FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

January 4, 2011

Via Electronic Filing

Molly C. Dwyer, Clerk
U.S. Court of Appeals for the Ninth Circuit
95 Seventh Street
San Francisco, CA 94103

Re: *Modesto Irrigation District, et al. v. FERC*, Nos. 09-72775, *et al.* (Oral argument held September 23, 2010)

Dear Ms. Dwyer:

Respondent Federal Energy Regulatory Commission ("FERC" or "Commission") hereby files this supplemental letter brief in response to the Court's order dated November 24, 2010. In that order, the Court directed the parties to address two questions:

1. What would be the practical effects of ruling that section 206(b) of the Federal Power Act, 16 U.S.C. § 824e(b), does not vest FERC with authority to retroactively reset rates when it determines that refunds are appropriate?

2. Did any entity preserve a challenge to FERC's authority to retroactively reset rates when ordering refunds under section 206(b) of the Federal Power Act?

WOULD THERE BE PRACTICAL EFFECTS FROM A RULING THAT FERC'S REFUND AUTHORITY DOES NOT INCLUDE THE ABILITY TO RETROACTIVELY RESET RATES?

Yes, considerable. Section 206(b) of the Federal Power Act authorizes the

Commission (i) to "establish a refund effective date," and (ii) after finding that a rate, charge, or classification is unjust, unreasonable, or unduly discriminatory, to determine the amounts "which would have been paid under the just and reasonable rate, charge, classification, rule, regulation, practice or contract which the Commission orders to be thereafter observed . . . ." 16 U.S.C. § 824e(b). There is no dispute that section 206(b) empowers the Commission to award refunds back to the refund effective date, and that those refunds must be calculated with reference to a Commission-determined just and reasonable rate. *See, e.g.*, FERC Br. at 31. The only question is whether, in doing so, the Commission resets the rates previously charged during the refund period to a just and reasonable level. *Id*.

Retroactively resetting rates found to be unjust and unreasonable is "essential to [the Commission's] ability to exercise [its] statutory authority to order refunds." *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 127 F.E.R.C. ¶ 61,191, P 23 (2009), ER 5. If it were not permitted to reset rates during the refund period, the Commission "would be unable to determine what amount would be in excess of a just and reasonable rate," and would thus "be incapable of complying with [its] statutory obligations under FPA section 206(b)." *Id*. at P 20, ER 5. *See also* FERC Br. at 31-35. A number of additional practical consequences would follow if this Court were to hold that the Commission's refund authority under section 206(b) does not encompass the ability to

retroactively revise rates found to be unjust and unreasonable, but instead is limited to a mathematical calculation of the amounts that would have been paid under a hypothetical just and reasonable rate for the refund period.

First, such a ruling could hamper the development and maintenance of robust markets for the wholesale sale of electric energy. For more than a decade, the Commission has encouraged and guided the development of organized, competitive markets throughout the nation for the sale of electric energy and associated transmission and ancillary services. *See, e.g., Public Utils. Comm'n of California v. FERC*, 462 F.3d 1027, 1036-37 (9th Cir. 2006) ("*PUC of California*") (discussing Order No. 888 open access rulemaking and creation of competitive markets for wholesale electric power and transmission). *See also Morgan Stanley Capital Group v. Public Utility District No. 1 of Snohomish County*, 128 S.Ct. 2733, 2740-42 (2008) (discussing FERC market-based reforms designed to promote a "free market in wholesale electricity"). These markets play a central role in encouraging investment in the new generation assets and high-voltage transmission lines needed to supply power in an economical and efficient manner. Entities subject to FERC's jurisdiction (*e.g.*, public utilities) and those that are not (*e.g.*, municipalities and other governmental entities, such as Petitioners here) are "integrated co-participants" in these markets. *See Transmission Agency of No. California v. FERC*, No. 09-1213, 2010 U.S. App.

LEXIS 25251, at *13 (D.C. Cir. Dec. 10, 2010) ("the court has accepted that jurisdictional and non-jurisdictional entities are regularly integrated co-participants in modern power markets").

