. This web involves contracts to finance and build new generation, to make long-term purchases and sales with other utilities, to reduce consumption during peak hours, to arrange for supplies and transmission services, and to hedge costs through futures, options, and other financial instruments. Buyers and sellers will make these long-term financial commitments, involving hundreds of billions of dollars, only so long as they are confident that the deals to which they agree will be enforced according to their terms.[10]

The *Mobile-Sierra* doctrine as it has been understood for the last 50 years provides that much-needed assurance. To foster contract stability, a contracting party is presumed to have bargained away any right to seek a unilateral change to its rates unless the contract expressly states otherwise. *See, e.g., United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103, 112 (1958) (contracting parties may expressly reserve right to modify rates). California understood that. Indeed, CDWR expressly agreed with

[10] *See* Pet. App. 243a ("Competitive power markets simply cannot attract the capital needed to build adequate generating infrastructure without regulatory certainty, including certainty that the Commission will not modify market-based contracts unless there are extraordinary circumstances.") (105 FERC ¶ 61,182).

Sempra that their contract's "rates, terms and conditions ... are 'just' and 'reasonable' within the meaning of the FPA and that changes in market conditions will not render such rates, terms and conditions 'unjust' or 'unreasonable' for purposes of" FPA § 206. Pet. App. 221a.

In light of the Ninth Circuit's ruling, parties can no longer trust that wholesale energy contracts will be enforced according to their terms. Because the Ninth Circuit insists that *Mobile* and *Sierra* do not apply if there is any gap in time between FERC's evaluation of a seller's market power and its execution of a market-based rate contract, the most that a market-based seller could now do to insulate its contract from the risk of future modification would be to seek FERC's blessing of *every* transaction immediately before it takes effect. But that would be wholly impracticable in today's fluid markets. And in any event, such efforts would not provide the seller any real security because, under the Ninth Circuit's approach, FERC would still be required to entertain *post hoc* challenges based on evidence of market "dysfunction" that a party or "'FERC itself only notices in hindsight.'" *Id.* at 10a (citation omitted). The uncertainty bred by this decision will reduce the supply and increase the price of capital necessary to support power markets, because sellers will demand risk premiums to offset the chance that their contracts will later be undone; it will also leave buyers exposed to spot market volatility, because suppliers will be less willing to enter forward contracts. This will be especially true when market conditions are tight and volatile—precisely when additional market participation and capital are most needed. These consequences will likely translate into tens of billions of dollars in increased electricity costs for consumers.

II. THE NINTH CIRCUIT ERRED BY IMPOSING ITS OWN SHORTSIGHTED VIEW OF THE "PUBLIC INTEREST"

The Ninth Circuit also ruled that FERC erred "in the substantive standard it used in determining that the contracts at issue did not affect the public interest." *Id.* at

271a. The court of appeals held that the factors this Court identified in *Sierra* apply only in "the context of a *low-rate* challenge." *Id.* at 323a. In a *high-rate* challenge such as this case, it declared that "the key 'public interest' ... is assuring that the consuming public pays fair rates," which requires FERC to determine whether the contract rates fall outside the "zone of reasonableness." *Id.* at 325a. That holding ignores the teachings of *Mobile* and *Sierra*, conflicts with decisions of other circuits that forbid FERC from collapsing the public interest standard into the traditional just and reasonable standard, and fundamentally usurps FERC's policymaking responsibilities.

A. The Ninth Circuit's Public Interest Standard for High-Rate Challenges Conflicts with *Mobile* and *Sierra* and Decisions of the First and D.C. Circuits

The straightforward rule that this Court announced in *Mobile* and *Sierra* assures contracting parties that FERC will displace traditional contract principles and modify contracts only in "extraordinary circumstances" of "unequivocal public necessity." *Ark. La. Gas Co.*, 453 U.S. at 582; *see also Permian Basin*, 390 U.S. at 820, 822. The Court recognized that this heightened deference to rates established in valid contracts is essential to achieve Congress's goal of ensuring a stable and sufficient supply of electric power. *See Mobile*, 350 U.S. at 344. Yet the Ninth Circuit gave only lip service to this principle, and proceeded to require the abrogation of any "unreasonable" contract rates, regardless of the long-term consequences for electricity markets and consumers. The Ninth Circuit's holding that buyers may undo the terms of their voluntarily negotiated contracts whenever they can show that wholesale contract rates exceed the *"just and reasonable range,"* Pet. App. 326a (emphasis added), provides sellers no greater protection than if there were no contract at all.

