

**ORAL ARGUMENT IS SCHEDULED FOR MAY 10, 2006**

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**IN THE UNITED STATES COURT OF APPEALS  
FOR THE DISTRICT OF COLUMBIA CIRCUIT**

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**Nos. 02-1367, *et al.* (consolidated)**

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**CONSTELLATION ENERGY COMMODITIES GROUP, INC., *et al.*,  
PETITIONERS,**

**v.**

**FEDERAL ENERGY REGULATORY COMMISSION,  
RESPONDENT.**

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**ON PETITION FOR REVIEW OF ORDERS OF THE  
FEDERAL ENERGY REGULATORY COMMISSION**

**BRIEF OF RESPONDENT  
FEDERAL ENERGY REGULATORY COMMISSION**

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**JOHN S. MOOT  
GENERAL COUNSEL**

**ROBERT H. SOLOMON  
SOLICITOR**

**LONA T. PERRY  
SENIOR ATTORNEY**

**FOR RESPONDENT  
FEDERAL ENERGY REGULATORY  
COMMISSION  
WASHINGTON, D.C. 20426**

**MARCH 24, 2006**

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## CIRCUIT RULE 28(a)(1) CERTIFICATE

### A. Parties and Amici

The parties before this Court are identified in the briefs of Petitioners.

### B. Rulings Under Review

1. *Constellation Power Source, Inc. v. California Power Exchange Corp.*, 100 FERC ¶ 61,124 (2002) (“Constellation Complaint Order”);
2. *Constellation Power Source, Inc. v. California Power Exchange Corp.*, 100 FERC ¶ 61,380 (2002) (“Constellation Rehearing Order I”);
3. *Constellation Power Source, Inc. v. California Power Exchange Corp.*, 111 FERC ¶ 61,147 (2005) (“Constellation Rehearing Order II”);
4. *Powerex Corp. v. California Power Exchange Corp.*, 102 FERC ¶ 61,328 (2003) (“Powerex Complaint Order”);
5. *Powerex Corp. v. California Power Exchange Corp.*, 104 FERC ¶ 61,119 (2003) (“Powerex Rehearing Order”);
6. *Coral Power LLC v. California Power Exchange*, 109 FERC ¶ 61,027 (2004) (“Chargeback Order”); and
7. *Coral Power LLC v. California Power Exchange*, 110 FERC ¶ 61,288 (2005) (“Chargeback Rehearing Order”).

C. Related Cases

These consolidated cases have not previously been before this Court or any other court. There are a number of petitions for review of related FERC orders, which are identified in the Opening Brief of Petitioner Southern California Edison Company and Petitioner-Intervenor Pacific Gas and Electric Company.

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Lona T. Perry  
Senior Attorney

March 24, 2006

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100-Day Discovery Proceeding	<i>San Diego Gas and Electric Co.</i> , 101 FERC ¶ 61,186 (2002)
Chargeback Complaint Order	<i>Coral Power LLC v. California Power Exchange</i> , 109 FERC ¶ 61,027 (2004)
Chargeback Rehearing Order	<i>Coral Power LLC v. California Power Exchange</i> , 110 FERC ¶ 61,288 (2005)
Collateral Orders	Constellation Complaint Order; Constellation Rehearing Order I; Constellation Rehearing Order II; Powerex Complaint Order; Powerex Rehearing Order
Constellation	Petitioner Constellation Energy Commodities Group, Inc.
Constellation Complaint Order	<i>Constellation Power Source, Inc. v. California Power Exchange Corp.</i> , 100 FERC ¶ 61,124 (2002)
Constellation Rehearing Order I	<i>Constellation Power Source, Inc. v. California Power Exchange Corp.</i> , 100 FERC ¶ 61,380 (2002)
Constellation Rehearing Order II	<i>Constellation Power Source, Inc. v. California Power Exchange Corp.</i> , 111 FERC ¶ 61,147 (2005)
Edison	Southern California Edison Company
FERC	Federal Energy Regulatory Commission
FERC Report to Congress	“The Commission’s Response to the California Electricity Crisis and Timeline for Distribution of Refunds,” Report Submitted to the United States Congress by the Federal Energy Regulatory Commission (Dec. 27, 2005)
ISO	California Independent System Operator

## GLOSSARY (Cont.)

PG&E	Pacific Gas & Electric Company
<i>PG&amp;E</i>	<i>Pacific Gas &amp; Electric Co. v. California Power Exchange Corp.</i> , 95 FERC ¶ 61,020 (2001)
Powerex	Powerex Corporation
Powerex Complaint Order	<i>Powerex Corp. v. California Power Exchange Corp.</i> , 102 FERC ¶ 61,328 (2003)
Powerex Rehearing Order	<i>Powerex Corp. v. California Power Exchange Corp.</i> , 104 FERC ¶ 61,119 (2003)
PX	California Power Exchange

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**ON PETITIONS FOR REVIEW OF ORDERS OF THE  
FEDERAL ENERGY REGULATORY COMMISSION**

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**BRIEF OF RESPONDENT  
FEDERAL ENERGY REGULATORY COMMISSION**

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**STATEMENT OF THE ISSUES**

1. Whether the Commission reasonably concluded that electricity suppliers' accounts with the California Power Exchange ("PX") were not "billed and settled" within the meaning of Schedule 2, § 2.2 of the PX tariff, where the suppliers had outstanding, unliquidated claims against them for refunds flowing from transactions with the PX.

2. Whether the Commission reasonably allowed the release of all of the collateral of one supplier, Constellation Power Source, Inc. (now Constellation Energy Commodities Group, Inc.) (“Constellation”), in excess of its potential refund liability, where Constellation had no other potential liabilities to the PX.
3. Whether the Commission reasonably denied requests for immediate refunds of cash chargeback payments, collected pursuant to an unjust and unreasonable application of the PX tariff, where such immediate cash refunds would discriminate against PX participants whose chargeback liability was netted against their receipts, rather than paid in cash.

### **STATUTES**

The relevant statutes are contained in the Addendum to the Opening Brief of Petitioner Southern California Edison Company and Petitioner-Intervenor Pacific Gas and Electric Company (“Edison Br.”).

## COUNTERSTATEMENT OF JURISDICTION

The arguments raised in the following sections of the Brief for Petitioners Constellation Energy Commodities Group, Inc., Powerex Corp. (“Powerex”), and Supporting Intervenors (“Constellation Br.”), are jurisdictionally barred as petitioners failed to raise these arguments on rehearing: Constellation Br., Argument Section I(A), at 17-22; Argument Section I(C)(1), at 24-25; and Argument II, Br. at 26-28.

As more fully discussed *infra* in Section I of the Argument, in the challenged orders, the Commission interpreted Schedule 2, § 2.2 of the PX tariff to permit the PX to retain participant collateral until the conclusion of proceedings regarding refunds in the markets operated by the PX and the California Independent System Operator (“ISO”). Until PX participant liability for refunds can finally be established, the Commission determined that the participant accounts cannot be deemed “billed and settled” as required by PX tariff § 2.2 for the release of collateral.

On brief, petitioners Constellation and Powerex contend that the Commission’s interpretation is refuted by the other provisions of the tariff and is contrary to standard commercial usage. Constellation Br., Argument Section I(A), at 17-22; Argument Section I(C)(1), at 24-25. Petitioners also contend that the

Commission erred in finding PX collateral applicable to cover an entity's liabilities in the ISO market when the PX was not acting as a Scheduling Coordinator for that entity. Argument II, Br. at 26-28.

These arguments were not made to the Commission on rehearing.

Accordingly, the Court lacks jurisdiction to hear these claims. FPA § 313(b), 16 U.S.C. § 825l(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 City of Orrville, Ohio v. FERC*, 147 F.3d 979, 990 (D.C. Cir. 1998) (court lacks jurisdiction to hear arguments not made on rehearing); *Platte River Whooping Crane Critical Habitat Trust v. FERC*, 876 F.2d 109, 113 (D.C. Cir. 1989) (same).