In order to ensure that a uniform set of rules is applied to these markets, all market participants agree by contract to abide by the terms and conditions of the FERC-jurisdictional tariffs and any related FERC rulings. *See, e.g.*, *Bonneville Power Administration v. FERC*, 422 F.3d 908, 925 (9th Cir. 2005) (noting that it is "true" that governmental entities "entered into agreements with [the Independent System Operator] and [California Power Exchange] that obligated them to abide by the ISO and CalPX tariffs"). If the Court were to rule that Commission refund orders do not retroactively modify those tariffs, then two sets of rules would apply in the market. Sales by non-jurisdictional market participants would only be subject to the terms of the relevant tariff – regardless of whether those terms are found to be unjust and unreasonable – while sales by FERC-jurisdictional entities would be subject to an additional set of regulations, untethered from the tariff itself, designed to ensure just and reasonable rates.

FERC-jurisdictional entities would be faced with the possibility of having to pay refunds to their own customers, without being able to secure refunds for their own purchases made at unjust and unreasonable rates. This could cause them to exit auction markets entirely, since there is no way to ensure that they transact only

with FERC-jurisdictional entities. For the same reasons, FERC-jurisdictional entities may refuse to enter into long-term power sales contracts with governmental entities. And as the Court has recognized, long-term forward contracts are prevalent in, and critical to the stability of, centralized power markets. *See PUC of California*, 462 F.3d at 1039 (noting that "80% of transactions are made through long term forward contracts, [which] lend[] stability to the markets"); *Morgan Stanley*, 128 S.Ct. at 2749 (noting the "important role of contracts" in the Federal Power Act, which are a "key source of stability").

Second, a holding that FERC lacks authority to reset rates when ordering refunds could inhibit the use of contract actions to enforce uniform market rules. The use of contracts to ensure that one set of rules governs centralized power markets is "not novel." *Bonneville*, 422 F.3d at 925. In the *MAPP* proceedings – which involved a power pool that included both public utility and non-public utility transmission owners – the Commission determined that portions of the power pool's tariff violated the Federal Power Act and ordered FERC-jurisdictional entities to pay refunds, but found that it lacked authority to order refunds by governmental entities. *Mid-Continent Area Power Pool*, 89 F.E.R.C. ¶ 61,135, at 61,385 (1999). *See also Bonneville*, 422 F.3d at 925-26 (discussing *MAPP* proceedings).

Participants in the power pool subsequently brought a contract action against

the Nebraska Public Power District ("Nebraska District"), a governmental market participant that refused to make any refunds. The district court noted that, although the Nebraska District was not subject to FERC regulation, it was, "as a signatory" to the market participation contract, "bound by revisions to the contract ordered by FERC regulation." *Alliant Energy, Inc. v. Neb. Pub. Power Dist.*, Civ. No. 00-2139, 2001 U.S. Dist. LEXIS 17802, at *10 (D. Minn. Oct. 18, 2001). The court found that the Commission's refund order "nullified certain terms" of the power pool's tariff, *id*. at *12 – a "nullification . . . [that] was retroactive" to the date FERC accepted the tariff subject to refund. *Id*. at *13.

The Eight Circuit affirmed, noting that the Nebraska District "bound itself [by contract] to any FERC-ordered modification of the [contract] – despite the fact that FERC normally would not be able to order [the Nebraska District] to do anything." *Alliant Energy v. Neb. Pub. Power Dist.*, 347 F.3d 1046, 1050 (8th Cir. 2003). In requiring the Nebraska District to fulfill its contractual obligations, the court was not "enforcing the FERC order," bur rather "an agreement, which [the Nebraska District] freely entered." *Id. See also Transmission Agency of N. Cal.*, 2010 U.S. App. LEXIS 25251 at *13, *17 (noting that "the mere presence of a governmental entity [does not] defeat [FERC's] jurisdiction over a public utility," and upholding FERC orders that "regulat[ed] only the []ISO's rates," even where such regulation had an incidental effect on governmental entities).

