Nos. 06-1457, 06-1462

IN THE

Supreme Court of the United States

MORGAN STANLEY CAPITAL GROUP INC., *Petitioners*,
v. PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY WASHINGTON, *et al.*, AND FEDERAL ENERGY REGULATORY COMMISSION, *Respondents.*

CALPINE ENERGY SERVICES, L.P., *et al.*, *Petitioners*,
v. PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY WASHINGTON, *et al.*, AND FEDERAL ENERGY REGULATORY COMMISSION, *Respondents.*

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

BRIEF OF RESPONDENT MIRANT ENERGY TRADING, LLC IN SUPPORT OF PETITIONERS

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QUESTIONS PRESENTED

Respondent Mirant Energy Trading, LLC, supports and incorporates the questions presented in the petitions for a writ of certiorari filed by Morgan Stanley Capital Group, Inc. and Calpine Energy Services, L.P., *et al.*

RULE 29.6 STATEMENT

Pursuant to Rule 29.6 of the Rules of this Court, Mirant Energy Trading, LLC, respondent in support of petitioners states as follows:

Mirant Energy Trading, LLC, formerly known as Mirant Americas Energy Marketing LP, is owned by Mirant Corporation. No publicly held company owns more than 10% of the stock of Mirant Corporation.

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The opinion of the United States Court of Appeals for the Ninth Circuit (Pet. App. 1a–67a)[1] is reported at 471 F.3d 1053. The Administrative Law Judge's decision is reported at 101 FERC ¶ 63,031 (2002) (Pet. App. 68a-245a). FERCs order denying the complaints (Pet. App. 246a–313a) is reported at 103 FERC ¶ 61,353, and rehearing was denied at 105 FERC ¶ 61,185 (2003).

JURISDICTION

The judgment of the United States Court of Appeals for the Ninth Circuit was entered on December 19, 2006. On March 6, 2007, Justice Kennedy extended the time for filing petitions for a writ of certiorari to and including May 3, 2007. Morgan Stanley and Calpine, *et al.*, filed timely petitions, which were docketed on May 4 and May 7, 2007, respectively. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1). Mirant intervened in the Ninth Circuit and, as a party to that proceeding, files this brief as a respondent in support of the petitions for certiorari pursuant to Supreme Court Rule 12.6.

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. 331a–41a.

STATEMENT OF THE CASE

In early 2001, when spot market prices for electricity in the West were particularly high and volatile, Respondent

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[1] Citations to "Pet. App." refer to the Appendix to the Morgan Stanley Capital Group, Inc. Petition for a Writ of Certiorari, No. 06-1457, docketed May 4, 2007.

Mirant Energy Trading, LLC ("Mirant")[2] entered into a five-year and nine-month wholesale contract to sell power to Golden State Water Company ("Golden State").[3] The contract rate was substantially below the then-prevailing spot market prices, but both parties expected that spot market prices would decline in the future. For Golden State, the fixed-price contract provided instant respite from purchasing in overheated and volatile spot markets when its then-existing supply contract terminated, at a cost of possibly paying higher-than-market prices in the later years of the contract. For Mirant, which initially had to fulfill its supply obligations by purchasing high-priced power in those same spot markets or near-term forward markets, it meant accepting short-term losses in the hopes of realizing long-term gains. Both parties were well aware of the risks. However, when spot market prices fell below the contract rate, Golden State sought to undo the bargain, complaining to FERC under FPA § 206 that the rate to which it had agreed was "unjust and unreasonable."

After a hearing before an Administrative Law Judge and oral argument before the full Commission, FERC dismissed Golden State's complaint. Applying the "public interest" standard of review articulated by this Court more than 50 years ago, FERC found no wrongdoing by Mirant or any other justification for the extraordinary remedy of abrogating a valid contract.

In a blatantly results-driven decision that ignored FERC's factual findings and brushed aside decades of settled law, the Ninth Circuit reversed and ordered FERC to modify any rates that in hindsight appear unjust or unreasonable. The Ninth Circuit's refusal to attach any

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[2] Mirant Energy Trading, LLC, is the successor to Mirant Americas Energy Marketing, LP ("MAEM"), which was the intervenor in the proceedings below; MAEM, in turn, was the successor to Southern Company Energy Marketing, L.P. MAEM has since been dissolved.