## INTRODUCTION

This is just one of many cases arising from the California energy crisis of 2000-2001, and the Commission's efforts to, prospectively, lower prices and, retroactively, calculate refunds for rates in excess of just and reasonable levels or in violation of tariff obligations. Many of these cases are still pending, most in the Ninth Circuit. *See Public Utilities Commission of the State of California, et al. v. FERC*, 9th Cir. Nos. 01-71051, *et al.* (Phase I scope of Commission's refund

authority) (argument heard April 13, 2005); *Public Utilities Commission of the State of California, et al. v. FERC*, 9th Cir. Nos. 01-71934, et al. (Phase II calculation of refunds) (in abeyance pending disposition of Phase I issues). *See generally* “The Commission’s Response to the California Electricity Crisis and Timeline for Distribution of Refunds,” Report Submitted to the United States Congress by the Federal Energy Regulatory Commission (Dec. 27, 2005) (detailing FERC actions and judicial review proceedings) (“FERC Report to Congress”).<sup>1</sup>

Petitioners Constellation and Powerex are power marketers that participated in California wholesale electricity markets administered by the PX and the ISO. As a condition of participation, Schedule 2, § 2.2 of the PX tariff required that participants like Constellation and Powerex maintain “sufficient collateral to cover their aggregate outstanding liabilities” during “the period in which the liabilities are incurred and when payment is billed and settled.” After the PX ceased operation in 2001, both Constellation and Powerex filed complaints seeking return of their collateral, on the ground that they had paid all invoices issued to them by the PX and no further liabilities could be incurred in the PX markets as the PX was no longer operating.

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<sup>1</sup> The Report is available at: <http://www.ferc.gov/legal/staff-reports/comm-response.pdf>.

The Commission denied these complaints because, well prior to the time they were filed, Constellation and Powerex were parties to actions in which they had outstanding but not yet liquidated refund liabilities based upon their transactions in the PX and ISO markets. Accordingly, the Commission found that petitioners' accounts were not "billed and settled" under the PX tariff and they were required to maintain collateral to cover their potential refund liability. *See Constellation Power Source, Inc. v. California Power Exchange Corp.*, 100 FERC ¶ 61,124 (2002) ("Constellation Complaint Order"), JA 53; *Constellation Power Source, Inc. v. California Power Exchange Corp.*, 100 FERC ¶ 61,380 (2002) ("Constellation Rehearing Order I"), JA 69; *Constellation Power Source, Inc. v. California Power Exchange Corp.*, 111 FERC ¶ 61,147 (2005) ("Constellation Rehearing Order II"), JA 75; *Powerex Corp. v. California Power Exchange Corp.*, 102 FERC ¶ 61,328 (2003) ("Powerex Complaint Order"), JA 79; *Powerex Corp. v. California Power Exchange Corp.*, 104 FERC ¶ 61,119 (2003) ("Powerex Rehearing Order"), JA 87 (collectively the "Collateral Orders").

However, Constellation had \$66.5 million in collateral posted with the PX,<sup>2</sup> when, at the time of its complaint, its estimated refund liability in the PX and ISO markets was \$3.7 million. In light of this, the Commission granted Constellation's alternative request that its collateral be reduced to an amount sufficient to cover its potential refund obligation. The Commission found that collateral of \$10 million, which was several times Constellation's estimated refund liability, was sufficient. Constellation Rehearing Order I; Constellation Rehearing Order II. In contrast, no reduction was made in Powerex's \$67 million in collateral, as Powerex's estimated refund liability of \$178 million exceeded its collateral and potentially was subject to significant further increases due to pending allegations of market manipulation against Powerex. Powerex Complaint Order; Powerex Rehearing Order.

Petitioner Southern California Edison Company ("Edison") and Intervenor Pacific Gas & Electric Company ("PG&E") contended that the Commission lacked substantial evidence for concluding \$10 million was sufficient collateral to cover Constellation's potential refund liability. The Commission rejected this contention,

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<sup>2</sup> Although this figure was kept confidential during the EL02-63 Constellation Complaint proceedings and therefore does not appear in the public record, this figure was publicly disclosed by Constellation in a September 14, 2005 filing in the EL00-95 Refund Proceeding. *See* Cost and Revenue Study of Constellation Energy Commodities Group, Inc., filed September 14, 2005 in Docket No. EL00-95-158, Accession Number 20050919-0094.

finding the \$10 million figure sufficient because it was several times Constellation's estimated refund liability, which allowed for potential increases. Constellation Rehearing Order I; Constellation Rehearing Order II.

Petitioners Powerex and Constellation also challenge the Commission's failure to refund immediately "chargeback" payments collected by the PX under its tariff to compensate for substantial defaults by Edison and PG&E. The Commission found the implementation of the tariff chargeback procedures to be unjust and unreasonable under the circumstances, given the magnitude of the defaults at issue, and required the PX to rescind the chargeback invoices. The PX has in fact credited participant accounts for the chargeback invoices. The Commission declined, however, to require the PX to return chargeback cash immediately because such immediate cash payments would discriminate against PX participants whose chargeback invoices were netted against their receipts, who would not receive reimbursement until resolution of outstanding refund claims. *See Coral Power LLC v. California Power Exchange*, 109 FERC ¶ 61,027 (2004) ("Chargeback Order"), JA 101; and *Coral Power LLC v. California Power Exchange*, 110 FERC ¶ 61,288 (2005) ("Chargeback Rehearing Order"), JA 111.

## STATEMENT OF FACTS

### I. Events Leading To The Challenged Orders

#### A. Restructuring of the California Electric Energy Market

In January 1995, retail electricity rates in California were nearly double the national average and rising. *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator and the California Power Exchange*, 93 FERC ¶ 61,121 at 61,351 n.6 (2000). In response, the California legislature restructured the state’s electric energy industry with the passage of Assembly Bill 1890 (“AB 1890”) which was intended to introduce a market-based regulatory regime to bring California’s electricity rates more in line with average rates. *See In re California Power Exchange*, 245 F.3d 1110, 1114-1115 (9<sup>th</sup> Cir. 2001); *Western Power Trading Forum v. FERC*, 245 F.3d 798, 799-802 (D.C. Cir. 2001); *Pacific Gas & Electric Co. v. Lynch*, 216 F. Supp. 2d 1016, 1035 (N.D. Cal. 2002); *San Diego Gas & Electric*, 93 FERC at 61,351.

AB 1890 called for the creation of the PX, a nonprofit entity that served primarily as a mandatory auction market for the trading of electricity in California. *California Power Exchange*, 245 F.3d at 1114. As a public utility under the FPA, the PX commenced operations in 1998 pursuant to a FERC-approved tariff and

FERC wholesale rates schedules. *Id.* Initially, the PX operated only a single-price auction for day-ahead and day-of electricity trading (the “Core” market). *Id.* The PX would determine, on an hourly basis, a single market clearing price paid to all electricity suppliers, based on short term demand and supply bids submitted by PX participants. *Id.* In the summer of 1999, the PX opened a block forward market, matching supply and demand bids for long term electricity contracts (the “Block Forward” market). *Id.*

AB 1890 also created the ISO, a non-profit entity charged with managing the state’s electricity transmission grid. *Id.* at 1115. As grid manager, entrusted to assure grid reliability, the ISO operated a real-time electricity supply market to ensure supply met demand at the time of delivery (the “Real Time” market). *Id.*

AB 1890 required California’s three main investor-owned utilities – PG&E, Edison, and San Diego Gas & Electric Company – to divest a substantial portion of their generation assets and to purchase all their electricity supply from the PX Core markets during a transition period. *Id.* at 1114-15. The California Public Utilities Commission later permitted the investor-owned utilities to purchase a limited amount of their combined load in the long-term Block Forward market, but the bulk of their load still had to be purchased in the short-term PX Core markets. *Id.* at 1115.

AB 1890 provided that the California power industry would be deregulated in several phases. *Id.* The deregulation of the wholesale market (except for the requirement to buy and sell from the PX and the limitation on forward contracting) was the first phase, to be followed later by retail deregulation. *Id.* AB 1890 provided for a ten percent retail rate reduction for certain customers and a retail rate cap through 2002, or until the investor-owned utilities recovered their stranded costs, whichever came first. *Id.*

#### **B. Events of Summer 2000**

In the summer of 2000, California wholesale electricity prices increased dramatically, affecting all markets run by the PX. *Id.* Retail rates for San Diego Gas & Electric Company customers rose 200 to 300 percent, while PG&E and Edison, which were still subject to the AB 1890 rate freeze, incurred billions of dollars of debt because they were unable to pass their wholesale costs onto their customers.<sup>3</sup> *Id.*

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<sup>3</sup>The AB 1890 rate freeze terminated for San Diego Gas & Electric customers when the utility recovered its stranded costs in 1999.

