No. 06-1462

IN THE

Supreme Court of the United States

CALPINE ENERGY SERVICES, L.P.,
AMERICAN ELECTRIC POWER SERVICE CORP.
AND
ALLEGHENY ENERGY SUPPLY CO., LLC,
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

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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Contrary to Respondents' characterizations, the Ninth Circuit's decision below (Berzon, J, joined by Browning and Pregerson, JJ.) effected a radical shift in the regulatory paradigm applicable to electricity supply arrangements. Heretofore, the courts, FERC, and market participants understood that the *Mobile-Sierra* doctrine was "'refreshingly simple'": "Whether [the] *Mobile-Sierra* doctrine applies is a question of contract interpretation: . . . 'The contract between the parties governs the legality of the filing [to modify a rate]. Rate filings consistent with contractual obligations are valid; rate filings inconsistent with contractual obligations are invalid.'" *Union Pac. Fuels, Inc. v. FERC*, 129 F.3d 157, 161 (D.C. Cir. 1997) (quoting *Richmond Power & Light v. Fed. Power Comm'n*, 481 F.2d 490, 493 (D.C. Cir. 1973) and citing *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956); *Fed. Power Comm'n v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956)).

Following the Ninth Circuit's decision, application of *Mobile-Sierra* is no longer solely "a question of contract interpretation." Now, FERC must nullify voluntary wholesale energy contracts—absent the requisite showing of public necessity—if FERC determines in hindsight that: (1) the market attendant to contract formation was not "fully functioning" (Pet. App. 60a); or (2) when a rate challenge is brought by a buyer, the negotiated rate is unreasonable or, absent the challenged contract, retail rates for energy would be lower (Pet. App. 64a-66a). The Ninth Circuit's rulings are plainly contrary to long-established precedent of this Court, as well as that of the First and D.C. Circuits.

Acquiescing in a judicial reversal that expands its regulatory powers, FERC claims (Opp. 12-13) that it will exercise this new authority responsibly and without imposing unreasonable uncertainty on energy market participants. However, because the Ninth Circuit has prescribed that a "market function" test be satisfied before the traditional public interest standard is applied and has weakened the public interest test when

assessing buyers' contract challenges, market participants can no longer predict whether contract commitments will be honored. Immediate review by this Court is warranted.

I. FERC UNDERSTATES THE SCOPE OF THE NINTH CIRCUIT'S DECISION

A. FERC Would Wish Away The Fundamental Change In Law Created By The Decision Below

The Petition (at 14-22) explained that the Ninth Circuit's decision has undermined the certainty of energy contracts by vesting FERC with unprecedented discretion to modify those contracts. FERC responds that this new authority will be exercised carefully. Even so, the Ninth Circuit's new rules will profoundly affect the regulatory regime and the decisions of market participants.

1. FERC argues that the decision below is limited to the unique circumstances of the 2000-2001 western power markets, claiming that the decisions "stand for the narrow proposition" that, when determining whether the public interest standard applies, FERC must take into account "a credible claim that severe market dysfunction has affected the formation of a market-based contract." Opp. 12. To the contrary, however, the Ninth Circuit broadly purported to "distinguish[]" today's regulatory regime from "that present in *Mobile* and *Sierra*," and to "delineate" the "prerequisites" for the application of the *Mobile-Sierra* doctrine in the modern "regulatory context" as a whole. Pet. App. 10a.

The Ninth Circuit did not limit itself to a narrow, "severe market dysfunction" test: "*Mobile-Sierra* cannot apply without a determination that the challenged contract was initially formed free from the influence of improper factors, such as market manipulation, the leverage of market power, or an otherwise dysfunctional market." Pet. App. 57a.

The Ninth Circuit also held that the public interest standard cannot apply if the market at the time of contract formation was not "fully functioning" (Pet. App. 60a), even if the buyers

entered into the challenged contracts voluntarily and there was no evidence of unfairness, bad faith or duress in the original contract negotiations (Pet. App. 59a). Thus, the decision below gives disgruntled buyers an open-ended opportunity to challenge energy contracts by claiming that a "market irregularity" existed at the time of contract formation. There is every reason to believe that the Ninth Circuit and FERC will broadly apply this new rule.

The breadth of the new rule is apparent by applying it to the situation in *Sierra*. Sierra was considering whether to purchase power from the Bureau of Reclamation, which had unused capacity at Shasta Dam. *See* 350 U.S. at 351-352. PG&E had agreed to a specific low rate because it wanted "[t]o forestall the potential competition." *Id.* The Ninth Circuit's "market function" test would require FERC to ignore the intent of the contracting parties and instead examine the abnormal market forces operating in the *Sierra* case—the temporary unused capacity at Shasta Dam. The Ninth Circuit's analysis cannot be reconciled with this Court's decision in *Sierra*.