[3] Golden State is the successor to Southern California Water Company.

significance to the fact that these rates were freely negotiated among sophisticated parties conflicts squarely with decisions of this Court and other courts of appeal. In particular, the Ninth Circuit felt free to "modify" this Court's unanimous 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*"), that the Commission has no power under the FPA to abrogate valid contracts except in extraordinary circumstances where the contracts are unequivocally contrary to the "public interest." If not reversed, the Ninth Circuit's disregard for that bedrock principle will destabilize the nation's power industry, which has long depended on mutually binding contracts to buy and sell power at wholesale—leading to higher prices and a less reliable power supply, results that assuredly are not in the public interest.

Mirant respectfully submits this brief in support of the petitions for a writ of certiorari filed by Morgan Stanley Capital Group, Inc. ("Morgan Stanley Petition") and Calpine Energy Services, L.P., *et al.* ("Calpine Petition").

Factual Background

1. Negotiation and Execution of Challenged Contract

Mirant is a power marketer. It does not own electric generation facilities, but instead buys and resells power in the wholesale power markets. Mirant conducts these activities under a blanket authorization to sell power at negotiated or "market-based rates," which FERC granted after determining that Mirant and its affiliates lack market power. *See S. Co. Energy Mktg., L.P.*, 81 FERC ¶ 61,009 (1997); *Mirant Americas Energy Mktg., LP*, FERC Docket No. ER97-4166 (unpublished letter order issued Mar. 28, 2002) (reaffirming Mirant's market-based rate authorization); *Mirant Americas Energy Mktg., LP,* 111 FERC ¶ 61,252 (2005) (same).

Golden State is an investor-owned utility serving approximately 21,000 customers in and around the Big Bear Lake resort area in Southern California. Golden State does not have generation facilities of its own. Pet. App. at 167a. Accordingly, Golden State entered into long-term power contracts "[t]o avoid relying entirely on the spot markets, which it viewed as significantly risky." *Id.* at 28a.[4] Between May 1999 and April 2001, Golden State's long-term contracting with another power marketer permitted it to "avoid [spot] market volatility and achieve savings—approximately $13.26 million ... as compared to the costs [it] would have incurred had it purchased exclusively from the centralized spot markets." *Id.* at 167a.

In the late fall of 2000, after observing a significant rise in prices in the shorter-term markets in California, Golden State received long-term contract offers from suppliers, including an offer from its then-supplier to extend their existing contract, which was scheduled to terminate at the end of April 2001. Golden State's then-supplier offered rates ranging from $46.50 to $54.50 per megawatt-hour ("MWh"). *Nev. Power Co. v. Enron Mktg.*, 105 FERC ¶ 61,185 at 61,988 (2003); *see also* Pet. App. at 174a. Golden State declined these offers, however, and waited until early March 2001—less than two months before the termination of its existing contract—to solicit new offers. Pet. App. at 168a.

Golden State solicited six suppliers and received three offers in response, including one from Mirant. *Id.* at 169a. This fifty percent response rate was better than Golden

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[4] When California restructured its electric markets in the late 1990s, it required the three largest investor-owned utilities in California to purchase all power required to serve their retail customers from newly established centralized, auction-based spot markets established by California. *See* Pet. App. at 23a. Golden State, however, was exempted from this requirement (*see id.* at 28a) and therefore free to enter into long-term contracts to hedge against the risk of price volatility in the shorter-term markets.

State had received to its solicitation in the late fall of 2000, before prices spiked in the California spot markets. *Id.* at 169a n.415. "[Golden State] made no subsequent effort to seek out other offers, consult a broker, or reissue the [solicitation] to get other proposals." *Id.* at 278a.

On March 19, 2001, Golden State accepted Mirant's offer of $95/MWh for five years and nine months, beginning on April 2001, *id.* at 80a, 122a n.199, as "the offer that best balanced price against contract length." *Id.* at 29a. This price "was substantially below the then prevailing expected future spot market prices for the remainder of 2001 through the summer of 2002" and gave Golden State "front-end loaded" savings while also "provid[ing] stability and price protection from volatility." *Id.* at 278-79a.