## C. FERC's Response

### 1. The Refund Proceeding

In response to the price spikes, FERC instituted hearing procedures under FPA § 206, 16 U.S.C. § 824e, to investigate, *inter alia*, the justness and reasonableness of the rates of the FERC-jurisdictional sellers into the PX and ISO markets. *San Diego Gas & Electric*, 93 FERC at 61,370. On November 1, 2000, the Commission found “clear evidence that the California market structure and rules provide the opportunity for sellers to exercise market power when supply is tight and can result in unjust and unreasonable rates [for short-term or spot market energy] under the FPA.” *Id.* at 61,350.

To remedy the situation, FERC ordered a number of structural and rule changes for the California electricity markets. *San Diego Gas & Electric Co.*, 93 FERC ¶ 61,294 (2000). Among other things, the Commission eliminated the requirement to sell into and buy from the PX by terminating the PX's wholesale tariffs. *Id.* at 61,999. It also precluded the investor-owned utilities from selling all but their surplus generation into the PX markets. *Id.* at 62,001.

A separate hearing was commenced to determine appropriate refunds for ISO and PX spot market transactions during the refund effective period. *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 96 FERC ¶ 61,120 at

61,499 (2001) (“Refund Proceeding”). The Commission set a refund effective date of October 2, 2000 under FPA § 206(b), 16 U.S.C. § 824e(b), which at that time limited refunds to a period commencing no earlier than 60 days after the filing of the complaint instituting the proceeding, and lasting no longer than 15 months. *San Diego Gas & Electric Co.*, 93 FERC at 61,370.

Recognizing that the refund effective period might expire before long-term remedies in the California markets may take effect, the Commission on November 1, 2000 also prospectively conditioned the market-based rate authorizations of public utility sellers in the ISO and PX markets on continuing a refund obligation until such time as long-term remedies could be expected to be in place, a period ending December 31, 2002. *Id.* Additionally, while the Commission recognized it had authority to direct additional remedies (including the disgorgement of profits) for unlawful rates charged during any time period, it found, when it set the refund effective date, that no violation of sellers’ market-based rate tariffs had yet been demonstrated. *San Diego Gas & Electric Co.*, 96 FERC at 61,507-08. The Commission also set a mitigated market clearing price methodology that would be used to calculate refunds for sales made into the ISO and PX markets during the period October 2, 2000 through June 20, 2001. *San Diego Gas & Electric Co.*, 93 FERC at 61,520.

The Refund Proceeding ultimately found that suppliers owe the ISO and PX a refund of \$1.8 billion dollars, but since the suppliers, in turn, were owed \$3.0 billion, the net result is that suppliers are due \$1.2 billion after refunds. *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 102 FERC ¶ 61,317, *order on reh'g*, 105 FERC ¶ 61,066 (2003). Dozens of appeals of these and other Commission orders in the Refund Proceeding are currently pending before the United States Court of Appeals for the Ninth Circuit. *See Public Utilities Commission of the State of California, et al. v. FERC*, 9<sup>th</sup> Cir. Nos. 01-71051, *et al.* (Phase I on scope of refund authority; submitted April 13, 2005), and Nos. 01-71934, *et al.* (Phase II on refund calculation issues; in abeyance).

## **2. The Investigation into Market Manipulation**

In early 2002, after uncovering evidence that Enron had abused its market-based pricing tariff authority, the Commission initiated a broadly-based fact-finding investigation into whether any entity manipulated short-term prices in Western energy markets during the time period commencing January 1, 2000. *See Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, 98 FERC ¶ 61,165 (2002). In addition, on November 20, 2002, the Commission issued an order allowing the parties in the Refund Proceeding 100 days to adduce additional evidence that was either indicative or counter-indicative of market

manipulation that may have occurred during the California energy crisis. *See San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 101 FERC ¶ 61,186 (2002), *order on reh'g*, 102 FERC ¶ 61,164 (2003) (the “Market Manipulation Proceedings”).

Commission staff’s Final Report concluded, among other things, that the tariffs of the ISO and PX prohibit abuses of market power impairing the efficient operations of the ISO and PX markets, and identified instances of alleged market power abuses and tariff violations. The Commission initiated a number of proceedings to examine instances of potential wrongdoing and to take remedial action as appropriate, regardless of when the wrongdoing occurred. Many of the Commission’s investigative and enforcement actions are the subject of appeals that remain undecided pending the outcome of the Refund Proceeding appeals. *See Pacific Gas & Elec. Co., et al. v. FERC*, 9th Cir. Nos. 03-72874, *et al.* (appeals of FERC orders approving settlements with Reliant and Duke); *Pacific Gas & Elec. Co., et al. v. FERC*, 9th Cir. Nos. 05-71008, *et al.* (appeals of gaming/collusion show cause orders); *Nevada Power Co., et al. v. FERC*, D.C. Cir. Nos. 04-1039, *et al.* (appeals of orders revoking Enron’s market-based rate sales authority); *Pacific Gas & Elec. Co., et al. v. FERC*, 9th Cir. Nos. 05-71436, *et al.* (appeals of orders terminating anomalous bidding investigations); *People of the State of Cal., et al. v.*

*FERC*, 9th Cir. Nos. 05-75487, *et al.* (appeals of orders initiating and conducting investigation of Enron activities).

By December 27, 2005, the Commission had completed all but one of 60 investigations regarding market manipulation. *See FERC Report to Congress* at 3. Further, to date, the Commission has facilitated settlements in both the Market Manipulation Proceedings and the Refund Proceeding resulting in recovery of over \$6.3 billion. *Id.*

#### **D. PG&E and Edison Default**

In the meantime, PG&E and Edison continued to be unable to pass their increased wholesale power costs on to their customers because they were still subject to a retail rate freeze imposed by AB 1890. *Duke Energy Trading and Marketing v. Davis*, 267 F.3d 1042, 1045 (9<sup>th</sup> Cir. 2001); *California Power Exchange Corp.*, 98 FERC ¶ 61,097 at 61,302 (2002). As a result, in January 2001, PG&E and Edison defaulted on hundreds of millions of dollars of obligations to the PX for December and January purchases in the PX markets. *Duke Energy*, 267 F.3d at 1045. On January 18, 2001, after PG&E and Edison's debt ratings were downgraded to "junk" status, the PX suspended their trading privileges. *Id.*

As PG&E and Edison were two of the largest PX participants, their default had a severe impact on the PX. *Id.* By the end of January 2001, the PX had

suspended trading in its markets and commenced wrapping up its operations. *Id.* at 1046. On March 9, 2001, PX filed for bankruptcy. *Id.* The PX's rate schedules were terminated effective at the close of business on April 30, 2001. *San Diego Gas and Electric Co.*, 93 FERC at 62,020.

## **II. The Challenged Orders**

The orders challenged in this appeal concern two issues arising out of the termination of the PX markets and the Edison and PG&E defaults: (1) the retention by the PX of collateral posted by participants in the PX markets pending resolution of participants' refund liability; and (2) the PX's failure to return \$15 million in cash collected pursuant to the PX tariff "chargeback" mechanism.

### **A. The Collateral Orders**

As a condition for participating in the PX's markets, the PX tariff required participants to post collateral for 100 percent of their requirements in the PX's markets in excess of any unsecured line of credit they were granted by the PX. Constellation Complaint Order at P 5, JA 54. Following termination of the PX markets, power marketers Constellation and Powerex filed complaints seeking release of their collateral held by the PX. The Commission denied those complaints based upon its interpretation of the PX tariff.

Schedule 2, Section 2.2 “Collateral Requirement” of the PX’s tariff provides that:

Each CalPX Participant shall maintain sufficient collateral to cover its aggregate outstanding liabilities. . . . to and from the CalPX between clearing cycles or during the period in which the liabilities are incurred and when payment is billed and settled.

Constellation Complaint Order at P 26, JA 57. Upon review of the PX tariff, the Commission found that this tariff language supported retaining the collateral. Constellation Complaint Order at P 27, JA 58; Powerex Complaint Order at P 27, JA 84. The tariff requires that participants post collateral as security for potential defaults arising from a participant’s failure to pay its outstanding liabilities to the PX, and its outstanding obligations are not extinguished until they are billed and settled. *Id.* Final billing and settlement had not yet taken place given the numerous ongoing contested proceedings regarding the transactions that occurred in the PX markets, including the Refund Proceeding and the Market Manipulation Proceedings. *Id.* See Constellation Complaint Order at PP 26-28, JA 57-58; Constellation Rehearing Order I at PP 10-12, JA 71; Powerex Complaint Order at P 27, JA 84; Powerex Rehearing Order at PP 12-13, JA 89.

