

1 IN THE SUPREME COURT OF THE UNITED STATES

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3 MORGAN STANLEY CAPITAL :

4 GROUP INC., :

5 Petitioner :

6 v. : No. 06-1457

7 PUBLIC UTILITY DISTRICT NO. 1 :

8 OF SNOHOMISH COUNTY, :

9 WASHINGTON, ET AL.; :

10 and :

11 AMERICAN ELECTRIC POWER :

12 SERVICE CORPORATION, ET :

13 AL., :

14 Petitioners :

15 v. : No. 06-1462

16 PUBLIC UTILITY DISTRICT NO. 1 :

17 OF SNOHOMISH COUNTY, :

18 WASHINGTON, ET AL. :

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20 Washington, D.C.

21 Tuesday, February 19, 2008

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23 The above-entitled matter came on for oral  
 24 argument before the Supreme Court of the United States  
 25 at 11:04 a.m.

1 APPEARANCES:

2 EDWIN S. KNEEDLER, ESQ., Deputy Solicitor General,  
3 Department of Justice, Washington, D.C.; on behalf  
4 of Respondent FERC, in support of Petitioners.

5 WALTER DELLINGER, ESQ., Washington, D.C.; on behalf  
6 of the Petitioners.

7 CHRISTOPHER J. WRIGHT, ESQ., Washington, D.C.; on behalf  
8 of the Respondents.

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P R O C E E D I N G S

(11:04 a.m.)

JUSTICE STEVENS: I'll repeat myself. I didn't have the mike on. The Court will hear argument in Morgan Stanley Capital Group, Inc., against Snohomish Public Utility District No. 1, or Public District -- Snohomish County No. 1.

Mr. Kneedler.

ORAL ARGUMENT OF EDWIN S. KNEEDLER

ON BEHALF OF RESPONDENT FERC,

IN SUPPORT OF THE PETITIONERS

MR. KNEEDLER: Thank you, Justice Stevens, and may it please the Court:

The Federal Energy Regulatory Commission in this case reasonably denied Respondent's request to modify the wholesale contracts that the purchasing power companies had entered into in 2000 and 2001. The Commission reasonably concluded that Respondents had not made the requisite showing under the Federal Power Act and under this Court's decisions in Mobile and Sierra that modification of the contracts was necessary in the public interest.

In reaching that conclusion, FERC first drew on three factors that this Court had identified in Sierra and found that they were not satisfied. Thus, it

1 found that Respondents had failed to show that the  
2 contracts would impose financial strain on the  
3 purchasing companies; that it would impose excessive  
4 burdens on the customers; or that they were unduly  
5 discriminatory. But FERC also looked --

6 JUSTICE GINSBURG: But FERC thought it could  
7 live with the Ninth Circuit's decision, because the  
8 government recommended that we deny cert in this case;  
9 isn't that so?

10 MR. KNEEDLER: That is -- that is correct,  
11 and FERC thought that perhaps the decision could be  
12 limited to the circumstances arising out of the  
13 California energy crisis in the years 2000- 2001, and  
14 that it could channel its concerns about contract  
15 stability through those other factors.

16 But, nonetheless, FERC believes, as its  
17 decisions make clear and as our position in this Court  
18 makes clear, that the Ninth Circuit's reformulation of  
19 the Mobile-Sierra doctrine or interpretation of the act  
20 was incorrect. And, now that the Court has granted  
21 review, we urge affirmance of FERC's decision in this  
22 case.

23 JUSTICE SCALIA: Wasn't it clear to the  
24 government that the Ninth Circuit, which is what, about  
25 10 percent of the country, was going to continue this

1 interpretation of the act, and that was not a matter of  
2 any consequence to FERC or to the government?

3 MR. KNEEDLER: It was of consequence, but  
4 FERC still believed it had some interpretive authority  
5 after the decision. Maybe this was a wrong judgment at  
6 the time, but FERC thought that it still had some  
7 interpretive authority under the decision, and that it  
8 could --

9 JUSTICE GINSBURG: But, Mr. Kneedler, this  
10 is a decision, the Ninth Circuit decision, that empowers  
11 FERC. FERC says: Oh, we don't have that authority.  
12 And the Ninth Circuit said: Yes, you do. So this is an  
13 agency arguing that it can't do what the Ninth Circuit  
14 says it can. And why can it not? Because of two  
15 decisions of this Court. Is that right?

16 MR. KNEEDLER: Well, two decisions of this  
17 Court and 50 years of intervening FERC, before that  
18 Federal Power Commission, practice.

19 JUSTICE SCALIA: Well, wait, wait, wait. It  
20 didn't just say the agency may do it. It said the  
21 agency must do it. I don't -- I don't consider "must"  
22 to be an empowerment. I consider that to be a  
23 direction.

24 MR. KNEEDLER: Right. That -- that is  
25 correct. I mean it, I think -- I took the question to

1 be that it might give FERC broader flexibility, but at a  
2 very substantial cost to the stability of contracts,  
3 which was the underlying point that this Court stressed  
4 in its decision in Sierra: That the Federal Power Act,  
5 unlike -- and the Natural Gas Act, unlike the Interstate  
6 Commerce Act, contemplates that rates will be set by  
7 contract, or at least can be set by contract; and that  
8 therefore, like in most situations, a party to a  
9 contract cannot unilaterally walk away from that  
10 contract or insist upon its modification because it may  
11 become disadvantageous over time.

12 JUSTICE GINSBURG: I thought -- let's go  
13 back a step. I thought FERC's position was: We could  
14 not decide as a matter of discretion to do this because  
15 we are limited by those Supreme Court decisions.

16 MR. KNEEDLER: Well, FERC --

17 JUSTICE GINSBURG: So it's not what FERC --  
18 FERC independently interpreting the statute to reach the  
19 conclusion, which it might, to reach the conclusion the  
20 Ninth Circuit did. It's FERC saying: We can't do that  
21 because we have our marching orders from the Supreme  
22 Court.

23 MR. KNEEDLER: No. I think -- I mean there  
24 are -- there are two interpretive questions here: When  
25 does the public interest standard identified in this

1 Court's decisions in Mobile and Sierra apply? And then  
2 there is the further question of what is necessary to  
3 satisfy the public interest standard for modifying a  
4 contract.

5 We think on both points the Commission's  
6 decision in this case reflects an interpretive judgment  
7 that the Court's decision, or the interpretation  
8 reflected in the Court's decision, in Sierra applies  
9 equally in the market-based rate system without any of  
10 the -- either of the two prerequisites that the Ninth  
11 Circuit formulated as a precondition to applying the  
12 public interest standard.

13 And I would point the Court's attention, in  
14 the joint appendix in the Commission's decision, to  
15 joint appendix 1244 and 1245, repeated again at 1572 and  
16 1573; and also the passage quoted in the Morgan Stanley  
17 brief at page 17, reflects a determination of what the  
18 Commission's longstanding policy has been that,  
19 contracts once entered into, their integrity must be  
20 protected and should not be lightly set aside.

21 And also, the Commission specifically  
22 rejected at pages 1564 and 1565 of the joint appendix  
23 the prerequisites that the Ninth Circuit came up with in  
24 this case, that there must be an opportunity to  
25 determine whether the rates were within a zone of just



1 and reasonableness at the time the contracts were  
2 entered into in order for Mobile and Sierra to apply.

3 Under a market-based rate system, what FERC  
4 does is determine at the outset when an applicant  
5 applies for a market-based tariff whether that company  
6 has market power and if so, whether it's mitigated.  
7 Only in those circumstances is the company granted the  
8 authority to market -- to set prices by the market.