2. FERC Proceedings

For the remainder of the spring and part of the summer of 2001, Golden State enjoyed the benefit of below-market rates under the Mirant contract, while Mirant (which obtained its supply at higher, near-term forward market rates) fulfilled its obligations at a loss. Indeed, in April 2001 Golden State sold excess power back to Mirant at a substantial profit and credited this profit back to its customers. *Id.* at 215a-16a; *see also id.* at 299a-300a (Golden State was able to buy power from Mirant at $95/MWh and sell it back to Mirant at $173/MWh.). However, when prices in the short-term markets fell below the contract price in the fall of 2001, and the favorable long-term contract became its albatross, Golden State experienced a classic case of buyer's remorse. On December 21, 2001, Golden State filed a complaint under § 206 of the FPA alleging that the contract it had voluntarily entered into was unjust and unreasonable and asking FERC to relieve it from its unwanted contractual obligations.

FERC consolidated Golden State's complaint with two other complaints challenging long-term contracts—one by Nevada Power Company and Sierra Pacific Power Company against a number of sellers, and the other by Public Utility

District of Snohomish County Washington against Morgan Stanley. After an evidentiary hearing, the ALJ recommended that each of the complaints be dismissed. FERC agreed.

FERC found the "public interest" standard established in *Mobile* and *Sierra* applied to the contract between Mirant and Golden State because neither party had preserved the right to unilaterally seek modifications to the contract. *Id.* at 248a-49a, 263a-65a; *see also id.* at 278a. In assessing whether the contract was contrary to the public interest, FERC went out of its way to consider and address the complainant's concerns. The Commission considered not only the specific evidentiary record in this proceeding, but also a later-published report by FERC Staff assessing claims of market manipulation and dysfunction in the spot and forward markets and evidence garnered in the Commission's other market investigations. *Id.* at 292a-93a. Based on this broad review, FERC found that Golden State failed to meet its burden of proof. *Id.* at 293a.

As a threshold matter, the Commission concluded that Golden State had failed to adduce any evidence demonstrating the contract to be contrary to the public interest under the three factors set forth in *Sierra—i.e.*, whether the contract rate "'might impair the financial ability of a public utility to continue service, cast upon other [customers] an excessive burden, or be unduly discriminatory.'" *Id.* at 250a (alteration in original) (quoting *Sierra*, 350 U.S. at 355).

The Commission found that Golden State's settlement with the California Public Utilities Commission ("CPUC") would allow Golden State to recover most of the costs incurred under the Mirant contract. 105 FERC ¶ 61,185 at 61,986. Thus, FERC concluded that there was "no evidence that the challenged contract placed [Golden State] in financial distress." *See* Pet. App. at 295a; *see also* 105 FERC ¶ 61,185 at 61,988 ("[Golden State] also agrees on rehearing that the [Golden State]-Mirant contract did not impose a financial burden on [Golden State]."). Although Golden State argued that its ratepayers saw a 38 percent increase in their bills, FERC explained "[t]he bottom line for the public interest test is not the percentage increase as compared to prior rates" but rather whether there has been an "excessive burden on ratepayers sufficient to modify the contract." *Id.* at 61,986. Under Golden State's CPUC settlement, permanent residents in Golden State's territory incurred no rate increases at all and those with vacation homes pay average monthly electric bills of $35.13. Pet. App. at 214a. Based on this evidence, FERC affirmed that Golden State had not demonstrated how the contract imposed an "excessive burden" on its customers. *See* 105 FERC ¶ 61,185 at 61,986.[5]

FERC also accepted the ALJ's finding that the contract price of $95/MWh was reasonable. Pet. App. at 283a. As a power marketer, Mirant "had to purchase power in the market in order to resell it to [Golden State]," *id.*, and was "paying prices in the same price range as those reflected in [its contract with Golden State.]" *Id.* at 181a. Mirant's business practice is to hedge its risks associated with fixed-price, long-term power sales contracts by entering into agreements with other parties in the wholesale market to buy power that it can then resell to meet its contract obligations. *Id.* at 171a-72a. Mirant followed this practice for its Golden State contract, initially purchasing power in the market at substantially higher prices than the contract price, thereby "los[ing] a substantial amount of money on the contract from April 1 to December 31, 2001." *Id.* at 299a-300a. Mirant expected to recoup these losses in the later years of the contract, but Mirant "would be able to earn any profit margin on the [Golden State] contract only if the contract price is honored through the term." *Id.* at 283a.