The Commission further rejected Powerex’s argument that the Commission had departed from its policy that a guaranty for the payment of refunds is required

only in extraordinary circumstances. Powerex Rehearing Order at P 14, JA 89. The Commission found this assertion misplaced because retention of Powerex's collateral was required under the PX tariff. *Id.*

The Commission granted, however, Constellation's alternative proposal to reduce its collateral to the amount necessary to cover its potential refund liability, and to have amounts in excess of that amount released. Constellation Rehearing Order I at PP 13-14, JA 71. Constellation pointed out that, while it had \$66.5 million of collateral posted with the PX, the current refund claims of the PX and ISO against it equaled only \$3.7 million. *See* 02-1367 R. 72 at 3, JA 385. Based upon the amount of the current refund claims, the Commission ordered that Constellation maintain collateral with the PX in the amount of \$10 million, which by the Commission's conservative estimate would be sufficient to cover the potential refund liability resulting from Constellation's transactions in the PX and ISO markets, even if they were to substantially increase. Constellation Rehearing Order I at P 10, 14, JA 71.

In contrast to Constellation, the Commission denied Powerex any release of collateral because Powerex's estimated \$178 million in refund exposure in the Refund Proceeding was already well in excess of Powerex's \$67 million in collateral, and was subject to many uncertainties, including the potential for

significant additional refund liability arising from the Market Manipulation Proceedings. Powerex Rehearing Order at n. 11, JA 89. Similarly, in *PG&E Energy Trading Power, L.P.*, 102 FERC ¶ 61,091 at P 16 (2003), the Commission denied another power marketer, PG&E Energy Trading, the release of any collateral because PG&E Energy’s potential refund liability for both CalPX and ISO transactions [approximately \$27 million] substantially exceeded the total amount of collateral it had posted [\$19 million].

**B. The Chargeback Orders**

To cover the defaults by Edison and PG&E, the PX began applying its “chargeback” tariff mechanism against other market participants. *Pacific Gas & Electric Co. v. California Power Exchange Corp.*, 95 FERC ¶ 61,020 at 61,040 (2001) (“*PG&E*”). The chargeback is an allocation mechanism intended to allow the PX to recover the uncollected receivables of a defaulting PX debtor from the remaining participants in the PX market. *Id.* Section 5.3 of the PX tariff provides that:

In the event that amounts owed to the PX Participants on a payout date cannot be fully paid due to an insufficiency of funds in the PX clearing accounts, the PX will allocate the shortage to the PX Participants using the proportional charge-back methodology described below. If payments are received, they will be remitted to the relevant PX Participants on the same basis using the same ratio as the original chargeback.

Default charge-back to PX CORE MARKET Participants shall be assessed using the following methodology:

The PX Participant's outstanding default amounts will be charged back to all current PX Participants based upon the percentage of its gross sales in MWhs to the total gross of MWhs sales in the Core Market during the three calendar months preceding the event plus the current month-to-date.

*Id.* (quoting PX Tariff Section 5.3). The Commission accepted the PX chargeback mechanism as part of PX Tariff Amendment No. 18. *Id.* (citing *California Power Exchange Corp.*, 92 FERC ¶ 61,096 (2000)).

In February and March of 2001, three complaints were filed at the Commission challenging the PX's implementation of the chargeback mechanism. *PG&E*, 95 FERC at 61,043-44. In *PG&E*, the Commission found that the PX's use of the chargeback mechanism had had, and would continue to have, an impact on otherwise creditworthy PX participants that would exacerbate the existing adverse market conditions in California, and potentially cause virtually all PX participants to default. *Id.* at 61,045. Therefore, the Commission concluded that the chargeback provision in the PX tariff was not designed to address default of this magnitude, and its application in these circumstances was unjust and unreasonable. *Id.*

The Commission directed the PX to: (1) rescind all prior chargeback actions related to PG&E's and Edison's liabilities; and (2) refrain from taking any future

chargeback action related to PG&E's and Edison's liabilities. *Id.* The Commission deferred further action on the question of how the PX should account for the Edison and PG&E defaults, in light of other pending matters that might significantly affect that determination. *Id.* at 61,046.

In response to *PG&E*, the PX credited the chargebacks on account summaries it issued to PX participants, but did not return \$15 million in cash collected pursuant to the chargeback mechanism. Chargeback Order at P 1, JA 102. Upon consideration of numerous competing filings, see *id.* at PP 17-42, JA 104-08, the Commission decided that disbursement of the cash collected pursuant to the chargeback mechanism should await a final computation of who owes what to whom, particularly as the Commission expected that the Refund Proceeding would be concluded shortly. *Id.* at P 47, JA 109.

While the PX had collected approximately \$15 million in cash payments from 26 PX participants on chargeback invoices, Chargeback Order at P 32, JA 107, other chargebacks did not result in payments of cash, but rather in a reduction in the dollar amount of payments made to market participants. Chargeback Order at P 1 n. 1, JA 102. During the time period the chargebacks were in effect, the PX distributed to PX participants and the ISO approximately \$385 million on account of prior sales into markets administered by the PX, which distributions were based

on allocations including the chargeback methodology. Chargeback Order at P 20, JA 105.

The PX rescinded this category of chargebacks through accounting entries. Chargeback Order at P 1 n. 1, JA 102. Awaiting the conclusion of the Refund Proceeding to disburse the \$15 million in chargeback payments collected therefore would also assure that those who paid their chargeback through receiving a reduced payment from the PX will be treated similarly to those who paid the chargeback in cash. *Id.* at P 47 n. 30, JA 109. The Commission found that the retention of the chargeback amounts until the conclusion of the Refund Proceeding would accordingly assure the proper allocation of the chargeback funds. *Id.* at P 47, JA 109; Chargeback Rehearing Order at P 6, JA 112.

## SUMMARY OF ARGUMENT

In the Collateral Orders, the Commission reasonably interpreted Schedule 2, § 2.2 of the PX tariff to require that market participants maintain collateral with the PX until their refund liability for transactions in the California wholesale electricity markets is finally determined.

On appeal, petitioners Constellation and Powerex largely abandon the arguments they made before the Commission in opposition to this interpretation, and assert new arguments, which the Court lacks jurisdiction to consider. Specifically, petitioners now assert that a number of other PX tariff provisions, as well as “standard commercial usage,” support their interpretation of § 2.2. Petitioners also now assert that a participant’s PX collateral cannot be held to cover refund liability in the ISO market unless the PX was acting as the participant’s Scheduling Coordinator. As none of these arguments were made to the Commission on rehearing, they cannot be considered now.

The one argument properly raised before the Commission – that the tariff interpretation is contrary to FERC precedent refusing to require guarantees for potential refund liabilities – is without merit. As the Commission found, the orders here did not require the posting of a guarantee to secure refunds, but rather enforced

the terms of the PX tariff, by which petitioners voluntarily agreed to abide as a condition of participating in the PX markets.

Appealing from the opposite direction, petitioner Edison and intervenor PG&E challenge the Commission's release of all but \$10 million of the collateral posted by Constellation. They assert that the Commission provided no basis for the selection of this amount. To the contrary, the Commission selected \$10 million because it was several times the amount of refunds claimed against Constellation, and would therefore adequately cover Constellation's potential obligations, even if they were to increase substantially. In comparison, the Commission denied the release of any of Powerex's collateral because its potential refund liability of \$178 million in the Refund Proceeding substantially exceeded its \$67 million in collateral, and Powerex was potentially subject to further refund exposure in the Market Manipulation Proceedings.

Petitioners Powerex and Constellation also challenge the Commission's failure, in the Chargeback Orders, to refund immediately "chargeback" payments collected under the PX tariff upon the defaults of Edison and PG&E. The Commission found the implementation of the tariff chargeback procedures to be unjust and unreasonable under the circumstances, given the magnitude of the defaults at issue, and required the PX to rescind the chargeback invoices. The PX

has in fact credited participant accounts for the chargeback invoices. Exercising its remedial discretion, however, the Commission did not require the PX to return immediately cash collected pursuant to the chargeback invoices, because immediate disbursement would unfairly favor PX participants who paid their chargeback invoices in cash over participants that had their chargeback liability netted against amounts due them from the PX.