9 JUSTICE ALITO: What happens if that  
10 approval is given and then a seller enters into  
11 contracts and then it's later discovered that, contrary  
12 to what FERC thought when it granted the approval, the  
13 seller has exercised market power or has otherwise  
14 manipulated the market? Is there any remedy in that  
15 situation?

16 MR. KNEEDLER: Well, what the Commission  
17 determined in this case is that there was -- there was  
18 no manipulation or exercise of market power identified  
19 with respect to these specific contracts. And what the  
20 Commission decided was that the importance of the  
21 integrity of contracts in that circumstance required  
22 that the contract be maintained. If the Respondents had  
23 shown bad faith or something like that in the  
24 connection -- or fraud in connection with the formation  
25 of these particular contracts, that would have been

1 quite a different matter.

2                   It's also important to note that the  
3 Commission found in this case that there was no  
4 dysfunction in the forward market, which is what we have  
5 here. What was going on is that there was dysfunction  
6 in the spot market in 2000, 2001 for a variety of  
7 reasons, some of them going to market fundamentals such  
8 as a shortage of generation capacity, a shortage of  
9 hydropower.

10                   JUSTICE KENNEDY: Just so I understand your  
11 answer to Justice Alito's question, the Commission has  
12 retroactive authority to alter the permission to engage  
13 in these contracts only if there is fraud --

14                   MR. KNEEDLER: No it can -- I'm sorry --

15                   JUSTICE KENNEDY: -- or something similar?

16                   MR. KNEEDLER: Once it has granted  
17 market-based rate authority, FERC can revoke that. And  
18 in fact, companies -- there is a triennial review of  
19 that --

20                   JUSTICE KENNEDY: Retroactive?

21                   MR. KNEEDLER: Pardon?

22                   JUSTICE KENNEDY: Retroactively?

23                   MR. KNEEDLER: No. It would be revoked --

24                   JUSTICE KENNEDY: But Justice Alito's  
25 question, I think as I understood it, or at least a

1 question in my mind that followed upon it, was whether  
2 or not -- what's the basis for any retroactive  
3 revocation of that or --

4 MR. KNEEDLER: No, it wouldn't be  
5 retroactive. It would be from the date of the complaint  
6 that was filed.

7 JUSTICE SCALIA: Would it be a public  
8 interest finding, a finding that because of the market  
9 manipulation by the seller that affected this very  
10 contract, the public interest demands that we not hold  
11 the --

12 MR. KNEEDLER: Yes. In that situation there  
13 is an important public interest in eliminating fraud.

14 JUSTICE SCALIA: I didn't say fraud. I said  
15 market manipulation.

16 MR. KNEEDLER: Or market manipulation.

17 JUSTICE SOUTER: Isn't the remedy for the  
18 finding of market manipulation the abrogation of the  
19 contract, which is a separate process from, from the  
20 revocation of market-based tariff?

21 MR. KNEEDLER: There are. And this is the  
22 point I was going to make --

23 JUSTICE SOUTER: The same reason may support  
24 each, but --

25 MR. KNEEDLER: Right. I was going to make

1 that point in response to Justice Kennedy's question.  
2 If it turns out that subsequent evidence shows that a  
3 particular company has acquired market-based power, then  
4 FERC can revoke that authority on a going-forward basis  
5 to continue to sell on that basis. And in fact,  
6 companies are required to report any changes in their  
7 circumstances that might affect their market power, and  
8 there is a triennial review of that. But as long ago  
9 the market --

10 JUSTICE GINSBURG: Did the companies who  
11 were involved in this case make those reports? I mean,  
12 there was something about during this energy crisis  
13 there was rampant noncompliance with the filing, with  
14 the quarterly report filing.

15 MR. KNEEDLER: There was, and the Ninth  
16 Circuit found that in the Lockyer decision. But that is  
17 the sort of flaw and market oversight that should be  
18 addressed directly by FERC. It shouldn't be -- it  
19 shouldn't be addressed by collateral attacks on  
20 contracts that were entered into under the regulatory  
21 regime as it existed.

22 JUSTICE SCALIA: Mr. Kneedler, I'm not  
23 entirely understanding you. Why should the fact that  
24 the seller later acquired market power have anything to  
25 do with whether the initial contract, when he did not

1 have market power, was a fair one? The contracts are  
2 already down in black and white, his later acquisition  
3 of market power cannot affect --

4 MR. KNEEDLER: No, that is certainly  
5 correct. I think the question, what concerned the Ninth  
6 Circuit -- actually, the Ninth Circuit wasn't addressing  
7 market power. It was addressing the possibility of  
8 market dysfunction.

9 JUSTICE SCALIA: I understand. But later  
10 acquisition of market power would result in a  
11 cancellation of the permission for this particular firm  
12 to enter into contracts for the future, but I don't see  
13 why it would affect the past contracts.

14 MR. KNEEDLER: And we don't think it should,  
15 except to the extent the public interest standard is  
16 met.

17 JUSTICE SOUTER: Maybe I think I led us into  
18 this, Mr. Kneedler. The situation that I was positing  
19 was a situation in which the power marketer had engaged  
20 in market manipulation in the context of which, at the  
21 time of which, it made this contract. And my suggestion  
22 to you, which I think you took, was that in a situation  
23 like that there would be a basis for public interest  
24 review and abrogation of this contract because of the  
25 market manipulation in fact.

1           And the market manipulation would also be a  
2 reason to say market power had been acquired. It had  
3 not been mitigated, and hence, the market-based tariff  
4 authority would also be revoked. And that was the, that  
5 was the limit of my question. And I take it your answer  
6 there is it could do each of those things?

7           MR. KNEEDLER: Yes. It could revoke the  
8 market-based power going forward. And with respect to  
9 manipulation, especially if there was manipulation  
10 affecting the particular contract, that would be a basis  
11 for finding that the public interest required the  
12 contract to be modified.

13           If I may, I'd like to reserve the balance of  
14 my time.

15           JUSTICE GINSBURG: Mr. Kneedler, I do have  
16 one question. It was the position that FERC took in  
17 December of 2000, when it was encouraging the entrance  
18 into the long-term contracts rather than using the spot  
19 market, and in that order FERC said that it would  
20 monitor long-term contracts vigorously for rate  
21 reasonableness and that buyers could challenge rates  
22 through 206 proceedings. What happened to that  
23 position?

24           MR. KNEEDLER: This is such a challenge, but  
25 what FERC has concluded is that the public interest

1 standard has to be satisfied in that situation. FERC  
2 encouraged parties to go into the long-term market in  
3 order to diminish the market volatility and it would  
4 frustrate that encouragement of policy --

5 JUSTICE GINSBURG: And how did FERC monitor  
6 the rates vigorously to make sure they were reasonable?

7 MR. KNEEDLER: There was extensive staff  
8 studies and monitoring in subsequent decisions that are,  
9 that are shown and that are in the joint appendix, in  
10 April -- in January and April and June when FERC came up  
11 with its final program to mitigate the problems in the  
12 spot market.

13 JUSTICE STEVENS: Mr. Dellinger.

14 ORAL ARGUMENT OF WALTER DELLINGER

15 ON BEHALF OF THE PETITIONERS

16 MR. DELLINGER: Justice Stevens, good  
17 morning, and may it please the Court:

18 Justice Ginsburg began by asking whether the  
19 Ninth Circuit decision did not in fact empower rather  
20 than restrict the authority of the Commission. The  
21 answer is that the Ninth Circuit decision fundamentally  
22 precludes the Commission from carrying out what the  
23 Commission believes is essential to its mandate to  
24 assure an abundancy of electrical energy at the lowest  
25 possible cost. And that is to encourage a market-based

1 approach to recognize that if you're going to have, as  
2 the Commission has said, the kind of investment in the  
3 building of infrastructure to produce energy, people are  
4 going to have to be able to rely upon long-term  
5 contracts.