To give Golden State and the other complainants the fullest opportunity to make their case, FERC went beyond the three *Sierra* factors and also considered the

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[5] Golden State did not even allege the contract to have been discriminatory. Pet. App. at 296a.

circumstances surrounding contract formation. But FERC found no "other factor introduced into evidence warrants a finding that any of the contracts is contrary to the public interest." *Id.* at 293a. In particular, the Commission determined that there was no "market manipulation specific to the long-term contracts at issue here." *Id.* at 301a. Moreover, the Commission found that Golden State had numerous options in the late fall of 2000, including the ability to extend its existing long-term contract at rates far below the $95/MWh to which it eventually agreed, *id.* at 279a, but that Golden State had instead made the "choice to wait until March 2001 when the energy prices were at their peak to start a bid solicitation process to replace its contract ... [which] was to expire in May 2001." *Id.* at 299a; *see also* 105 FERC ¶ 61,185 at 61,988.

The Commission further found that Golden State went into that solicitation process with its eyes open. Golden State "did not expect high prices to persist for long," *id.* at 61,989, yet its bid solicitation restricted bidders to contract terms ranging from one to seven years and indicated a preference for fixed price offers in the range of $90/MWh. Pet. App. at 278a; *see also id.* at 171a, 175a-76a (Golden State expected prices to drop in the fall of 2001 because of changing market conditions.). Golden State chose to "avoid price volatility by shifting the risks on to Mirant." 105 FERC ¶ 61,185 at 61,989. FERC therefore concluded that the contract was "the result of choices voluntarily made by [Golden State] and to the extent [Golden State] left [itself] open to unnecessary risks, it was also [Golden State's] choice." Pet. App. at 300a. Golden State's later buyer's remorse, FERC concluded, did not entitle Golden State to undo its contract. *Id.* at 301a.

3. The Ninth Circuit Decision

Discarding as anachronistic decades of settled law, 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." *Id.* at 3a (footnote omitted).

The Ninth Circuit conceded that the parties intended the *Mobile-Sierra* public interest standard to govern their contracts. *Id.* at 42-46a. Nevertheless, the court felt free to override that intent, reasoning that in today's world there must be "a further barrier" to the application of that foundational standard. *Id.* at 38a. The court declared that FERC can no longer rely on *Mobile-Sierra*'s "presum[ption] that private parties have negotiated an agreement that they view as just and reasonable over the time period covered," unless two new preconditions are met. *Id.* at 37a. *First*, the Ninth Circuit held that there must be an initial "opportunity for plenary, 'just and reasonable' agency review," *id.* at 41a, and that the Commission's earlier determination that the sellers lacked market power was not a sufficient basis to presume the contracts' rates just and reasonable. *Id.* at 51a-57a. *Second*, it held that FERC must be willing to consider all factors "relevant to the propriety of the contract's formation," *id.* at 41a, and that, here, the contract rates should not be protected by the public interest standard if evidence shows the rates were affected by dysfunction in the marketplace. *Id.* at 56a-57a.

After severely limiting the applicability of the public interest standard—to a world with perfect markets, unmarred by scarcity, flawed state regulatory schemes, or third-party misconduct—the Ninth Circuit proceeded to eviscerate the protection that the public interest standard might afford sellers in the few cases in which the standard could still apply. The Ninth Circuit held that the three public interest factors articulated in *Sierra* for "the *low-rate* challenge presented in that case" have no place in a case like this, where a buyer is complaining about rates being too high. *Id.* at 62a. In a high-rate challenge such as this, the Ninth Circuit held the public interest is injured by any rate that exceeds a "'zone of reasonableness,'" and adversely affects consumers' electricity bills. *Id.* at 64a (citation omitted).