## ARGUMENT

### I. STANDARD OF REVIEW

The Court reviews FERC orders under the arbitrary and capricious standard. *Florida Municipal Power Agency v. FERC*, 315 F.3d 362, 365 (D.C. Cir. 2003). Under that standard, the Commission’s decision must be reasoned and based upon substantial evidence in the record. The Commission’s factual findings are conclusive if supported by substantial evidence. FPA § 313(b), 16 U.S.C. § 825l(b). The substantial evidence standard “‘requires more than a scintilla, but can be satisfied by something less than a preponderance of the evidence.’” *Florida Municipal*, 315 F.3d at 365 (quoting *FPL Energy Maine Hydro LLC v. FERC*, 287 F.3d 1151, 1160 (D.C. Cir. 2002)). The Court affords deference to the Commission’s reasonable interpretation of its tariffs on file, “even where the issue simply involves the proper construction of language.” *Koch Gateway Pipeline Co. v. FERC*, 136 F.3d 810, 814 (D.C. Cir. 1998) (internal citation and quotation marks omitted). *See also Natural Gas Clearinghouse v. FERC*, 965 F.2d 1066, 1070 (D.C. Cir. 1992); *Long Island Lighting Co. v. FERC*, 20 F.3d 494, 497 (D.C. Cir. 1994).

The Court also in general “defer[s] to FERC’s decisions in remedial matters, respecting that the difficult problem of balancing competing equities and interests

has been given by Congress to the Commission with full knowledge that this judgment requires a great deal of discretion.” *Koch Gateway*, 136 F.3d at 816 (internal quotation marks omitted). As a result, the Court does not ordinarily interfere with FERC’s exercise of its discretion so long as the agency’s determination has a rational basis. *Id.* See also, e.g., *Connecticut Valley Electric Co. v. FERC*, 208 F.3d 1037, 1044-45 (D.C. Cir. 2000) (explaining the Commission’s broad remedial discretion under the statutes it administers); *Towns of Concord, Norwood, and Wellesley, Massachusetts v. FERC*, 955 F.2d 67, 72-76 (D.C. Cir. 1992) (same).

**II. PETITIONERS’ CHALLENGES TO THE COMMISSION’S INTERPRETATION OF SCHEDULE 2, § 2.2 OF THE PX TARIFF ARE LARGELY JURISDICTIONALLY BARRED, AND, WHERE VIABLE, ARE WITHOUT MERIT.**

**A. The Commission Denied Complaints For Release Of Collateral Based On Its Reasonable Interpretation Of The PX Tariff.**

In complaints filed with the Commission on February 25, 2002 and February 20, 2003 respectively, Constellation and Powerex contended that the PX was obligated under the terms of its tariff to release the collateral that they had been required to post to secure their transactions in the short-term PX Core and long-term Block Forward markets. 02-1367 R. 1 at 2, JA 242; 03-1285 R. 1 at 3-10, JA 597-604. Constellation and Powerex contended that they had paid all of the monthly

bills related to transactions in the Core markets, all of their contracts in the Block Forward market had expired, and there was no potential for any further participation in those markets. *Id.* Therefore, they argued all their transactions had been “billed and settled” as required by Schedule 2, § 2.2 of the CalPX tariff. *Id.*

The Commission resolved Constellation’s and Powerex’s complaints based upon the language of the PX tariff. Constellation Complaint Order at P 26, JA 57; Powerex Complaint Order at P 27, JA 84. Schedule 2, Section 2.2 of the PX tariff, “Collateral Requirement,” provides that each PX participant shall maintain collateral to cover its liabilities in the PX Day-Ahead and Day-Of markets until payment is billed and settled:

**Day-Ahead/Day-Of Market.** Each PX Participant shall maintain sufficient collateral to cover its aggregate outstanding liabilities in the Day-Ahead and Day-Of markets to and from the PX between cash clearing cycles or during the period in which the liabilities are incurred and when payment is billed and settled.

03-1285 R. 9 at 5, JA 729. Section 2.2 also requires PX participants to maintain sufficient collateral to cover their estimated potential ISO Real-Time aggregate outstanding liability:

**Real-Time Market.** Each PX Participant shall maintain sufficient collateral to cover its aggregate outstanding liabilities in the Day-Ahead and Day-Of markets to and from the PX between cash clearing cycles or during the period in which the liabilities are incurred and when payment is billed and settled.

*Id.* Appendix B to the PX tariff, Master Definitions Supplement, defines the term “Real-Time Market” to mean the ISO Real-Time Market:

**Real-Time Market.** The competitive generation market controlled and coordinated by the ISO for arranging real-time imbalance energy.

*Id.* at 6, JA 730.

The Commission found that this tariff language supported retaining the collateral, since outstanding liabilities had not yet been billed and settled, as required by the tariff. Constellation Complaint Order at P 27, JA 58; Powerex Complaint Order at P 27, JA 84. Under the provisions of the PX tariff, a market participant is required to post collateral as security for potential defaults arising from this participant’s failure to pay its outstanding liabilities to the PX. *Id.* Outstanding obligations are not extinguished until they are billed and settled. *Id.* The Commission found that final billing and settlement had not yet taken place given the numerous ongoing contested proceedings regarding the transactions that occurred in the PX markets, and thus the trades made in the PX markets are not yet full resolved. *Id.*

For example, when Constellation filed its complaint on February 25, 2002, all participants had been aware for a year and a half -- since the Commission’s order of August 23, 2000 -- that, in the Refund Proceeding, the Commission was

investigating the justness and reasonableness of rates for all sales in the ISO and PX markets, and had set a refund effective date for the awarding of refunds. *See San Diego Gas & Electric Co.*, 92 FERC ¶ 61,172 (2000). Petitioners' outstanding liability for such refunds could not be known until the completion of the Refund Proceeding. Constellation Complaint Order at P 28, JA 58. Only upon completion of that proceeding could the Commission begin to determine the liabilities of each supplier, and until those figures are determined, the process of final billing and settlement could not start. *Id.*

However, as Constellation had \$66.5 million in collateral posted at the PX, and Constellation's estimated refund obligation in its complaint was \$3.7 million, the Commission allowed Constellation's collateral to be reduced to \$10 million, as a conservative estimate of the amount of collateral sufficient to cover Constellation's potential refund liability. Constellation Rehearing Order I at P 14, JA 71.

In contrast, the Commission found no basis to release any of Powerex's collateral. By the time Powerex filed its complaint on February 20, 2003, the Commission in the Market Manipulation Proceedings had received evidence that various sellers, including Powerex, had engaged in market manipulation. Powerex Complaint Order at P 25, JA 57. Based on this evidence, the Commission was

contemplating expanding the refund liability of such sellers beyond the refunds contemplated in the Refund Proceeding. *Id.*

Thus, in deciding whether to release Powerex's collateral, the Commission had to consider not only Powerex's potential refund liability in the Refund Proceeding, but also whether Powerex has additional liability for refunds in the Market Manipulation Proceedings. Powerex Complaint Order at P 26, JA 83. Until all those issues are resolved and the figures known, the Commission found that the process of final billing and settling of Powerex's transactions in the PX markets could not take place. *Id. See also* Powerex Rehearing Order at P 12-13, JA 89. The Commission therefore reasonably declined to release any of Powerex's collateral, notwithstanding Powerex's contention that its refund liability in the Refund Proceeding was more than offset by monies owed to Powerex by the PX and ISO. *See* Powerex Complaint Order at 10-11, JA 81.

**B. Petitioners Have Largely Abandoned On Appeal The Arguments They Raised On Rehearing Challenging The Commission's Interpretation.**

Before the Commission, Constellation contended that, under PX Tariff Schedule 2, § 2.2, Constellation's "letters of credit were pledged solely to insure that it was able to cover its aggregate 'outstanding' liabilities in CalPX markets 'between cash clearing cycles or during the period in which the liabilities are

incurred and when payment is billed and settled.” 02-1367 R. 72 at 3, JA 385.

According to Constellation, “any liabilities that may hereafter arise in [the Refund Proceeding] will do so after the close of the cash clearing cycles in which the liabilities addressed by Schedule 2, Section 2 apply, and thus are not ‘outstanding.’”

*Id.* In Constellation’s view “its collateral was intended only to insure that CalPX Participants paid their bills when invoiced, which Constellation has done, not to secure potential refunds. . . .” *Id.* Powerex made substantially the same argument.