2. FERC seeks (Opp. at 14-16) to sidestep the fundamental flaws in the order below by emphasizing recent changes to FERC's market monitoring systems and FERC's new statutory authority to impose greater sanctions for market misbehavior. FERC's claims ignore the fundamental change in law effected by the Ninth Circuit. Under the prior regime, application of the *Mobile-Sierra* public interest test turned solely on the intent of the parties to the contract at issue. *See* Pet. 9-11. Under the Ninth Circuit's subjective, after-the-fact "market function" test, application of *Mobile-Sierra* turns on the judgments and policy preferences of FERC, and ultimately of the Ninth Circuit, in a way that even FERC acknowledges (Opp. 17-18) has been poorly defined. Now, even if the currently-sitting Commission exercises its new powers prudently, respect for contract stability is a policy preference that could evaporate at any time.

It is impossible for FERC to predict how frequently buyers will mount after-the-fact contract challenges based on asserted market irregularities. Neither FERC nor the California Public Utilities Commission ("CPUC") anticipated the spot market dysfunctions created by their own prior rulings. A potential market disruption is likely to arise from an unanticipated source. In any event, no market monitoring system can remove the Ninth Circuit's fundamental error. FERC's efforts to promote more effective power markets do nothing to diminish FERC's (and ultimately the Ninth Circuit's) new power to override the choice of market participants to invoke the public interest standard.

3. FERC claims that the impact of the Ninth Circuit's decision will be limited as shown by FERC's dismissal of a recent rate complaint. *See* Opp. 12 (citing *CAlifornians for Renewable Energy, Inc. v. Cal. Pub. Utils. Comm'n*, 119 F.E.R.C. ¶ 61,058 (2007)). CARE's only claim relating to the market conditions at contract formation was to point out that the buyer had several other purchase options. *CARE*, 119 F.E.R.C. ¶ 61,058, para. 44. Thus, FERC's order failed to delineate the quantum of "market function" evidence needed to override the parties' intent to invoke the public interest standard. Moreover, because CARE offered "no specific evidence" to support the claim that the rates at issue were "unjust and unreasonable," *id.*, para. 42, FERC would have dismissed the complaint under any standard of review.

Under the Ninth Circuit's decisions, FERC's action on CARE's complaint does not bar FERC from revisiting the issues raised whenever a disappointed contract party claims to have identified new information about market conditions in effect when the contract was negotiated. In *Public Utilities Commission v. FERC*, 474 F.3d 587 (9th Cir. 2006), the Ninth Circuit held that FERC's initial opportunity to review a filed contract was not sufficient to trigger the public interest standard because FERC's original review "would have been hampered by limited information" and the "full scale of spot

market manipulation and forward market dysfunction was not nearly as fully known as it is today." Pet. App. 375a-376a. Under this test, no initial review would be sufficient. New market data will always be grounds to revisit the question whether *Mobile-Sierra* applies.

4. FERC and CPUC acknowledge (Opp. 6-7; CPUC Br. 5-6) that FERC urged utilities to sign long-term contracts in 2001 to *remedy* market instability and price spikes in the spot markets while FERC continued to determine appropriate *prospective* changes in the market structure. The parties to the resulting contracts knew that the contracts were being entered in the face of spot market difficulties; in fact, the purpose of those forward contracts was to mitigate the impact of short-term factors. In entering those contracts, the parties relied on FERC's prior guidance in Order No. 888 that prospective rule changes would "not upset transactions entered into pursuant to existing market-based rate authority." *See* Pet. App. 19a (citation and internal quotation marks omitted). As FERC found, no one forced the buyers to sign the contracts, and Nevada Power and other buyers had many supply options. Pet. 4-5.

The *Mobile-Sierra* doctrine respects the stability of electricity supply contracts. In contrast, the Ninth Circuit holds that, in the face of temporary market instability and price spikes, *Mobile-Sierra* should be ignored, thereby abrogating the long-term contracts FERC had urged the utilities to enter. As FERC held in the administrative proceedings below, such a result is contrary to *Mobile* and *Sierra* and the public interest.