6           In this case, what the Ninth Circuit's  
7 decision did is to take away a very important option  
8 that the Commission believes is essential in times of  
9 market volatility and dysfunction. And that is the  
10 option for parties to get out of the spot market and to  
11 enter into a long-term contract of a secure supply.

12           If the Ninth Circuit's decision stood,  
13 literally parties, buyers and sellers, would both be  
14 precluded from entering into that, because you would  
15 know if there were dysfunction that nothing you could  
16 say in the contract could mean that you could buy power  
17 for the next eight years at \$105 at a time, as was the  
18 case here, when the spot market was \$300. It would take  
19 away the option. And sellers would know they couldn't  
20 enter into a contract they could rely upon subject only  
21 to being overridden in the public interest, which FERC  
22 does. And that would be very damaging to the very  
23 processes which the Commission has used consistent with  
24 this Court's decision of 50 years ago to encourage  
25 development in this industry.



1 JUSTICE GINSBURG: Well, those decisions are  
2 puzzling transposed to this setting, because in those  
3 decisions it was the seller who had made a bad bargain;  
4 the price was too low; and the seller wanted to get out,  
5 right?

6 MR. DELLINGER: Yes.

7 JUSTICE GINSBURG: And now we are  
8 transposing that. And one of the main themes I think of  
9 Justice Harlan's decision was this Act was meant to  
10 protect the consumer, to make sure that the consumer  
11 wasn't going to be overcharged. And that runs through  
12 those two 1956 decisions, at a time when there was no  
13 market-based authority, or any such, right?

14 MR. DELLINGER: Well, yes. Justice  
15 Ginsburg, that is correct. That was a case where a  
16 seller was seeking to get out of a contract that was  
17 paying too low.

18 But the fundamental purpose -- the Court  
19 recognized even in Justice Harlan's opinion that  
20 maintaining the stability and expectation of contracts  
21 was going to be important to consumers, to buyers as  
22 well as to sellers. In this -- and FERC has adopted  
23 that position.

24 In this case you have a situation where the  
25 Commission decided that instability in the spot markets

1 was being partly caused by the fact that the State  
2 regulatory process had discouraged people from entering  
3 into longer term contracts; and FERC said in its 2000  
4 San Diego order, we strongly urge utilities to move  
5 their load to long-term contracts of two years or more.

6 JUSTICE GINSBURG: That's the same order  
7 where they said we are going to monitor the rates for  
8 reasonableness.

9 MR. DELLINGER: That is true. And when they  
10 did indeed undertake a review of this, they decided that  
11 with respect to these contracts there was no evidence of  
12 bad faith. There was no evidence of unfairness. There  
13 was no evidence of duress. There was no evidence of any  
14 market manipulation that affected the contracts  
15 specifically in these long-term cases.

16 The long-term contracts were part of the  
17 solution or the mitigation of the problem. It was a  
18 long-term contract that allowed the utilities in this  
19 case to get out from under \$300 a megawatt prices and to  
20 enter into a contract at \$105, in one of the cases.

21 JUSTICE STEVENS: Can I ask this question?  
22 Assuming there is absolutely no bad faith or fraud or  
23 anything like that, but there is just a general  
24 conclusion that the market was such -- in such turmoil  
25 that there could not be made reasonable or long-term

1 contracts, because the predicate for that kind of  
2 negotiation just didn't exist. Would that be a basis  
3 for setting aside the contract?

4 MR. DELLINGER: No; and it's very important  
5 that not be a basis, because if that were the case,  
6 parties would know and parties -- both -- all parties  
7 were aware that there was volatility, and the Commission  
8 had announced that the conditions were conducive to  
9 manipulation of the spot markets. That would mean that  
10 a seller would say to a buyer, we know you would like to  
11 get out of this volatility and get a regular supply  
12 guaranteed at a -- at a much lower price for long term.  
13 We can't enter into that contract, because the fact that  
14 we know there has been this problem in the market means  
15 that our contract won't be upheld.

16 Now, the Ninth Circuit decision says that  
17 contract terms are not binding if they were influenced  
18 by a dysfunctional market; and that is the very most  
19 important circumstance in which having long-term  
20 contracting is most valuable.

21 JUSTICE KENNEDY: Is volatile the same as  
22 dysfunctional?

23 MR. DELLINGER: Justice Kennedy, I don't  
24 know precisely what the Ninth Circuit means by  
25 dysfunctional. There is volatility. I think the

1 difference would be is there manipulation, is one  
2 factor; there were a number of factors that caused the  
3 volatility here --

4 JUSTICE STEVENS: Mr. Dellinger, does that  
5 mean that it is your position that no matter how  
6 dysfunctional the market was, just complete turmoil, as  
7 long as the contract was made in good faith without any  
8 fraud or abuse of power, it's a binding contract?

9 MR. DELLINGER: That is correct, unless --  
10 and this is an important unless -- the Commission  
11 reviews those contract terms and finds that the public  
12 interest necessitates a revision of the contract. They  
13 have that discretion. They have that authority. They  
14 are prepared to and have exercised it, but in -- in this  
15 case --

16 JUSTICE SCALIA: For example --

17 MR. DELLINGER: For example --

18 JUSTICE SCALIA: For example, if the prices  
19 down the road turn out to be so high for the utility,  
20 that the utility would go out of business?

21 MR. DELLINGER: That is an example that the  
22 Court gave in Mobile and -- and Sierra. But the  
23 Court -- but what the Commission would know is that the  
24 circumstances would have to be rather extraordinary.  
25 Because whenever you were to modify the terms of a

1 contract that the sellers have been relying upon, the  
2 sellers became buyers. They also went out on the  
3 market. They are buying and selling.

4 So unraveling all of these buying and  
5 selling would itself be -- would be dysfunctional; but  
6 what sellers would know thereafter is that they couldn't  
7 rely upon the contracts. They would either have to stay  
8 out of that market or they would have to charge a risk  
9 premium, which would raise prices to buyers and  
10 consumers.

11 So that long run harm of making it less  
12 reliable to engage in contracting would have to be  
13 overcome by a fairly severe showing of what the  
14 short-term harms would be to one particular set of  
15 buyers.

16 The Commission has made those findings.  
17 They found circumstances where the contracts gave first  
18 priority to commercial uses of power, and at a time of  
19 shortage that meant that residential customers would be  
20 cut off. The Commission ordered that done.

21 The Commission has been on the job here.  
22 They have -- the process by which they grant  
23 market-based rate authority is an elaborate one. They  
24 get assurances that the sellers lack transmission market  
25 power, generation market power, that there are no

1 barriers to entry, that if they have transmission  
2 facilities there is open access. They -- any party can  
3 challenge that. And any party in this case, any party  
4 in this case --

5 JUSTICE GINSBURG: You said the Commission  
6 is on the job, but one of the pieces of information here  
7 is that the Commission staff said that the dysfunction  
8 in the spot market carried over into the forward market,  
9 such that prices in the forward market were inflated.

10 MR. DELLINGER: That is correct. But what  
11 the Commission realized is that the parties were aware  
12 of what was going on in the spot market. They were able  
13 to contract on that basis. They could have asked for  
14 what's called a Memphis clause, giving either party the  
15 right to seek modification based on some administrative  
16 determination of what a right price would be at some  
17 later point. They did not. They kept in the clauses  
18 that allowed only joint approaches to the Commission,  
19 and indeed in one contract said that the rates are fixed  
20 and shall remain in effect for the terms of this  
21 agreement. That language is illustrative of how you  
22 could not enter into a long-term contract and assure  
23 that the terms were binding. The fact that --

24 JUSTICE SCALIA: I don't understand what  
25 that statement means, anyway. The current dysfunction

1 carries over into -- into the future market? What does  
2 that mean?