A ruling by this Court that FERC's refund authority does not include the ability to retroactively revise tariff provisions found to be unjust and unreasonable would, in all likelihood, preclude contract actions against governmental market participants that have agreed to abide by FERC-jurisdictional tariffs. That would, of course, nullify the Court's suggestion in *Bonneville* that "a contract claim" may provide the remedy for unjust and unreasonable rates charged by governmental entities. 422 F.3d at 925. And such a result would put this Court at odds with the Eighth Circuit, which found that governmental entities are bound by market participation agreements, even when such contracts (or related tariffs) are retroactively revised by FERC orders.

Third, such a ruling could limit the Commission's flexibility in fashioning appropriate remedies for unjust and unreasonable rates. In this case, the Commission established one rate methodology for prospective sales (*i.e.*, those after June 2001), and a separate methodology applied retroactively to sales made during the October 2000-June 2001 refund period. *See* FERC Br. at 11-12 (discussing refund orders); *PUC of California*, 462 F.3d at 1043-44 (discussing and affirming rate methodologies). If the Court were to adopt Petitioners' position – *i.e.*, that FERC's refund authority is limited to calculating the difference between the prospective just and reasonable rate and that actually charged during the refund period – this remedial flexibility could be diminished.

Fourth, such a ruling could potentially impact the Commission's recently-granted refund authority with respect to sales made by the Bonneville Power Administration, one of the Petitioners here. Section 206(e)(4) of the Federal Power Act, added by the Energy Policy Act of 2005, authorizes refunds for short-term sales made by Bonneville "at rates that are higher than the highest just and reasonable rate charged by any other entity" for comparable sales. 16 U.S.C. § 824e(e)(4)(B). If the Commission could not retroactively reset rates in cases like this where all sales were found to have taken place at unjust and unreasonable rates, questions could arise as to the scope of Bonneville's refund liability – *e.g.*, how should it be calculated when there is no just and reasonable rate for comparable sales during the refund period? *Cf. San Diego Gas & Elec. Co.*, 127 F.E.R.C. at P 20 ("Absent our resetting of rates during the refund period, we would be unable to determine what amount would be in excess of a just and reasonable rate"), ER 5.

DID ANY ENTITY PRESERVE A CHALLENGE TO THE COMMISSION'S AUTHORITY TO RESET RATES WHEN ORDERING REFUNDS?

No. In its July 2001 refund order, the Commission made clear that it was resetting the marketing clearing price when ordering refunds: "Our action thus revises the market clearing prices that all market participants previously agreed to accept for their sales." *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 96 F.E.R.C. ¶ 61,120, 61,152 (2001), ER 151. *See also* FERC Br.

at 45-46 (discussing earlier holdings). While certain parties disputed the Commission's authority to require refunds from governmental entities, the Commission is unaware of any party preserving a challenge to its authority to retroactively reset rates when ordering refunds. Any argument in this regard is thus barred by Section 313 of the Federal Power Act. *See* 16 U.S.C. § 825*l*(b) ("[n]o objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure to do so"). *See also* California Parties Br. at 5-9.

CONCLUSION

For the foregoing reasons, and those stated in the Brief of Respondent and at oral argument on September 23, 2010, FERC respectfully requests that the petitions for review, if not dismissed for lack of standing, be denied and FERC's orders upheld in all respects.

Respectfully submitted,

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CERTIFICATION OF COMPLIANCE WITH PAGE LIMIT PURSUANT TO THIS COURT'S NOVEMBER 24, 2010 ORDER FOR CASE NUMBERS 09-72775 *et al.*

I certify that this supplemental letter brief complies with the page limit set forth by this Court's order dated November 24, 2010 because it is 10 pages. This brief also complies with Fed. R. App. 32(a)(5) and (6) because it is proportionately spaced and has a typeface of 14 points.

/s/ Robert M. Kennedy
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January 4, 2011

CERTIFICATE OF SERVICE

I hereby certify that on January 4, 2011, I electronically filed the foregoing document with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system.

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I further certify that some of the participants in the case are not registered CM/ECF users. I have mailed the foregoing document by First-Class Mail, postage prepaid, or have dispatched it to a third party commercial carrier for delivery within 3 calendar days to the following non-CM/ECF participants.

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