The Ninth Circuit's new rule improperly collapses the "public interest" inquiry into the statutory standard for measuring "just and reasonable" rates in the absence of a valid contract. *See id.* (citing *INGAA*, 285 F.3d at 31–36). This Court in *Sierra* forbade the Commission from undoing a contract even though FERC had determined the contract rates to be "'unreasonably low and therefore unlawful.'" *Sierra*, 350 U.S. at 354 (citation omitted). And both the First and D.C. Circuits have recognized that the *Mobile-Sierra* rule is "much more restrictive" than the "just and reasonable" evaluation that FERC undertakes when there is no contract. *Atl. City Elec. Co. v. FERC*, 295 F.3d 1, 14 (D.C. Cir. 2002). As the D.C. Circuit explained in *Transmission Access Policy Study Group v. FERC*, under *Mobile-Sierra*, FERC must "show more than that the contract was unjust and unreasonable—the Commission had to find that contract modification was in the public interest." 225 F.3d 667, 710 (D.C. Cir. 2000) (citing *Sierra*, 350 U.S. at 355), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002). In *Northeast Utilities*, the First Circuit rejected FERC's attempt to circumvent *Mobile-Sierra* by "conflat[ing] the 'just and reasonable' and 'public interest' standards." *Ne. Utils.*, 993 F.2d at 961. It further cautioned that "[t]he distinction between the 'just and reasonable' and 'public interest' standards loses its meaning entirely if the Commission may modify a contract under the public interest standard where it finds the contract" unjust or unreasonable. *Id.* By equating the "public interest" with the "zone of reasonableness," the Ninth Circuit's holding conflicts directly with these decisions.

This Court's refusal in *Sierra* to permit FERC to "relieve[]" a seller "of its improvident bargain"—even though FERC had found the contract rate to be unreasonably low, 350 U.S. at 355—applies equally to buyers challenging rates they believe to be unreasonably high. As the First Circuit explained, it is "logically inferable" that both sellers and "purchasers can make bargains which in hindsight prove improvident." *Boston Edison Co. v. FERC*, 856 F.2d 361, 372 (1st Cir. 1988). The Ninth Circuit's construction of the statute to grant buyers more favorable post-contract remedies destroys the "symmetry to the ratemaking process." *Id.* Under the Ninth Circuit's asymmetric approach, buyers can challenge any contracts that are no longer favorable to them, while insisting that sellers continue to adhere to contracts sellers are performing at a loss. This "heads I win, tails you lose" rule will prove a potent disincentive to suppliers' commitment to long-term sales agreements and cannot be reconciled with the goal of preserving "contract stability." *Mobile*, 350 U.S. at 344. And it conflicts squarely with decisions of other circuits that have applied *Mobile-Sierra*'s "deference to freely arrive[] at contract prices" even when the rates are challenged as too high. *San Diego*, 904 F.2d at 730 (rejecting argument by buyer that contract should be modified because after-the-fact market changes made rates unjust and unreasonable); *see also Boston Edison v. FERC*, 233 F.3d 60, 68–69 (1st Cir. 2000) (remanding for FERC to consider whether rates are "so high as to be contrary to the public interest"); *Potomac Elec. Power Co. v. FERC*, 210 F.3d 403, 412 (D.C. Cir. 2000) (affirming FERC's application of stringent public interest standard in high rate challenge).

B. The Ninth Circuit Improperly Assumed the FERC's Policymaking Role When It Imposed Its Idiosyncratic View of the Public Interest

As this Court recognized in *Sierra*, whether a contract rate will "have an adverse effect on the public interest is of course a question to be determined in the first instance by the Commission." *Sierra*, 350 U.S. at 355. In reviewing the Commission's ratemaking decisions, "courts must determine whether Commission orders, issued pursuant to indirect regulation, are supported by substantial evidence and whether it is rational to expect them" to accomplish the aims of the FPA, such as "'maintain[ing] financial integrity, attract[ing] necessary capital, and fairly compensat[ing] investors for the risk they have assumed,'" while also protecting the public interest. *Texaco*, 417 U.S. at 393 (citation omitted). Because Congress delegated to FERC the responsibility to make informed decisions about energy policy and to exercise its expertise in this area, "[a] presumption of validity therefore attaches to each exercise of the Commission's expertise." *Permian Basin*, 390 U.S. at 767. The Ninth Circuit's holding ignored these traditional principles of agency deference.

FERC recognized that *Sierra* only "gave examples of factors that would meet the 'public interest' standard," Pet. App. 94a, and that "[b]oth *Mobile* and *Sierra* addressed seller challenges to contract rates alleged to be too low." *Id.* FERC therefore did not base its public interest determination solely on *Sierra*'s three factors, but considered a broad range of factors potentially relevant to the public interest. *Id.* at 243a, 263–64a. After considering "the evidence and the totality of circumstances," the Commission concluded that Respondents failed to identify *any* discernible public interest factor supporting contract modification. *Id.* at 96a. In reaching its decision, the Commission also gave substantial weight to the long-standing policy of "respecting contract sanctity and creating the regulatory certainty needed to attract sufficient capital to competitive power markets." *Id.* at 246a.