3 MR. DELLINGER: Right. Well --

4 JUSTICE SCALIA: Does it mean that because  
5 of the current dysfunction, you can't predict for sure  
6 what the rates are going to be down the road? Of course  
7 it means that. But doesn't a dysfunction always mean  
8 that?

9 MR. DELLINGER: Yes. Dysfunction --

10 JUSTICE SCALIA: And isn't that why you  
11 enter into long-term contracts?

12 MR. DELLINGER: Yes. Yes.

13 JUSTICE SCALIA: Because given the current  
14 dysfunction you have no idea what the price is going to  
15 be down the road.

16 MR. DELLINGER: That's exactly right.

17 JUSTICE GINSBURG: Mr. Dellinger, wasn't the  
18 staff saying something more than that in that -- in that  
19 report?

20 MR. DELLINGER: I don't -- I don't know what  
21 you're intimating, but what the conclusion was of the  
22 Commission was, for example, that there was no basis to  
23 support a finding that the Respondents exercised market  
24 --

25 JUSTICE GINSBURG: But the Commission didn't

1 -- didn't respond to the staff report, right? Didn't  
2 say anything one way or another about it.

3 MR. DELLINGER: Well, the Commission  
4 expressly said with respect to the -- to the staff  
5 report that there was no evidence of any manipulation.

6 JUSTICE GINSBURG: Did they say it with  
7 respect to the staff report? Or -- I thought they  
8 thought the staff report was irrelevant?

9 MR. DELLINGER: Yes. The aspect of the  
10 staff report that said that forward prices were  
11 influenced by prices in the spot market and that there  
12 had been dysfunction was irrelevant precisely because it  
13 would have been relevant were the Commission making its  
14 own bureaucratic determination of a right price. But  
15 the parties made the determination of the prices that  
16 they wanted to agree to, the terms they wanted to agree  
17 to, and they did so with full knowledge both that they  
18 knew there had been some manipulation, that there was  
19 volatility and that they knew they didn't know, as  
20 Justice Scalia, said the extent of it; and, therefore,  
21 that's precisely why you want to be involved in a  
22 contract that guarantees you today that, no matter what  
23 happens to prices in the next year or next summer, one  
24 of these -- one of these utilities has a guarantee of  
25 power at \$105.



1 I will reserve my time for Mr. Kneedler,  
2 unless there are questions.

3 No, I'm not. He is going to do a rebuttal,  
4 whatever amount of time we have, Justice Stevens --

5 JUSTICE STEVENS: All right.

6 MR. DELLINGER: -- unless there are further  
7 questions.

8 Thank you.

9 JUSTICE STEVENS: Mr. Wright.

10 ORAL ARGUMENT OF CHRISTOPHER J. WRIGHT

11 ON BEHALF OF RESPONDENTS

12 MR. WRIGHT: Thank you, Justice Stevens, and  
13 may it please the Court:

14 I'd like to start off by picking up on  
15 Justice Ginsburg's observation that FERC understood  
16 itself to be without discretion here, and add the point  
17 that this is an extremely unusual case where FERC  
18 thought it lacked discretion to apply the statute. In  
19 the briefs, there is now agreement that the just and  
20 reasonable standard applies to all rates under the Act  
21 and couldn't be more clear that the just and reasonable  
22 standard applies. FERC --

23 JUSTICE ALITO: Among your arguments, and  
24 the arguments of the Respondent, seems to be in some  
25 tension -- seems to me in some tension to FERC's

1 market-based rate program. Do you -- do you acknowledge  
2 that that is permissible interpretation of the Federal  
3 Power Act or not?

4 MR. WRIGHT: I -- there is much that we  
5 don't disagree with about the market-based rate program.  
6 I suppose we do think that there are two things that  
7 FERC has to make sure that it does as part of that  
8 program.

9 First, in -- in approving the market-based  
10 rate program, Judge Douglas Ginsburg said when there is  
11 a competitive market, FERC may rely upon market-based  
12 rates in lieu of cost-of-service regulations. That  
13 makes perfect sense to us, but when there is a  
14 competitive market. So we think a critical part of a  
15 market-based rate program is that there must be an  
16 inquiry into whether or not the market was competitive  
17 when the contract was entered into. Of course, we have  
18 the unusual circumstance here where Professor Kahn and  
19 nine other deregulatory economists wrote a letter in May  
20 2001 saying markets are out of control, this is the  
21 unusual circumstance where FERC should enter a price  
22 cap.

23 JUSTICE ALITO: Isn't it -- isn't it a  
24 central requirement of a market-based rate program that  
25 FERC cannot, except perhaps in very limited

1 circumstances, go back and undo contracts that had been  
2 entered into under that program, based on a  
3 retrospective determination that the rates are not just  
4 and reasonable, in the same sense that FERC would have  
5 applied that term if the utility had simply filed a  
6 tariff?

7 MR. WRIGHT: Justice Alito, all rates must  
8 be just and reasonable. We are not arguing that FERC  
9 needs to go back to a cost-of-service ratemaking  
10 approach; but an agency that sees just and reasonable  
11 and thinks it's applying a just and reasonable standard,  
12 for 70 years has thought it's either going to do a  
13 cost-of-service approach, or more recently it's going to  
14 rely on the market to make rates just and reasonable,  
15 our modest point is that it can't ignore the market. It  
16 --

17 JUSTICE SOUTER: No, but I guess this is  
18 what's bothering us. Your point does not seem, at least  
19 to me, to be a modest point, because if I understand  
20 where you're going, you're saying that in a market with  
21 the degree of volatility of this one at the time these  
22 contracts were made, no contract is enforceable. It  
23 will last only so long as -- as one party does not  
24 complain about a disadvantage, and the minute it does,  
25 it's back in front of FERC. And the argument is being

1 made that in fact a market-based rate cannot be enforced  
2 through contract because the very premise -- i.e., what  
3 you call and what was called a competitive -- Judge  
4 Ginsburg called a competitive market -- was absent.  
5 Isn't that the consequence of what you're arguing?

6 MR. WRIGHT: Yes. Let me make four points  
7 here, though, that I think make absolutely clear that it  
8 would not set a broad precedent to revisit the contracts  
9 here.

10 And the four points are first, the  
11 Government acknowledges in its brief at page 16, this  
12 was the worst electricity market crisis in history.

13 Second --

14 JUSTICE SOUTER: Well, how do we know when  
15 we're only in the second worst?

16 (Laughter.)

17 MR. WRIGHT: Well --

18 JUSTICE SOUTER: Well, but I mean the  
19 problem is --

20 MR. WRIGHT: No, no --

21 JUSTICE SOUTER: And I don't see any -- and  
22 I realize that you're giving me limiting principles to  
23 what seems to me in effect a general rule that says no  
24 contracts are enforceable, if they are made during  
25 periods of market volatility, however sensible they may

1 be given the premise of that volatility.

2 And your first proposal for a limiting  
3 principle is this is the worst of times, and I don't see  
4 how that's going to help because somebody is always  
5 going to claim, well, these times are -- are almost as  
6 bad.