03-1285 R. 15 at 4, 9-10 JA 750, 755-56. Constellation and Powerex both also argued that the Commission’s interpretation was inconsistent with Commission precedent denying bonds or guarantees for refund liability. 02-1367 R. 72 at 5, JA 387; 03-1285 R. 15 at 13-16, JA 759-62.

Constellation also argued before the Commission that collateral posted for the short-term PX Core market could not be used to cover obligations in the long-term PX Block Forward market. *See* 02-1367 R. 72 at 20, JA 402 (citing PX tariff Schedule 2, § 4.3, concerning the division between the Core and Block Forward markets).<sup>4</sup>

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<sup>4</sup>This argument was rejected by the Commission, Constellation Complaint Order at P 29, JA 58; Constellation Rehearing Order I at P 12, JA 71. Schedule 2, Section 5 of the PX tariff provides that “[i]f a PX Participant default occurs in the Core Market, the PX Participant will be deemed to have defaulted in all CTS and Core

On appeal, Constellation and Powerex now assert that the Commission’s tariff interpretation based on PX tariff § 2.2, is: (1) inconsistent with PX Tariff Schedule 6, § 5.2 and other specified provisions of the PX tariff, Constellation Br., Argument Section I(A), at 17-22 and Argument Section I(C)(1), at 24-25; and (2) inconsistent with “standard commercial usage,” *id.* at Argument I(C) 1, 24-25. Petitioners also argue that the phrase “to or from the CalPX” in § 2.2 can only apply to ISO Real-Time market transactions in which the PX acted as a Scheduling Coordinator for the petitioners. Constellation Br. Argument II, Br. at 26-28.

**C. The Arguments Newly Raised On Brief Are Jurisdictionally Barred.**

On rehearing petitioners never cited to PX Tariff Schedule 6, § 5.2 or any other provisions of the PX tariff now cited in their brief,<sup>5</sup> nor to any standard commercial usage of the terms in § 2.2. Similarly, the term “Scheduling

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Markets.” JA 140. The Core Market includes the PX’s Day-ahead and Day-of energy markets. *Id.* The CTS Market, which is run by California Trading Services, a division of the PX, includes the Block Forward energy market. *Id.*

<sup>5</sup> As noted above, on rehearing Constellation did argue that the collateral posted for the short-term PX Core markets could not be used to cover obligations in the long-term PX Block Forward market, *see* 02-1367 R. 72 at 20, JA 402 (citing PX tariff Schedule 2, § 4.3, concerning the division between the Core and Block Forward markets), but this argument was rejected by the Commission, *see* Constellation Rehearing Order I at P 12, JA 71, and has been abandoned on appeal.

Coordinator” did not appear in the rehearing requests, much less form the basis for an argument against the Commission’s interpretation of the tariff.<sup>6</sup>

Accordingly, these arguments made on brief are jurisdictionally barred. It is well settled that this Court strictly construes the jurisdictional rehearing requirement of FPA § 313(b), which requires that a petitioner seek rehearing before the Commission and that the petitioner raise in that rehearing request “the very objection urged on appeal.” *Town of Norwood v. FERC*, 906 F.2d 772, 774 (D.C. Cir. 1990) (quoting *Tennessee Gas Pipeline Co. v. FERC*, 871 F.2d 1099, 1110 (D.C. Cir. 1989)). The argument must be raised with sufficient specificity so as to put the Commission on notice of the ground on which rehearing was being sought. *Intermountain Municipal Gas Agency v. FERC*, 326 F.3d 1281, 1285 (D.C. Cir. 2003) (interpreting identical language of § 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b)).

Petitioners may attempt to rely upon general statements in their pleadings before the Commission, but those references are wholly inadequate. In a separate “Request for Clarification” section of Constellation’s request for rehearing, 02-1367 R. 72 at 26-27, JA 408-09, Constellation sought clarification that “the collateral that

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<sup>6</sup>Petitioners’ rehearing requests are found in the record at 02-1367 R. 72, JA 383 and 03-1285 R. 15, JA 747.

is currently being retained” does not “relate to potential refunds that it may have in the ISO’s markets.” *Id.* In footnote 15, Constellation stated that “[i]n the event the requested clarification is not provided, Constellation requests rehearing of this matter pursuant to Section 313 of the Federal Power Act, 16 U.S.C. § 825*l*, and 18 C.F.R. § 385.713.” Constellation made no argument and gave no reason whatsoever to indicate why Constellation believed rehearing on this issue was warranted. It certainly made no reference to particular tariff provisions it now alleges contradicted this reading, no reference to allegedly contradictory standard commercial usage, and no reference to its current claim on brief that it never used the PX as a Scheduling Coordinator in the ISO real-time markets. Constellation did not seek rehearing of Constellation Rehearing Order I, in which the Commission retained its interpretation of the collateral requirement but permitted Constellation to reduce its collateral to \$10 million.

In its request for rehearing, Powerex acknowledged the Commission’s prior finding that “the collateral should cover both the CalPX and CAISO markets.” 03-1285 R. 15 at 4, JA 750. The only challenge to that finding is found in n.16, in which Powerex argues that, under the language of PX tariff § 2.2, “[t]he collateral held by the CalPX never was intended to secure refunds to the CalPX, nor was it intended to operate as security for participation in markets outside of the CalPX,

such as markets operated by the CAISO.” *Id.* at 9 n.16, JA 755. Again, there is no explanation of why Powerex believes this to be true, and certainly no citation to allegedly contrary tariff provisions, commercial usage, or mention of any issue regarding whether Powerex used the PX as a “Scheduling Coordinator.”

Thus, neither Constellation nor Powerex on rehearing cited any of the tariff provisions they now claim on brief are inconsistent with the Commission’s interpretation of § 2.2, and neither raised any allegedly contradictory standard commercial usage, nor mentioned the phrase “Scheduling Coordinator.” The Court therefore lacks jurisdiction to address these arguments. *See, e.g., Intermountain*, 326 F.3d at 1286 n. 7 (finding argument inadequately raised on rehearing where the petitioner did not even cite the statute or use the statutory language on which it now relies).

Intervenor Northern California Power Agency requested rehearing regarding the applicability of PX collateral to cover liabilities in the ISO market. 02-1367 R. 87 at 3-4, JA 569-70. *See* Constellation Rehearing Order II at PP 15-16, JA 77. Northern California Power argued that the language of § 2.2., referring to the collateral as covering liabilities “to and from the CalPX,” limited the use of collateral to covering liabilities between participants and the PX itself, and not liabilities incurred in other markets. 02-1367 R. 87 at 3-4, JA 569-70.

The Commission disagreed. Constellation Rehearing Order II at P 16, JA 77. Section 2.2 requires that each PX participant maintain sufficient collateral to cover the estimated potential *Real Time* aggregate outstanding liabilities to and from the PX. *Id.* Under the PX tariff, the “Real Time” market means “[t]he competitive generation market controlled and coordinated by the ISO for arranging real time Imbalance Energy.” *Id.* (quoting PX Tariff, Original Sheet No. 230). Accordingly, the Commission concluded that the PX tariff requires PX participants to post collateral to cover potential liabilities resulting from real-time transactions in the ISO markets. *Id.* As these transactions were the subject of the Refund Proceeding, the Commission found it proper to include this estimated potential refund liability in its calculations. *Id.* No party sought rehearing of this conclusion in Constellation Rehearing Order II.

Northern California Power’s request for rehearing does not aid petitioners. First, in order to be preserved for review, issues on rehearing must be raised by the petitioner itself, not some other party. *ASARCO, Inc. v. FERC*, 777 F.2d 764, 773 (D.C. Cir. 1985). Although Northern California Power is an intervenor in this matter, “absent extraordinary circumstances, intervenors ‘may join issue only on a matter that has been brought before the court by’ a petitioner.” *California Department of Water Resources v. FERC*, 306 F.3d 1121, 1126 (D.C. Cir. 2002)

(quoting *Alabama Municipal Distributors Group v. FERC*, 300 F.3d 877, 879 (D.C. Cir. 2002)).

Further, even though Northern California Power challenged use of PX collateral to cover refund liabilities in the ISO market, Northern California Power did not raise the challenge that petitioners do now on brief – that PX collateral may only be used to secure ISO transactions where the entity charged with refunds was using the PX as its Scheduling Coordinator. *See Constellation Br.* at 26-28. Thus, Northern California Power’s request for rehearing could not in any event provide a jurisdictional basis for considering the argument made on brief. *Town of Norwood*, 906 F.2d at 774 (petitioner must raise in rehearing request “the very objection urged on appeal”); *Tennessee Gas*, 871 F.2d at 1110.