The Ninth Circuit's results-oriented approach became even more blatant when it specifically addressed the Mirant and Golden State contract. The court simply disregarded key factual findings of the agency, and made new findings that are wholly unsupported by the record. In particular, it made light of the Commission's finding that Golden State should be accountable for having rejected superior supply options in the fall of 2000, *id.* at 28a n.17, and for having voluntarily chosen to wait until March 2001, a mere two months before its existing contract was to expire, before taking steps to solicit a new contract. *Id.* Instead, notwithstanding evidence that Golden State had many available resource options, *Id.* at 279a, the court declared that Golden State had somehow been forced into a "frenzied bidding process" when its then supplier informed Golden State in February 2001 that it was no longer interested in renewing its contract. *Id.* at 28a n.17 The court also summarily rejected the notion that Golden State should have filed a complaint challenging Mirant's market-based rate authority before it entered into the contract if it believed Mirant was exercising market power. *Id.* at 55a. Finally, the Ninth Circuit rejected FERC's finding that "electric bills of $35.13 per month for some [Golden State] customers" were not an "*excessive* burden" justifying the extraordinary remedy of contract reformation. *Id.* at 65a-66a. Paying only lip service to FERC's findings regarding the long-term importance of contract stability to the industry and consumers, the Ninth Circuit arrogated the agency's fact-finding and policy-making role to itself by holding that today's consumers should always be sheltered from rates that appear to be too high. *Id.* at 64a.

REASONS FOR GRANTING THE WRIT

For over 50 years, parties transacting in the wholesale power and natural gas markets and investing in critical infrastructure have done so in reliance on this Court's affirmation in *Mobile* and *Sierra* that wholesale power contracts are as enforceable as any other contracts. The power and natural gas industries have flourished under this Court's unanimous holdings in *Mobile* and *Sierra* that, like the common law, the FPA does not interfere with private contracts except in exceedingly rare circumstances of "unequivocal public necessity." *Permian Basin Rate Cases,* 390 U.S. 747, 822 (1968). Buyers and sellers of power at wholesale have "bargain[ed] in the shadow of the [*Mobile-Sierra*] doctrine," secure in their understanding that the deferential public interest standard will protect their vested contractual rights. *Boston Edison Co. v. FERC*, 233 F.3d 60, 66 (1st Cir. 2000). The Ninth Circuit's decision upsets those long-settled expectations, because it requires FERC to abrogate a contract whenever questions arise regarding market conditions at the time of contract formation and the agency in hindsight believes the contract rates are outside the "zone of reasonableness." Pet. App. at 63a-65a.

This Court should grant the Morgan Stanley and Calpine Petitions to reinforce its holdings in *Mobile* and *Sierra* and rectify the confusion the Ninth Circuit's decision has sown in the law. But, equally importantly, it should grant these petitions to prevent serious harm to the nation's vital electrical power and natural gas industries. The Ninth Circuit's decision to undermine contract stability will otherwise have severe adverse consequences for the entire economy and, ultimately, for consumers throughout the nation. As FERC has recognized, the regulatory certainty provided by the deferential *Mobile-Sierra* public interest standard is critical to the survival of today's largely market-based and highly capital intensive wholesale power industry. *CPUC v. Sellers of Long Term Contracts to the Cal. Dep't of Water Res.*, 105 FERC ¶ 61,182 at 61,941 (2003); *see also Mobile*, 350 U.S. at 344 ("[T]he stability of supply arrangements ... is essential to the health of the natural gas industry.").

I. THE NINTH CIRCUIT'S DECISION CONFLICTS WITH THIS COURT'S DECISIONS IN *MOBILE* AND *SIERRA* AND WITH DECISIONS OF OTHER COURTS OF APPEALS

As described in the Morgan Stanley and Calpine Petitions, review is necessary because the Ninth Circuit's decision conflicts with decisions of this Court and other courts of appeals in two fundamental respects.

First, the Ninth Circuit departed from settled precedents by holding that a contract will not be protected by the deferential public interest standard of review unless FERC had the opportunity to review the justness and reasonableness of the contract before it becomes effective. Contrary to the Ninth Circuit's view, this Court's decision to apply a deferential public interest standard of review to contract-based rates has never rested on FERC having had an initial opportunity upon the filing of the contract to engage in a full-dress just and reasonable analysis. Contracts are not given deference out of any such notion of administrative estoppel. Instead, the application of the deferential public interest standard is premised on Congress's recognition that buyers and sellers in these wholesale markets are "sophisticated businesses enjoying presumptively equal bargaining power" that can be "expected to negotiate a 'just and reasonable' rate as between the two of them." *Verizon Commc'ns, Inc. v. FCC*, 535 U.S. 467, 479 (2002); *see also* Morgan Stanley Petition at 12-13, 15-17; Calpine Petition at 9-10, 20-22. For that reason, in contrast to the Ninth Circuit, the First and D.C. Circuits have correctly held that FERC must apply the public interest standard regardless of whether contracts have been previously filed with and/or approved by the Commission. *See* Calpine Petition at 11-12.