7 MR. WRIGHT: Well, Your Honor, of course the  
8 Federal Power Act instructs a Federal agency to ensure  
9 that rates are just and reasonable. A -- the Federal  
10 Power Act --

11 JUSTICE SOUTER: Look --

12 MR. WRIGHT: The FERC, FERC needs to grapple  
13 with this.

14 JUSTICE SOUTER: That's a good -- I mean  
15 that's a fine general phrase, but the question is, is it  
16 possible to make an enforceable contract under these  
17 circumstances?

18 MR. WRIGHT: Well --

19 JUSTICE SOUTER: I haven't heard a limiting  
20 principle yet. You have three others.

21 MR. WRIGHT: I have three others. There was  
22 rampant noncompliance with the reporting requirements.  
23 The Government concedes that, too: FERC's market-based  
24 rate program, however well it might work today after  
25 it's been improved, as the Government said in its

1 opposition to cert, however well it's been improved on  
2 account of the 2005 amendments --

3 JUSTICE SOUTER: Did these -- did -- did the  
4 Petitioners here -- do you claim that the Petitioners  
5 here were guilty of failure to report?

6 MR. WRIGHT: Yes. They -- they were not --  
7 they were not complying with the -- we contend that the  
8 reporting requirements that were in effect in 2001 were  
9 inconsistent with the statute and not --

10 JUSTICE SOUTER: That's -- that's a  
11 different issue. That -- that may be that the  
12 Commission was derelict in -- in having a nonstatutory  
13 condition. But did these -- did these Petitioners -- do  
14 you claim, is it a basis for your claim before FERC,  
15 that these Petitioners failed to follow the reporting  
16 requirements that were in effect?

17 MR. WRIGHT: Our -- our basic argument is  
18 the rates weren't just and reasonable --

19 JUSTICE SOUTER: That's what I thought.

20 MR. WRIGHT: And the rates weren't just and  
21 reasonable on the day the contracts were signed. And  
22 let me make clear --

23 JUSTICE SOUTER: Okay, but here I just want  
24 to make sure I understand. You're saying one -- one  
25 limiting principle is the re-examination of contract

1 might be limited or at least only prompted by a -- a  
2 failure to follow reporting requirements. I can  
3 understand that and that offhand seems to me perfectly  
4 fair. It may not cover this case, but I can understand  
5 that. What are your other two reasons?

6 MR. WRIGHT: My third is, as Commissioner  
7 Massey stated in his dissent, without contradiction by  
8 the majority, that if the just and reasonable standard  
9 were -- would be applied, these rates would be declared  
10 unlawful, because they were multiples of traditional  
11 prices.

12 JUSTICE SOUTER: Okay, but that seems to me  
13 consistent with the problem that I have with your  
14 argument. And that is, if you make a contract in a  
15 period of high volatility, and it seems reasonable to  
16 the two parties to come up with a rate that is certainly  
17 a higher rate than anybody would come up with if they  
18 were going through cost-plus-return ratemaking, the  
19 contract is vulnerable. And it seems to me that  
20 Commissioner Massey's argument is consistent with the  
21 conclusion that all those contracts are vulnerable. So  
22 I don't see that as any limiting principle. What's your  
23 fourth one?

24 MR. WRIGHT: The fourth one is, as Justice  
25 Ginsburg has noted, that FERC said in December 2000,

1 before all of the contracts at issue were negotiated,  
2 that it would monitor and -- and would -- deems rates  
3 above \$74 suspect. All the contracts in here have rates  
4 above that benchmark. So it's the worst crisis in  
5 history; there's rampant noncompliance; rates were  
6 multiples of traditional pricings, and FERC had said it  
7 was going to study these rates closely.

8 JUSTICE SOUTER: Okay, I can understand --  
9 under your fourth point, I could understand the position  
10 if the argument were this is above \$74, and therefore it  
11 is suspect; but the claim you're making, as I understand  
12 it, is a much broader claim. You're saying the entire  
13 contract ought to be abrogated in the public interest,  
14 not merely above 74 but below 74. Isn't that correct?

15 MR. WRIGHT: Well, I'm sorry, Your Honor.  
16 We want this case to be sent back to FERC.

17 JUSTICE SOUTER: And when you get there,  
18 you're saying abrogate this contract.

19 MR. WRIGHT: We are saying reduce the rates,  
20 and --

21 JUSTICE SOUTER: Are you saying -- have you  
22 at any point said reduce the rates to \$74?

23 MR. WRIGHT: I'm sure different -- there are  
24 many different parties on my side. I'm sure we have  
25 many different theories. Could I tell you what FERC 's



1 done with respect to the --

2 JUSTICE SOUTER: I will -- I will stop the  
3 cross-examination, but I just wanted to get the four  
4 points.

5 MR. WRIGHT: I appreciate the  
6 cross-examination. It's helped me get out what I think  
7 our four points --

8 JUSTICE KENNEDY: If -- if your theory  
9 prevails and you go back to the Commission, does the  
10 Morgan Stanley contract, where the lower rate seller  
11 was, does that get reevaluated, too? You reevaluate all  
12 the contracts back down the line?

13 MR. WRIGHT: Well, I -- does Morgan  
14 Stanley's -- well, Morgan Stanley actually -- a number  
15 of parties in Morgan Stanley's situation chose to file  
16 protective actions, and Morgan Stanley didn't. So I  
17 don't know whether it has waived its rights or not. But  
18 I think FERC ought to grapple with that.

19 JUSTICE KENNEDY: Let me say that,  
20 consistent with your theory, that everybody -- that this  
21 whole unwinding process backs up all the way down to the  
22 original seller?

23 MR. WRIGHT: Right.

24 Well, Your Honor, the way these markets  
25 work, there is every reason to think that Morgan Stanley

1 doesn't have the sort of claim that they have suggested  
2 without telling us they have. And, of course, they know  
3 what their portfolio is.

4           There is every reason to think they bought  
5 power before the big spike came, and that they bought  
6 power since then, and that they're not -- they're not  
7 buying power at 104 and selling it to Snohomish at 105,  
8 Your Honor.

9           JUSTICE SCALIA: Well, good for them.

10           (Laughter.)

11           JUSTICE SCALIA: I mean you're suggesting  
12 they should be punished for that? I don't understand  
13 what -- what follows? I mean --

14           MR. WRIGHT: We're not, Your Honor, but I  
15 would remind you this is a plain-language case. The  
16 statute requires rates to be just and reasonable. That  
17 -- for 70 years, that's meant something to  
18 administrative agencies. The reason --

19           JUSTICE GINSBURG: But how would you -- how  
20 would you go about determining in this case? You said  
21 it's not the traditional cost of service, return on  
22 investment. So how -- if you prevail, what should FERC  
23 do to determine whether this rate was fair and  
24 reasonable?

25           MR. WRIGHT: Thank you, Your Honor.

1           We expect that, ultimately, it will do, or  
2 should do, what it's done with respect to the spot  
3 market. With respect to the spot market, it has  
4 provided relief to parties who bought at the same time.  
5 And what it has done is it has -- it has determined what  
6 it calls a mitigated market clearing price.

7           It has done this with great elaborate --  
8 elaboration for periods as low as 10 minutes for the  
9 period in 2000 - 2001, when it is now conceded  
10 manipulation raised rates on the spot market. And it  
11 has taken the prices that were paid, and it has -- it  
12 has reduced them to what it calls the "mitigated market  
13 clearing price."

14           This is -- this is described in painful  
15 detail in the -- in the Ninth Circuit's 2006 CPUC versus  
16 FERC opinion.

17           JUSTICE SCALIA: Didn't your clients know  
18 that the market was chaotic at the time they entered  
19 into this long-term contract? I mean does this come as  
20 a surprise that after the fact, now that you're paying  
21 more than the market price is, you want to kick over a  
22 long-term contract you entered into?