The Ninth Circuit gave no deference to FERC's balanced consideration, and instead ordered the Commission henceforth to assess the public interest primarily by reference to the effect of the contract on rates paid by existing customers. In fact, the court went so far as to suggest that FERC must find the public interest standard to be satisfied if existing retail rates would be lower but for the challenged contracts. *See, e.g., id.* at 13a–14a ("Even if rates did not increase in the months after CDWR signed the contracts, the retail rates charged consumers because of these contracts might have been higher than they would have been had the wholesale contract rates been lower."). The Ninth Circuit had no authority to take FERC's policy-making mantle and dictate the proper balance between short-term and long-term public interests. Certainly FERC *could* have placed greater emphasis when conducting the public interest analysis on the impact of the challenged rates on existing consumers as compared to the long-term stability of power markets. But the Ninth Circuit vastly overstepped its jurisdiction when it purported to circumscribe FERC's discretion by *insisting* that FERC focus on interests of present consumers, even if the result would jeopardize "the stability of supply arrangements which all agree is essential to the health of the ... industry." *Mobile*, 350 U.S. at 344.

C. If Not Reversed, the Ninth Circuit's Interpretation of the "Public Interest" Will Encourage Every Disgrunted Buyer to Sue and Consumers Will Suffer

By interpreting the ordinarily deferential public interest standard to require a searching "just and reasonable" inquiry whenever a contract rate is challenged as being too high, the Ninth Circuit's holding subverts Congress's intent to leave intact the right of utilities to set and enforce rates by contract save in extremely rare circumstances of public necessity. The Ninth Circuit's holding will encourage contract challenges at FERC every time there is a reason to question the providence of an existing contract. For instance, shortly after this decision and the companion decision in *PUD*, the Illinois Attorney General filed an FPA § 206 complaint alleging that contract rates resulting from a recent power auction that Illinois sponsored and supervised are beyond the "zone of reasonableness," and therefore billions of dollars of contracts should be abrogated or modified under the Ninth Circuit's holding in *PUD*.[11] That is just a taste of what will follow if the Ninth Circuit's ruling is not reversed. Because power prices are by their nature highly volatile, such complaints will become routine.

The Ninth Circuit's decision leaves no room for FERC to correct these problems on remand. Under the Ninth Circuit's holding, FERC "must give predominant weight" to

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[11] *See Complaint by the People of the State of Illinois, ex rel. Lisa Madigan*, FERC Docket No. EL07-47-000 (filed Mar. 15, 2007).

current consumer rates over all other concerns, Pet. App. 323a, even if FERC determines that consumers and market participants would be better off in the long run if the challenged contracts were enforced. The long-term consequences are sure to be disastrous. Fewer parties will agree to contracts when they are subject to such a loose (and lopsided) standard of modification, *see infra*, Section I.C., and consumers will ultimately be the ones to suffer from the ensuing market volatility.

III. THE NINTH CIRCUIT ERRONEOUSLY REVIVED COMPLAINTS AGAINST PPM BASED ON ARGUMENTS AND EVIDENCE NOT PRESENTED TO FERC

On June 19, 2001, FERC issued an order imposing comprehensive spot market mitigation measures throughout the Western United States. *See San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Serv.*, 95 FERC ¶ 61,418 (2001) ("June 19 Order"); *see also id.* at 62,546 (noting that spot and forward market prices had already dropped dramatically in the weeks prior to the issuance of the order); Pet. App. 5a (spot market prices returned to pre-crisis levels following the June 19 Order). Respondents' complaints before FERC conceded that the June 19 Order corrected any spot market dysfunctions, and Respondents failed to provide evidence of lingering market dysfunction after the date of the market mitigation order. *See* Ninth Circuit Supp. Excerpts of R. at 4, 6. FERC therefore dismissed the complaints as to parties, like PPM, that had entered into contracts with CDWR after June 20, 2001. Pet. App. 34a, 62a. On rehearing, Respondents argued that PPM and CDWR had entered into a Memorandum of Understanding ("MOU") prior to June 20, 2001, but FERC found that CDWR was not bound to the MOU's terms and could have renegotiated before executing its contract with PPM on July 6, 2001. *Id.* at 59a.

In their briefs before the Ninth Circuit, Respondents argued primarily that FERC's orders dismissing contracts such as PPM's entered into after June 20, 2001 indicated that contracts executed prior to that date must have been unjust and unreasonable. *See* Joint Br. of CPUC & CEOB at 75–76 (filed Mar. 22, 2004); Joint Reply Br. of CPUC & CEOB at 28 (filed Sept. 22, 2004). The Ninth Circuit, however, vacated FERC's dismissal of the complaint as to PPM based on the court's speculation that spot market dysfunction may have lingered even after FERC's June 19, 2001 Order. *See* Pet. App. 14a. This speculation was unsupported by any evidence presented to FERC in connection with the challenged contract. Instead, the Ninth Circuit cited as error FERC's failure to consider the staff report, which was delivered to FERC *almost one year after* the dismissal order. In so doing, the Ninth Circuit exceeded the proper scope of judicial review under Section 309 of the FPA, which makes clear that reviewing courts are limited to considering issues that have been raised before, and considered by, FERC. 16 U.S.C. § 825*l*.

CONCLUSION

For the foregoing reasons, the petition for certiorari should be granted.

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