### **III. IN ANY EVENT, THE COMMISSION REASONABLY INTERPRETED THE PX TARIFF.**

#### **A. The Commission’s Interpretation Of § 2.2 Is Fully Consistent With The Tariff Sections Cited By Petitioners.**

For the first time on brief, Constellation, Powerex and supporting intervenors cite other provisions of the PX tariff that they contend contradict the Commission’s interpretation of tariff § 2.2. *See Constellation Br.*, Section I(A) at 17-22 (citing PX tariff schedule 6, § 5.2 and other allegedly contradictory provisions of the tariff). According to petitioners, read in the context of these newly cited tariff provisions,

the PX collateral “was intended to guarantee timely payment of regular monthly invoices for actual purchases of power.” Constellation Br. at 21. Thus, once petitioners paid their regular monthly PX invoices, there was no basis under the tariff to retain their collateral, *id.* at 17, notwithstanding the known but unliquidated liability for refunds arising from those very same transactions.

To support this interpretation, petitioners point to tariff schedule 6, § 6.2,<sup>7</sup> JA 162, *see* Constellation Br. at 18, which provides:

The billing and payment process for Energy traded in the Day-Ahead Market and Hour-Ahead Market shall be based on the issuance of Preliminary and Final Settlement Statements for each hourly Settlement Period in Each Trading Day. All trading through the PX in the Day-Ahead Market and Hour-Ahead Market during each Trading Day *shall be settled and paid* on the fifteenth (15<sup>th</sup>) day of the calendar month succeeding the calendar month in which the Trading Day occurs or, if that is not a Business Day, on the next succeeding Business Day.

(Emphasis added). Petitioners contend that the highlighted language, along with other tariff provisions governing the monthly invoicing process, demonstrate that under the PX tariff, participant “liabilities” are “billed and settled” when the monthly invoices are paid, and thus, because petitioners have paid all their monthly invoices, their collateral should be returned. Constellation Br. at 18 and n. 10.

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<sup>7</sup> While petitioners cite this provision as PX Tariff Schedule 6, § 5.2, in the August 2000 version of the PX Tariff the quoted provision is PX Tariff Schedule 6, § 6.2.

Putting aside the fact that these tariff provisions were never cited to the Commission, they cannot be stretched to the lengths petitioners suggest. PX tariff Schedule 6, § 6.2 defines the “billing and payment process for Energy traded in the Day-Ahead Market and Hour-Ahead Market.” Likewise, the remaining tariff provisions cited concern aspects of the monthly billing and payment process. Constellation Br. at 18-19 and n. 10. There is no issue that, under normal circumstances, the monthly billing and payment process was intended to result in settlement of participant accounts. That does not mean, however, that the tariff did not anticipate, and allow for, circumstances in which participant liabilities are not finally settled in the monthly billing and payment process.

The PX operated only as an intermediary to facilitate transactions between buyers and sellers. *PG&E*, 95 FERC at 61,046 n. 17. In this capacity, it collected money from load serving entities that it then paid to sellers, acting solely as a conduit for those funds. *Id.* In this so-called “Clearinghouse Function,” the PX processed invoices for its Day-Ahead and Day-Of markets and for Block Forward Contracts, as well as ISO Real-Time market invoices. *See Powerex Complaint*, 03-1285 R. 1, Attachment 2, Appendix B at 4-7, JA 642-45. After the invoicing process was complete, participants who owed money were required to deposit those monies into a segregated Settlement Clearing Account. *Id.* at 5-6, JA 643-44. After

the PX determined that all monies billed had been received, the PX would first transfer its fees that had been billed into its operating accounts, and then distribute the remaining funds to other participants and the ISO. *Id.* at 6, JA 644. As a result, the Settlement Clearing Account would clear (have a zero balance) after all transactions had been completed. *Id.*

The PX tariff therefore contemplated that, under normal circumstances, participant accounts would be billed and cleared during the monthly billing and payment process. Indeed, this Clearinghouse Function was very routine and operated smoothly and as intended until PG&E and Edison defaulted on their payments. *Id.* at 5, JA 643. Following the defaults, however, there was no longer enough money in the Settlement Clearing Account to clear the billing cycle, and participant debits and credits began to accumulate. *Id.* at 6, JA 644. The PX had to create Account Summaries to track for each participant the balance due to or due from the PX Clearinghouse, because the PX could not longer track the cash for each billing cycle separately. *Id.*

Contrary to petitioners' view, *see* Constellation Br. at 18-21, 24, once the Settlement Clearing Account failed to clear properly, the PX tariff did not require that the PX treat accounts as "billed and settled" based on nothing more than the fact that a participant had paid monthly invoices issued to it. To the contrary, the

tariff expressly provides that collateral will be maintained for 100 percent of a participant's obligations under the tariff, and will be released or reduced only upon the PX's satisfaction that such obligations have been paid. Tariff § 18.3, on which petitioners rely, *see* Constellation Br. at 21, provides that, upon termination of a participant agreement, the PX will return monies or credit support to the participant only upon the PX's satisfaction that the PX Participant owes no amount under the tariff.<sup>8</sup> JA 126. Tariff § 2.4.1 provides that participant guarantees or other forms of credit support are "security for their payment obligations under this Tariff." JA 193. Tariff § 2.4.5 provides that a participant may obtain release of its collateral only if "the Participant is not then in breach of its obligations under this Tariff and will not owe, in relation to its trading through the PX, an amount that would exceed 100 % of the remaining credit support." JA 195.

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<sup>8</sup>Tariff § 18.3 provides:

A participation agreement may be terminated by either party upon written notice. The PX shall, within thirty (30) days of being satisfied that the PX participant who has terminated the participation agreement owes no amount under this Tariff, return or release to that PX Participant, as appropriate, any monies or credit support provided by the PX participant to the PX under Section 2.4 of this Tariff.

05-1094 R. 41 at 11, JA 779.

The PX tariff also expressly contemplates that disputes regarding participant liabilities may extend beyond payment of the regular invoices. Under tariff Schedule 6, § 8.3.1, PX participants are required to pay the charges on a final settlement statement, notwithstanding any dispute regarding the amount of such charges. JA 163. Schedule 9 of the tariff specifies the procedures to be used to resolve disputes arising under the PX documents, and, in § 1.1, preserves the rights of participants to file complaints with FERC concerning, *inter alia*, disputes regarding whether the rates and charges in the PX tariff are just and reasonable. JA 166.

Thus, while petitioners' arguments regarding the "context" of other PX tariff provisions, *see* Constellation Br. at 17, are jurisdictionally barred, it is nevertheless clear that the context of the tariff supports the Commission's interpretation of Schedule 2, § 2.2. *See, e.g., Ameren Services Co. v. FERC*, 330 F.3d 494, 501 n. 10 (D.C. Cir. 2003) (Commission may offer for the first time on appellate review argument that interpretation is consistent with overall reading of the document). The PX tariff contemplates that disputes regarding the rates charged could continue beyond the issuance of the final settlement statement, and requires that the PX retain collateral until it is satisfied that the participant owed nothing further under the tariff. The Court affords deference to the Commission's reasonable

interpretation of its tariffs on file. *See Natural Gas Clearinghouse*, 965 F.2d at 1070; *Long Island Lighting Co.*, 20 F.3d at 497.

Here, the Refund Proceeding was instituted for the precise purpose of determining what rates sellers could legally bill and what amounts are owed to and from each of the market participants. Constellation Complaint Order at P 28, JA 58. *See San Diego Gas & Electric Co.*, 96 FERC ¶ 61,120 at 61,520 (2001) (directing the administrative law judge “to make findings of fact with respect to: (1) the mitigated price in each hour of the refund period; (2) the amount of refunds owed by each supplier according to the methodology established herein; and (3) the amount currently owed to each supplier (with separate quantities due from each entity) by the ISO, the investor-owned utilities, and the State of California”). Only upon completion of that proceeding could the liabilities of each supplier be determined. Constellation Rehearing Order II at P 4, JA 76. Further, the Market Manipulation Proceedings produced evidence that various sellers, including Powerex, engaged in market manipulation, which might result in an expansion of Powerex’s refund liability beyond that awarded in the Refund Proceeding. Powerex Complaint Order at PP 25-26, JA 83; Powerex Rehearing Order at PP 12-13, JA 89. Under such circumstances, it was plainly reasonable for the Commission to interpret § 2.2 – which requires collateral sufficient to cover participant’s

“aggregate outstanding liabilities” – as requiring the collateral to be maintained while a dispute is pending regarding amounts charged, and therefore the petitioners’ accounts are not “billed and settled.”