23           What has changed? Did you not know that the  
24 market was chaotic? Wasn't that the very reason you  
25 entered into the long-term contract.

1           MR. WRIGHT: Your Honor, we had a sort of a  
2 Henry Ford choice. Any -- we had a choice of a variety  
3 of rates as long as they were unjust and unreasonable.  
4 We didn't have any alternative, because of the market  
5 manipulation, that allowed us to get a just and  
6 reasonable rate on the spot market, on long-term markets  
7 --

8           JUSTICE SOUTER: You were saying that the  
9 most -- the most reasonable thing for us to do was to  
10 enter into a long-term contract in order to mitigate the  
11 effects of the chaotic spot market. You understood  
12 that.

13           MR. WRIGHT: In large part, because FERC had  
14 told us they were going to monitor these contracts and  
15 use the \$74 benchmark.

16           JUSTICE SCALIA: In fact, you did very well  
17 under these contracts. Initially, you were even  
18 reselling some of the energy that you got. You got it  
19 at a price so much below what was then the market that  
20 you made a profit by reselling it.

21           But now that things have changed, you don't  
22 like the long-term contract.

23           MR. WRIGHT: Your Honor, it's our position  
24 that we have to prove these were just and reasonable on  
25 the day they were entered. And the way these markets

1 work, local utilities like Snohomish buy energy, and  
2 they always sell a little bit. They're going to lose  
3 153 million over the life of this contract. And it's  
4 always been the life of the contract that FERC has  
5 thought was the -- the real benchmark.

6 JUSTICE SOUTER: Mr. Wright, may I go back  
7 to your answer to Justice Ginsburg's question? She  
8 asked you: What do you want FERC to do if it does what  
9 you want them to do?

10 And you said: We want them to make the same  
11 kind of adjustments ex post that they made to the spot  
12 prices.

13 Isn't there one big difference here to --  
14 between readjusting spot prices and rewriting or  
15 abrogating a contract like this?

16 In the case of adjusting the spot prices, in  
17 effect. What they are saying is: Somebody isn't going  
18 to make the killing that he thought he was making. It  
19 was -- a spot price indicates it was a snap decision.  
20 People were reacting to -- to changes in the market from  
21 hour to hour. And the Commission is going to go back  
22 and say, you know, you're out of luck on the killing you  
23 thought you made.

24 When, on the other hand, the Commission, in  
25 effect, rewrites or abrogates a contract, it is saying

1 something very different. It is saying: You may not  
2 engage in long-term reliance on the agreements that you  
3 make. And isn't that a huge difference?

4 MR. WRIGHT: Your Honor, we think that FERC  
5 could, and it seems clear that it will, distinguish  
6 between the spot market and long-term contracts on these  
7 bases. Our point there is that we probably, if it does,  
8 then have to overcome a hurdle and show that there  
9 wasn't effective competition at the time the long-term  
10 contracts were entered into.

11 FERC might rationally, once it grapples with  
12 this, decide that that's the way the just and reasonable  
13 standard applies.

14 JUSTICE SOUTER: Yes, but with respect,  
15 doesn't that, in effect, mean -- going back to your  
16 answer to Justice Ginsburg -- that what you really want  
17 is to say there wasn't effective competition.

18 There wasn't effective competition because  
19 the market was chaotic.

20 And, therefore, in a chaotic market,  
21 including this one, a long-term contract which later  
22 turns out to be disadvantageous to one side is  
23 unenforceable.

24 Isn't that what you -- your real answer to  
25 Justice Ginsburg is.

1           MR. WRIGHT: Well, Your Honor, again, I  
2 don't think we should prevail, and it's not our position  
3 that we prevail, unless we show that we didn't have just  
4 and reasonable alternatives at the time we entered into  
5 the contract. We don't think we can --

6           JUSTICE SOUTER: No, but I mean -- that's  
7 where I don't think that, at least with me, helps your  
8 argument. We all know that there is a broad umbrella  
9 standard of justness and reasonableness. One index of  
10 justness is the set of conditions under which the  
11 parties operate. The conditions in this case were  
12 conditions of chaos.

13           And what the other side is saying, I think,  
14 is: We each tried to make the most reasonable deal we  
15 could, the most advantageous for us that we could, under  
16 these conditions of chaos.

17           They certainly produced a rate that wouldn't  
18 have been produced in a calm time either by market-based  
19 tariffs or by cost-plus-return ratemaking. But under  
20 the circumstances that we did operate in, this is what  
21 it produced. And we were dealing at arm's length.  
22 Nobody was engaging in fraud, et cetera. So that's  
23 just.

24           And I think when you say, as you did a  
25 minute ago, there is an overarching obligation or

1 standard of justness and reasonableness, I think you're  
2 saying that that reasoning that I just tried to outline  
3 is not sufficient reasoning for sustaining the contract.

4 Now, if I'm wrong, tell me.

5 If I'm right, it seems to me you're really  
6 saying ditch the contracts if they were entered into in  
7 a period of high volatility.

8 MR. WRIGHT: Well, Your Honor, let me make  
9 clear what -- what we mean by "chaos" or "high  
10 volatility." We think we have to show that manipulation  
11 was affecting the market. We don't -- we don't think we  
12 are entitled to relief if it was the weather that was  
13 affecting the market. FERC's 2003 staff --

14 JUSTICE SOUTER: Are you entitled to relief  
15 if there was manipulation, but these people were not  
16 engaging in the manipulation? In other words, they are,  
17 in effect, innocent of the manipulation; but they, as  
18 sellers, are in a chaotic market. Are you entitled to  
19 relief against them under those circumstances?

20 MR. WRIGHT: We -- we don't think that a  
21 statute that protects consumers and says that consumers  
22 get just and reasonable rates was enacted to prevent --  
23 to overcome contracts only when there is fraud in the  
24 contract.

25 JUSTICE SOUTER: The trouble is that



1 justness is a relational category, and you are -- I  
2 think you are saying we don't have to consider justness  
3 to the parties who were doing -- we will assume for the  
4 sake of the question -- the best that they could under  
5 bad circumstances. You are saying justness only goes to  
6 the ultimate retail ratepayer.

7 MR. WRIGHT: Again, Your Honor, we don't  
8 need the statute. The statute is superfluous insofar as  
9 it affects contracts, and that is its main effect, if it  
10 requires fraud in the negotiation of the contract.

11 And, again, if Morgan Stanley can show that  
12 it was a victim of manipulation, too, then it is  
13 entitled to relief. There has certainly been some of  
14 that with respect to some of these spot market deals  
15 where there are occasionally intervening parties.

16 JUSTICE SCALIA: Mr. Wright, I really don't  
17 understand why you would -- why you say, you know, if --  
18 if the chaos is due to the weather or maybe, you know,  
19 an Arab oil embargo or whatever, that that's perfectly  
20 okay. But if it's due to manipulation, it's bad. I can  
21 understand if you added manipulation by one of the  
22 parties, by the sellers, that I could understand.

23 But so long as it's a factor extrinsic to  
24 the parties to the contract, what difference does it  
25 make to the buyer whether the flukishness of the market

1 is caused by the weather or by manipulation by somebody  
2 other than the seller?

3 In other words, I think it's not enough to  
4 show manipulation. That's what's going on in the  
5 market. And you're trying to save yourself from it. So  
6 long as it's not manipulation by the seller, I don't see  
7 how you have a -- I don't know -- an equitable case.