B. FERC Discounts The Disparate Treatment Of Buyers And Sellers Created By The Decision Below

The Petition showed (at 22-24) that the Ninth Circuit's new regime strongly favors buyers by upholding contracts when their interests are favored by low-rate contracts, while giving FERC great discretion to void contracts when sellers' interests are favored by high-rate contracts. FERC does not seriously

defend this aspect of the order below, but merely points to passages in the decision that give lip service to the principles of contract stability. *See* Opp. 19-21. But it is undeniable that the decision below creates a regime strongly biased in favor of buyers' and against sellers' contract rights.

Under the decision below, a buyer can secure a rate change by demonstrating that "a challenged contract imposes any significant cost on ultimate consumers because of a wholesale rate too high to be within a zone of reasonableness" (Pet. App. 63a), but a seller can secure a rate change only if, for example, the contract rates "impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or [are] unduly discriminatory," *Sierra*, 350 U.S. at 355. Because 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 new distinction is illogical and should be rejected by this Court.

II. THE DECISION BELOW UNDENIABLY CONFLICTS WITH THE DECISIONS OF THIS COURT AND OF THE FIRST AND D.C. CIRCUITS

A. Respondents' Assertions That There Is No Conflict As To The Basic Nature Of The Regulatory Regime Are Wrong

The decision below plainly contravenes *Mobile* and *Sierra*, in which this Court recognized that FERC may modify privately negotiated rates only when it is "necessary in the public interest." *Mobile*, 350 U.S. at 344; *see also Sierra*, 350 U.S. at 355. The decision below also conflicts with decisions of the First and D.C. Circuits, which have held that FERC's prior review of a contract under the "just and reasonable" standard is not a prerequisite to application of the *Mobile-Sierra* "public interest" standard. *See Ne. Utils. Serv. Co. v. FERC*, 993 F.2d 937, 960-62 (1st Cir.

1993) ("*Northeast I*"); *Borough of Lansdale v. Fed. Power Comm'n*, 494 F.2d 1104, 1113-14 (D.C. Cir. 1974). The Ninth Circuit, in contrast, requires plenary review of every energy contract and permits FERC to abrogate privately negotiated agreements where there is no harm to the public interest. *See* Pet. 9-13.

FERC attempts (Opp. 12-13) to minimize this conflict by characterizing the decision below as a "narrow" opinion addressing "highly unusual" and "unique" circumstances. But, as noted in Part I, *supra*, the Ninth Circuit's decision cannot fairly be read as limited only to the facts of this case.

Respondents also argue that the cases cited in the Petition concerned contracts that were previously filed with FERC, not market-based rate contracts. *See* Opp. 24; CPUC Br. 13-17; Snohomish Br. 18. But the D.C. Circuit has held that FERC's market-based rate framework serves the same purpose as the initial filing of a contract in providing FERC with an opportunity to ensure that contract rates are just and reasonable. *See Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870-71 (D.C. Cir. 1993). Under D.C. Circuit law, that opportunity is sufficient. While the D.C. Circuit noted FERC's assurance that it would "exercise its . . . authority" to oversee the proper functioning of the market, *see id.* at 870, the Ninth Circuit alone requires that FERC "in fact" determine that the rates in each challenged contract were "'just and reasonable'" before the *Mobile-Sierra* standard applies (Pet. App. 51a)—a circular approach that defeats the public interest standard. By requiring such individualized review before reaching the public interest test, the Ninth Circuit has created a square conflict among the circuits.

FERC also suggests that there is no conflict between the decision below and *Northeast I* because the First Circuit, in a *subsequent* opinion, ultimately "affirmed Commission decisions to reform a contract under *Mobile-Sierra*." Opp. 23 (emphasis omitted). But the First Circuit affirmed

FERC's order only after the agency properly explained its application of the *public interest* standard, *see Ne. Utils. Serv. Co. v. FERC*, 55 F.3d 686, 692-93 (1st Cir. 1995) ("*Northeast II*"), following a remand from an opinion in which the First Circuit insisted that the public interest standard, not the just and reasonable test, applied. *See Northeast I*, 993 F.2d at 961-62 (rejecting the Commission's standard for reviewing a challenged contract because the Commission "conflate[d] the 'just and reasonable' and 'public interest' standards, thereby circumventing the *Mobile-Sierra* doctrine").