Even if an opportunity for initial plenary review were a precondition to application of the public interest standard, however, the Ninth Circuit erred (and created conflicts with decisions of the D.C. Circuit) by holding that FERC's market-based regulatory framework is insufficient to satisfy that requirement and that FERC must compensate by allowing post hoc challenges based on later-discovered evidence. *See* Calpine Petition at 12-13, 22-23 (describing mechanisms that FERC has in place to ensure that market-based rate transactions are just and reasonable); Morgan Stanley Petition at 19-23.

Second, the Ninth Circuit erred in gutting the protections that the public interest standard affords sellers by holding that, in high-rate challenges, FERC must modify wholesale energy contracts in the public interest whenever the contract rate "is outside the 'zone of reasonableness,'" Pet. App. at 65a, and "the contract could cause customers to pay higher rates than they would have without the contract." *Id.* In *Sierra*, this Court held that FERC cannot order contract modification just because the contract rate falls outside the bounds of what would normally be considered just and reasonable. *Sierra*, 350 U.S. at 354-55. Rather, where there is a valid contract, "the sole concern of the Commission would seem to be whether the rate [will] adversely affect the public interest." *Id.* at 355; *see also* Morgan Stanley Petition at 14-15, 23-24; Calpine Petition at 9-10. The First and D.C. Circuits have properly adhered to that limitation in high-rate challenges, holding that, regardless of whose ox is being gored, *Mobile-Sierra* demands "deference to freely arrived at contract prices." *San Diego Gas & Elec. Co. v. FERC*, 904 F.2d 727, 730 (D.C. Cir. 1990); *see also* Morgan Stanley Petition at 24, 25 n.11; Calpine Petition at 13-14. The Ninth Circuit's contrary view, giving buyers but not sellers a get-out-of-contract-free card, has no basis in this Court's jurisprudence and takes a dangerously myopic view of the public interest.

II. IF NOT REVERSED, THE NINTH CIRCUIT'S DECISION WILL HAVE SEVERE ADVERSE CONSEQUENCES FOR THE ENTIRE INDUSTRY AND CONSUMERS

The *Mobile-Sierra* doctrine was established and has been consistently applied by this Court and courts of appeals to ensure that buyers and sellers can participate in the wholesale electricity markets with the certainty that FERC will not interfere with their valid contracts except in "extraordinary circumstances" of "unequivocal public necessity." *Ark. La. Gas Co. v. Hall*, 453 U.S. 571, 582 (1981); *see also Permian Basin*, 390 U.S. at 820, 822. Yet the Ninth Circuit's decision makes any such certainty impossible: even when sophisticated parties have entered into a contract after weighing the risks and other options (as Golden State and Mirant did here), the Ninth Circuit forbids them from presuming their contract is lawful and secure. Unless it is reversed by this Court, the Ninth Circuit's decision will encourage buyers to challenge any contracts that appear in hindsight to have been bad bargains. From a practical perspective, as the Morgan Stanley and Calpine Petitions explain, the Ninth Circuit's ruling unwisely focuses on immediate benefits to consumers, while ignoring the long-term harms that will result from discouraging investment in this highly capital intensive industry. *See* Morgan Stanley Petition at 25-30; Calpine Petition at 15-19.

The Ninth Circuit's decision also poses a grave threat to FERC's decades-old market-based regulation of the wholesale power industry. "Market-based rates help[] to develop [the] competitive bulk power markets" that have dramatically enhanced the efficiency of the nation's power markets. Final Rule, *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 Fed. Reg. 21,540, 21,545 (May 10, 1996). The transition to market-based regulation has broken up the monopoly power that previously characterized the industry, allowing new participants, including power marketers like Mirant and independent power producers, to enter the marketplace. These new entities have invested heavily in needed infrastructure—"[b]etween 1996 and 2004, roughly 74 percent of electricity capacity additions were made by nonutility power producers." Electric Energy Market Competition Task Force, *Report to Congress* *on Competition in Wholesale and Retail Markets for Electric Energy* at 35 (Apr. 2007), *available at* http://www.ferc.gov/legal/maj-ord-reg/fed-sta/ene-pol-act/epact.final-rpt.pdf. In addition, large regions of the United States, including New England, New York, California, the Midwest, Texas, and the Mid-Atlantic, are served by centralized power exchanges that "increase the efficiency of the trading process ... and can give clear price signals indicating the best place and time to build new generation." *Id.* at 4-5. These "competitive centralized markets could not exist" under traditional cost-based regulation because participants are entering into transactions with little notice, requiring "blanket approval to sell power at market-based rates." Energy Information Admin., Office of Coal, Nuclear, Electric and Alternate Fuels, DOE, *The Changing Structure of the Electric Power Industry 2000: An Update* at 63 (Oct. 2000), *available at* http://tonto.eia.doe.gov/FTPROOT/electricity/056200.pdf. The development of fluid, competitive power markets and entry of new participants has resulted in approximately $34 billion in savings to consumers from 1997 to 2005, relative to the costs that would have been incurred under traditional cost-based regulation.[6]