8 MR. WRIGHT: It -- on the equities, if the  
9 local utilities end up bearing the brunt of making bad  
10 judgments about the weather, that's one thing. It's  
11 quite another thing if there is rampant non-compliance,  
12 hiding the fact that there's been massive withholding of  
13 energy, and driving -- and these spikes were not  
14 accidental, by any means. That seems to us to be, you  
15 know, a -- a sort of distinction that the -- that the  
16 law draws all the time.

17 And let me say the example came --

18 JUSTICE STEVENS: I'm still puzzled by your  
19 answer to Justice Scalia. If, say, it is something like  
20 an atom bomb or terrorism or something totally innocent,  
21 where the parties are -- but it causes the same economic  
22 consequence, namely: That the rates are a lot higher  
23 than they otherwise would be, why do you draw the  
24 distinction that he says doesn't make sense?

25 MR. WRIGHT: Well, I guess the ultimate

1 distinction is that there isn't somebody making a whole  
2 lot of money on account of market manipulation  
3 somewhere.

4 JUSTICE STEVENS: No, but in each case the  
5 rates would be higher than they otherwise would, and  
6 you'd have to say they're high enough to be no longer  
7 just and reasonable.

8 MR. WRIGHT: Well, "just and reasonable,"  
9 again, has always -- has traditionally first meant a  
10 sort of cost-of-service inquiry and more recently means  
11 a market inquiry. But, again, a market inquiry doesn't  
12 -- means a competitive market, an effective market, as  
13 Professor Kahn said, not a market totally infected by  
14 manipulation. And then, in any case --

15 JUSTICE STEVENS: Even if infected by an act  
16 of God, it seems to me the same consequence.

17 MR. WRIGHT: I guess consumers bear the  
18 brunt of acts of God, but don't -- shouldn't bear the  
19 brunt of market manipulation that was unlawful and now  
20 is --

21 JUSTICE KENNEDY: I think you could argue  
22 that it should be just the obverse.

23 JUSTICE SOUTER: Aren't you really arguing  
24 -- no, but aren't you really making the argument that  
25 the notion of justness does have an equitable component

1 that looks to the source of the trouble; and if the  
2 source of the chaos in the market are the very people  
3 who are trying to make a profit on your contract, that  
4 is a reason to say that that market-based rate is not a  
5 just one, because they created the conditions that gave  
6 them the leverage to get you to make the deal that you  
7 made?

8 But if they are not guilty of improper  
9 conduct in making it, then, you know, everybody has to  
10 take his lumps. Aren't you saying something like that?

11 MR. WRIGHT: We don't know because FERC  
12 hasn't looked at it, what -- who Morgan Stanley paid and  
13 what they paid and who made the money here.

14 JUSTICE SOUTER: No, but just as a general  
15 premise, in your answer to Justice Scalia weren't you  
16 assuming something like that?

17 MR. WRIGHT: We certainly think that the  
18 best result would be that whoever was manipulating the  
19 market ought to be the one who ends up getting their  
20 return cut; and that the local utilities and any  
21 innocent middlemen should be made whole, too. That's  
22 fine.

23 It was brought up earlier in discussing the  
24 market-based rate program sort of what sorts of remedies  
25 were allowed. And let me say that -- well, I think this

1 came out, but the Enron example shows very well. Enron  
2 got market-based rate authority in 1993. Enron was not  
3 the only player, but was a leading player in the market  
4 manipulation in 2000-2001. FERC didn't get around to  
5 lifting their market-based rate authority until 2003,  
6 and they did it strictly prospectively.

7           It is a core point of our argument today  
8 that that shouldn't be allowed. And I think the answer  
9 was: Well, market-based rate authority only results in  
10 lifting the market-based rate authority; a 206 action  
11 under the Federal Power Act is where consumers get  
12 relief.

13           That's right, and we're here to get relief,  
14 and we think that ultimately the parties that  
15 manipulated the market and made too much money on  
16 account of the manipulation ought to -- ought to lose  
17 what they paid; and, certainly, the ratepayers shouldn't  
18 bear the costs; and if there are innocent middlemen they  
19 shouldn't bear the cost, either.

20           JUSTICE SOUTER: And, to the extent that you  
21 make that argument, that's an answer, sort of, to the  
22 question that I put to you a couple of times: Why, why  
23 isn't your argument anything less broad than the fact  
24 that you can't make a contract in a chaotic market?

25           And you are, at least as a subset of what

1 you are saying, telling us that if the contract -- if  
2 the chaos in the market was caused by the impropriety of  
3 one contracting party, that party should not profit from  
4 it. And I understand that answer. That if -- to the  
5 extent that that is your position, it is an answer to my  
6 question.

7 MR. WRIGHT: Thank you, Your Honor.

8 And let me remind the Court that one case  
9 that the other side I don't think has acknowledged  
10 sufficiently is this Court's 1974 Texaco decision. That  
11 was a situation where FERC -- well, the Federal Power  
12 Commission attempted -- attempted to do what the other  
13 side is asking this Court to rule today, to essentially  
14 make contracts sacrosanct and not subject to any  
15 challenge.

16 FERC had told small producers that it  
17 wouldn't -- that they could enter into contracts and  
18 they didn't have to file the contracts, and the  
19 Commission wouldn't review the contracts to see if they  
20 were just and reasonable. This Court very clearly held,  
21 quote, "The Commission lacks authority to place  
22 exclusive reliance on market prices," unquote.

23 Under this statute, which requires just and  
24 reasonable rates, there must be coexistence between  
25 contracts and a regulatory backstop. And, again, in the

1 situation here that you helped me review -- the worst  
2 electricity market crisis in history, rampant  
3 non-compliance, rates that were multiples of traditional  
4 levels, and couldn't be justified under anything FERC  
5 has ever called a just and reasonable standard, and FERC  
6 had said it was going to examine a benchmark -- this is  
7 a case that FERC has to go back and explain why, at  
8 least explain why it thinks these rates are just and  
9 reasonable.

10 JUSTICE SCALIA: Just and reasonable when?

11 MR. WRIGHT: On the day they were made.

12 JUSTICE SCALIA: On the day they were  
13 agreed to.

14 MR. WRIGHT: And we think they weren't,  
15 because they were the product of market manipulation  
16 that made all of the rates available --

17 JUSTICE SCALIA: They were just and  
18 reasonable --

19 MR. WRIGHT: -- that made all rates unjust  
20 and unreasonable on that date, Your Honor.

21 JUSTICE SOUTER: But I think -- and here I  
22 want to be clear on this -- you're saying they were not  
23 just and reasonable on the date they were made, number  
24 one, if the market manipulation that caused the chaos  
25 was manipulation by these Petitioners. That at least is

1 part of your argument.

2 But I think you're also saying that the  
3 rates were not just and reasonable if they were the  
4 result of market manipulation by others, not these  
5 Petitioners. Am I correct that your argument is broad  
6 enough to encompass the second alternative?

7 MR. WRIGHT: Absolutely, Your Honor.

8 JUSTICE SOUTER: Okay.

9 JUSTICE ALITO: And even that argument is  
10 much narrower than what the Ninth Circuit held, isn't  
11 it? The Ninth Circuit just referred to "dysfunction in  
12 the market." They didn't say: And dysfunction means  
13 manipulation by anybody. They seemed to have included  
14 all sorts of other things: The California regulatory  
15 program, the weather, and a number of other factors.

16 MR. WRIGHT: Your Honor, we certainly agree  
17 that the test can't be dysfunction; that FERC has to  
18 grapple with this issue and give it a concrete meaning.

19 I'm sure there would be disagreement on  
20 remand as to exactly what it means, and there are lines  
21 to be drawn. But FERC needs to do that. FERC hasn't  
22 done that.