B. The Decision Below Conflicts With Decisions Of The First And D.C. Circuits As To The Disparate Treatment Of Buyers And Sellers

The Ninth Circuit's holding that the enforceability of a contract should be analyzed under different standards depending on whether the negotiated rates are alleged to be too high or too low also creates a circuit conflict. The First and D.C. Circuits have held that the *Mobile-Sierra* public interest standard governs challenges brought by buyers and sellers alike. *See Boston Edison Co. v. FERC*, 233 F.3d 60, 67-68 (1st Cir. 2000); *Potomac Elec. Power Co. v. FERC*, 210 F.3d 403, 409 (D.C. Cir. 2000). The court below, in sharp contrast, held that *Sierra*'s "excessive burden" factor "has no application" to challenges by buyers; "the proper standard" is whether the challenged rate "is outside the 'zone of reasonableness.'" Pet. App. 62a, 64a-65a.

Respondents do not meaningfully address this conflict. First, FERC dismisses *Boston Edison* based on the First Circuit's passing comment that "'[v]ery little useful precedent exists'" concerning the precise contours of how the public interest standard applies to high-rate challenges. Opp. 24 (citing *Boston Edison*, 233 F.3d at 68). However, the First Circuit expressly rejected FERC's suggestion that a "just and reasonable" standard applied. 233 F.3d at 63, 68-

69. Indeed, while it was uncontested that the rates at issue were "too high . . . to be just and reasonable," the court remanded for FERC to consider the public interest standard, the application of which "the parties ha[d] not briefed . . . on appeal." *Id.* at 68-69. The Ninth Circuit's adoption of a reasonableness standard for high-rate challenges directly contravenes the First Circuit's rejection of such a standard.[1]

Second, Respondents characterize *Potomac* as a case involving a mere failure of proof. Opp. 23-24; Snohomish Br. 22. But the purchaser's "failure of proof" was its failure to adduce evidence that the rates were "'unduly discriminatory or excessively burdensome on [the purchaser's] ratepayers.'" Opp. 24 (quoting *Potomac*, 210 F.3d at 409). That standard, which the D.C. Circuit drew from *Sierra* to govern a high-rate challenge, *Potomac*, 210 F.3d at 406, 412, is in direct conflict with the "zone of reasonableness" test with which the Ninth Circuit replaced *Sierra*'s inquiry into an "excessive burden" on consumers. Pet. App. 62a, 64a-65a. The obvious risk that the same contract would receive disparate treatment, depending solely on the circuit to which the case is brought, warrants this Court's immediate review.

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[1] Respondents also seize on dicta from *Northeast II* (which preceded and was not cited in *Boston Edison*) in which the court stated that *Sierra* did not set forth "an across-the-board definition" of the public interest for all "types of cases." *Northeast II*, 55 F.3d at 690. *See* CPUC Br. 21; Snohomish Br. 24. The court went on, however, to reaffirm the standard set forth in its prior *Northeast I* decision and drawn from *Sierra*, *see supra* at 6-8: FERC may "modify the terms of a private contract when third parties" (such as consumers) "are threatened by possible 'undu[e] discrimination' or the imposition of an 'excessive burden,'" not merely when a negotiated rate, in retrospect, appears unreasonable or uneconomic for one of the contracting parties. *Northeast II*, 55 F.3d at 691 (quoting *Northeast I*, 993 F.2d at 961).

III. DELAYING REVIEW IS NOT JUSTIFIED

1. FERC urges (Opp. 17) that review is premature because "it is unclear how [the Ninth Circuit's] position differs, in practical effect, from that of the Commission." FERC believes that it has a free hand to fashion a remedy on remand. Notwithstanding FERC's optimism, the difference between the Ninth Circuit's decisions and FERC orders is clear. FERC carefully applied the *Mobile-Sierra* standard to an extensive record, found that the public interest standard did apply, and held that the buyers had not justified a contract modification under the public interest standard. In sharp contrast, the Ninth Circuit held that *Mobile-Sierra*'s public interest standard did not apply to contracts negotiated under market-based rate tariffs or to so-called high rate cases, and even if it did, the benchmark would be the same "just and reasonable standard" that would apply if the *Mobile-Sierra* standard did not exist. Pet. App. 60a-65a.

It is not premature to consider the issues raised in this case. The record in the proceedings below is extensive; FERC considered the "totality of the circumstances" surrounding the formation of the challenged contracts. Pet. App. 319a. The Court's review will not be enhanced by delaying that review so that FERC can apply the Ninth Circuit's incorrect legal standard.

2. Until this Court addresses the Ninth Circuit's decision, there will be tremendous uncertainty regarding the stability of contracts in the energy industry. Under that decision, energy sellers can have no confidence that the market-based rate contracts they sign ultimately will be upheld. The Ninth Circuit's regime undeniably will chill energy markets and reduce entrepreneurship.

CONCLUSION

For the foregoing reasons, the petition should be granted.

Respectfully submitted,

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August 17, 2007

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