If not reversed, the Ninth Circuit's decision will deter further participation in, and reverse the efficiencies and cost-savings to consumers that have resulted from,

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[6] Cambridge Energy Research Associates, *Beyond the Crossroads: The Future Direction of Power Industry Restructuring* (Sept. 30, 2005) *summarized at* http://cera.ecnext.com/com2/summary-0236-681_ITM; *see also* FERC, Notice of Proposed Rulemaking, *Regional Transmission Organizations*, FERC Stats. & Regs. ¶ 32,541 at 33,719 (1999) (market-based regulation "has led to highly efficient new capacity coming on line" and "market incentives can lead to highly efficient plant operations"); *Economic Report of the President* at 216 (Feb. 1999), *available at* http://www.gpoaccess.gov/usbudget/fy00/pdf/1999_erp.pdf ("In a $212 billion industry, even small efficiency gains from competition can have large benefits.").

competitive wholesale power markets. Unlike traditional utilities, participants in these markets such as Mirant, Calpine, and Morgan Stanley are not guaranteed cost recovery on their sales, but instead rely on market-based rate contracts to support their capital investments and trading activities in the liquid, competitive wholesale power market. The Ninth Circuit's ruling undermines the basis for that reliance in two ways.

First, as a practical matter, it eliminates for market-based rate agreements the protection that the public interest standard of review provides other contracts. While a market-based rate seller could theoretically secure the protection of the public interest standard by seeking "plenary, 'just and reasonable' agency review" of every contract before it goes into effect, that would render FERC's initial grant of market-based rate authorization "a pointless exercise of no value to anyone," Pet. App. at 41a, 266a, and would be particularly impractical in the volatile and dynamic wholesale power markets where buyers and sellers must be able to act quickly in response to market signals. Moreover, in the real world, FERC could never evaluate de novo the thousands of contracts entered into each year by the more than eleven hundred entities with market-based rate authority.[7] And, in any event, even if FERC has reviewed and approved a contract, the Ninth Circuit's holding would still require FERC to entertain post hoc challenges based on allegations of "dysfunctional market conditions ... only notice[d] in hindsight." *Id.* at 56a, 324a.

Second, even if the public interest test still applied in some instances, under the Ninth Circuit's view, it subjects market-based sellers to an untenable Catch-22—requiring

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[7] *See Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services*, Notice of Proposed Rulemaking, 71 Fed. Reg. 33,102, 33,119 n.128 (proposed June 7, 2006) (to be codified at 18 C.F.R. pt. 35). Indeed, in the last quarter of 2007 alone, Mirant entered into 1,027 bilateral electricity transactions at market-based rates.

them to adhere to their contracts regardless of whether in hindsight the contract rates turn out to be too low and, at the same time, permitting buyers to walk away from the agreements whenever in hindsight they can show the rates are too high.

Unless it is reversed, the cloud of uncertainty created by the Ninth Circuit's decision will undermine parties' incentives to enter into market-based contracts and threaten the billions of dollars of enhanced efficiency and consumer gains that FERC has achieved by promoting market-based regulation over recent decades. Unless this decision is reversed, sellers can reasonably be anticipated to return to antiquated cost-based mechanisms, or demand substantial risk premiums to offset the dangers of future contract modification. Plainly, this is not in the interest of the nation or consumers.

CONCLUSION

For the foregoing reasons, and those set forth in the Morgan Stanley and Calpine Petitions, these petitions for a writ of certiorari should be granted.

Respectfully submitted,

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