23 FERC honestly thought -- again, this is an  
24 unusual case. FERC honestly thinks that the public  
25 interest standard, or thought that the public interest



1 standard, is a completely different animal than the just  
2 and reasonable standard.

3 JUSTICE SCALIA: If you are relying on the  
4 narrowest ground that Justice Souter mentioned, namely,  
5 manipulation by the seller, wasn't it incumbent on you  
6 to demonstrate that there was manipulation by the  
7 seller? Has that been -- has that been established?

8 MR. WRIGHT: We are relying on both, Your  
9 Honor. We are -- our -- our main argument is that all  
10 rates in the West at this period of time --

11 JUSTICE SCALIA: Because of manipulation by  
12 somebody.

13 MR. WRIGHT: -- were the result of  
14 manipulation.

15 JUSTICE SCALIA: Okay.

16 JUSTICE ALITO: Well, didn't the ALJ find  
17 there wasn't manipulation in this market, the forward  
18 market?

19 MR. WRIGHT: And the ALJ found that the spot  
20 market -- the ALJ found that the spot market  
21 manipulation didn't affect the forward markets. No one  
22 agrees to that today. FERC has disowned it. Morgan  
23 Stanley has disowned it. I'm told that the ALJ has  
24 disowned it.

25 JUSTICE ALITO: FERC disowned -- did FERC

1 reject the finding of the ALJ as to manipulation of this  
2 --

3 MR. WRIGHT: FERC said it was irrelevant.  
4 That was the part of FERC's first order, where it said  
5 it is irrelevant whether the manipulation of the spot  
6 markets affected manipulation in the long-term markets.  
7 That would be relevant only if the just and reasonable  
8 standard applies. Of course, the just and reasonable  
9 standard applies.

10 One final point. One remarkable aspect of  
11 this case is after FERC said that in its initial order,  
12 Morgan Stanley asked them to reconsider it, and they  
13 said we won't do that. Thank you.

14 JUSTICE SOUTER: Mr. Kneedler, in your  
15 rebuttal, will you address the state of the record with  
16 respect to evidence or findings about possible  
17 manipulation by these Petitioners?

18 REBUTTAL ARGUMENT OF EDWIN S. KNEEDLER  
19 ON BEHALF OF RESPONDENT FERC,  
20 IN SUPPORT OF THE PETITIONERS

21 MR. KNEEDLER: Yes. On page 1589 of the  
22 joint appendix the Commission said we've reviewed the  
23 staff reports findings in the 100-day discovery, which  
24 were discovery occurring in other proceedings, and found  
25 no evidence to support a finding of market manipulation

1 that specifically affected the contracts at issue.

2           It's important to recognize that there were  
3 two separate markets here. There was the spot market,  
4 which had struck in addition to all the weather and all  
5 those things, it had structural problems requiring the  
6 California investor-owned utilities to trade on the spot  
7 market, which contributed to the opportunities for the  
8 manipulation. The dysfunction and manipulation were  
9 tied together in that market, but there was -- the ALJ  
10 found that the long-term market was not dysfunctional.  
11 It was functioning, it operated as it should. Both  
12 parties --

13           JUSTICE STEVENS: -- know that's a premise  
14 in the debate. I find it hard to accept. How could the  
15 two be totally separate? It was the crisis that made it  
16 necessary to engage in the long-term account.

17           MR. KNEEDLER: FERC has great discretion in  
18 deciding how to apply the public interest standard.  
19 It's not necessary to find that they were absolutely  
20 separate. It's sufficient, though, to say that the  
21 problems in the two separate markets -- the situations  
22 in the two separate markets were very different. And in  
23 the long-term market, FERC concluded it was important to  
24 maintain the integrity of the contracts, indeed, under a  
25 market-based system, as Justice Alito said, more

1 important now even than at the time of Mobile, because  
2 you can't have a functioning market based-rate system  
3 without confidence that contracts would be upheld.

4 In that situation, as this Court suggested  
5 in Verizon, you had sophisticated buyers and  
6 sophisticated sellers dealing in a situation in which  
7 both knew that there was chaos in the spot market, that  
8 there was -- there were structural problems there, and  
9 that there were allegations of manipulation. But those  
10 allegations did not carry over to the, to the long-term  
11 market.

12 JUSTICE SCALIA: May I ask, I am sure you  
13 understand that a finding that there was no  
14 manipulations that affected these contracts is not the  
15 same as a finding that there was no manipulation by  
16 these sellers in the market.

17 MR. KNEEDLER: Right.

18 JUSTICE SCALIA: And there is no such  
19 finding that there was no manipulation?

20 MR. KNEEDLER: That's correct. But what --

21 JUSTICE SCALIA: And there is no finding  
22 that there was by these sellers.

23 MR. KNEEDLER: That's correct. And what the  
24 Commission was basically saying is we are treating the  
25 long-term market situation differently. Some of these

1 sellers may have been engaged in manipulation in the  
2 short-term market, but FERC was trying to draw a  
3 distinction between the spot market and moving forward  
4 and maintaining the integrity of markets in the  
5 long-term where both the buyers and the sellers were  
6 both buyers and sellers typically.

7 JUSTICE SOUTER: But, in fact, it didn't get  
8 that articulate. The closest it came to answering my  
9 question, I take it, is at the point to which you  
10 referred me in the joint appendix, no effect on these  
11 contracts?

12 MR. KNEEDLER: That's correct. We don't  
13 think FERC should have to engage in a market-based  
14 evaluation of possible manipulation in order to hold two  
15 parties, two sophisticated parties to their bargain.

16 JUSTICE SOUTER: Well, then what do you say  
17 about the standard of justness? In effect, I think  
18 you're saying it doesn't matter whether these particular  
19 Petitioners manipulated the market creating the  
20 conditions under which these contracts were made at a  
21 price which turned out to be much higher than the spot  
22 price would be later, it's irrelevant. That's your  
23 position, isn't it?

24 MR. KNEEDLER: The manipulation in the spot  
25 market, we think FERC properly concluded, did not have

1 to be taken into account --

2 JUSTICE SOUTER: I'm not talking about what  
3 FERC said. I'm talking about your position. I think  
4 your position is that even if these people -- even if  
5 these people -- Petitioners manipulated and that created  
6 the -- or contributing to creating the market under  
7 which these contracts were made, that is irrelevant in  
8 looking at the contracts --

9 MR. KNEEDLER: I think that's something that  
10 FERC would have to decide in this case. But I don't  
11 believe a claim of that sort has been made here. I  
12 believe the claim has --

13 JUSTICE SOUTER: I'm not asking what claim  
14 has been made. I want to know -- I want to know what  
15 the government's position is. And as I understand the  
16 government's position is that manipulation by these  
17 Petitioners would be irrelevant to a review under the  
18 public interest standard, is that right?

19 MR. KNEEDLER: I think that's the best way  
20 to read FERC's decision in this case. And I think  
21 that's --

22 JUSTICE SOUTER: Is that the best way to  
23 read the government's position.

24 MR. KNEEDLER: Yes.

25 JUSTICE SOUTER: Here and now in this

1 courtroom.

2 MR. KNEEDLER: That FERC -- our position is  
3 that FERC was not required in the public interest, which  
4 looks at the market as a whole not just the two parties  
5 to the contract, it looks to the consequences for the  
6 market as a whole in unraveling particular contracts  
7 because there might have been manipulation somewhere  
8 else. We think FERC, recognizing the importance of  
9 integrity of contracts, could decide that it was going  
10 to look no further than the particular contracts at  
11 issue in deciding whether there was market manipulation.

12 JUSTICE STEVENS: The case is undertaken.

13 (Whereupon, at 12:05 p.m., the case in the  
14 above-entitled matter was submitted.)

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