**B. This Interpretation Comports With Standard Commercial Usage.**

Petitioners assert on brief the additional new argument that the Commission’s interpretation of “settled” is contrary to standard commercial usage, pointing to definitions of “settled” as closing an account by payment. Constellation Br. at 24-25. To the contrary, it would violate standard commercial practice to release collateral for a secured debt before that debt is discharged. Under standard commercial usage, an account with a balance that has not been ascertained remains an open account. 1 Am. Jur. 2d Accounts and Accounting § 4. Here, the Refund Proceeding commenced on August 2, 2000 with the filing of the San Diego Gas & Electric complaint. *See San Diego Gas & Electric Co.*, 96 FERC at 61,499. Therefore, long before the Constellation and Powerex complaints were filed (on February 25, 2002 and February 20, 2003 respectively), petitioners were aware of their potential refund liability with respect to their PX and ISO transactions, and therefore that the final balance of their accounts had not been ascertained.

In order to have even an “account stated” -- let alone a “settled” account -- there must be *mutual* agreement regarding the correct balance. 1 Am Jur 2d

Accounts and Accounting § 26. The primary factual issue in determining whether an account is stated is whether both parties intended the transaction to become a full and final settlement of the entire indebtedness represented by the account stated. *Id.* at § 51. Given the pendency of the Refund Proceeding, the parties knew that the price of petitioners' transactions may be reduced and refunds required, and therefore there could be no intent that the monthly settlement statements represent a full and final settlement of petitioners' indebtedness.

Only once an account stated has been obtained -- with mutual agreement as to a full and final settlement of petitioners' indebtedness -- *and* the amount agreed upon has been paid, can petitioners' accounts become "settled accounts." *Id.* at § 27. Further, a creditor has no obligation to return collateral assigned as security until the debt for which the collateral was assigned is discharged. 68A Am Jur 2d Secured Transactions § 488. Thus, under standard commercial usage, until there is final agreement on the amount owed, and payment of the entire amount owed, there is no "settled account" nor any obligation on the part of the PX to return participant collateral.

Indeed, the PX's creditworthiness requirements, including the collateral requirements, were expressly adopted to conform the PX policies to current industry creditworthiness standards. *California Power Exchange Corp.*, 92 FERC

at 61,376-77. The collateral requirements and the default chargeback mechanism were the result of a comprehensive review and stakeholder process, which included analysis and recommendations by an outside consultant, Andersen Consulting, and the opportunity for active participation by all PX participants in workshops, meetings, and communications before the provisions were even filed with the Commission for approval. 05-1094 R. 41 at 5, JA 773. Parties agreed to do business with the PX subject to tariff provisions that included standard financial protections. *California Independent System Operator Corp. v. Sellers of Energy and Ancillary Services*, 94 FERC ¶ 61,132 at 61,510 (2001) (rejecting efforts to lower creditworthiness standards). The Ninth Circuit found that the California Governor intruded upon federal authority by commandeering the investor-owned utilities' block forward contracts because "[t]he federal scheme established by FERC for transactions through the CalPX required 'standard financial protections' and 'assurance of payment for third party sales.'" *Duke Energy*, 267 F.3d at 1059 (quoting *California ISO*, 94 FERC at 61,510).

Thus, since adoption of the PX tariff creditworthiness requirements in 2000, participants have been on notice that their collateral would remain with the PX until transactions are settled. *California Power Exchange*, 98 FERC at 61,306 (Breathitt, C., dissenting in part). Since the filing of the San Diego Gas & Electric Complaint

in August 2000, participants have also known that the prices in the PX and ISO markets were subject to change, and therefore the transactions were not settled. Releasing the collateral before the transactions were settled would “undermine the safeguards put in place to ensure that parties are creditworthy. It is hard to imagine how the PX’s accounts will ever be settled if the parties that owe money to the PX no longer have collateral at risk.” *Id.* In these circumstances, the Commission’s tariff interpretation is fully consistent with the parties’ expectations and standard business practice.

**C. Enforcing The Collateral Provision Of The PX Tariff Is Not Contrary To Commission Precedent.**

Petitioners contend that the Commission’s orders requiring the PX to retain participant collateral until the participant’s liabilities are fully resolved are contrary to Commission precedent finding that parties are not required to post collateral for possible refund obligations absent extraordinary circumstances. Constellation Br. at 22 (citing *Columbia Gas Transmission Corp.*, 75 FERC ¶ 61,206 at 61,684 & n. 15 (1996); *Columbia Gas Transmission Corp.*, 57 FERC ¶ 61,271 at 61,869 (1991); *Distrigas of Mass. Corp.*, 33 FERC ¶ 61,406 at 61,776 (1985); *Duke Energy Moss Landing LLC*, 86 FERC ¶ 61,187 at 61,657 (1999)). In the cited cases, the

Commission denied requests for bonds or escrow requirements to secure refund obligations for rates that had been set for hearing.

Here, in contrast, petitioners voluntarily agreed to abide by the PX tariff, including its collateral requirements, as a condition of doing business with the PX. Constellation Complaint Order at P 5, JA 54; Powerex Complaint Order at P 5, JA 80. Accordingly, the Commission found the cited precedent inapposite here because the Commission was not requiring a guaranty for the payment of refunds, but rather enforcing the terms of the PX tariff regarding retention of collateral. Powerex Rehearing Order at P 14, JA 89. The PX tariff requires a participant to post collateral as security for potential defaults arising from the participant's failure to pay its outstanding liabilities to the PX, and its outstanding obligations are not extinguished until they are billed and settled. Powerex Complaint Order at P 27, JA 84; Constellation Complaint Order at P 27, JA 58. Accordingly, as Powerex's and Constellation's final billing and settlement have not yet taken place, the Commission found that the PX's retention of collateral is not inconsistent with the PX tariff or FERC precedent, a violation of the filed rate doctrine, or otherwise contrary to public policy. Powerex Complaint Order at P 27, JA 84; Constellation Complaint Order at PP 26-28, JA 57-58; Constellation Rehearing Order I at P 10, JA 71.

#### **IV. THE COMMISSION REASONABLY SET CONSTELLATION'S COLLATERAL REQUIREMENT AT \$10 MILLION.**

##### **A. The Commission Never Reversed Itself On Constellation's Alternative Request For A Partial Release Of Collateral.**

In its February 5, 2002 Complaint, Constellation sought full release of its collateral held by the PX or, in the alternative, release of all of its collateral in excess of the amount necessary to cover its maximum exposure in the Refund Proceeding. 02-1367 R. 1 at 20, JA 260. In the Constellation Complaint Order, the Commission rejected Constellation's request for release of all its collateral, finding that Constellation's account was not "billed and settled" and therefore the PX tariff required that Constellation maintain collateral. Constellation Complaint Order at P 27-28, JA 58. In that order the Commission did not, however, address Constellation's alternative argument that the collateral held should be reduced to that necessary to cover its potential refund liability. *See id.* at PP 6-10, JA 54-55 (describing Constellation's complaint, omitting its alternative request that its collateral be reduced).

Constellation sought rehearing on the ground that, *inter alia*, the Commission failed to consider its alternative argument for a partial release of collateral. 02-1367 R. 72 at 24-26, JA 406-08. In Constellation Rehearing Order I, the Commission considered this argument for the first time, and granted rehearing on this issue,

finding that Constellation must maintain collateral in the amount of \$10 million. Constellation Rehearing Order I at PP 13-14, JA 71. That figure, by the Commission's conservative estimate, would be sufficient to cover the potential refund liability resulting from Constellation's transactions in the PX and ISO markets. *Id.*

Thus, Edison errs in contending that the Commission in the Constellation Complaint Order rejected Constellation's alternative argument for a partial release of collateral, and then reversed itself without explanation in Constellation Rehearing Order I. Edison Br. at 31-32. Rather, the Commission failed to consider this issue in its initial order and, upon consideration, found that Constellation was not required to maintain collateral in excess of that necessary to cover its potential refund obligations. *See, e.g., Ameren*, 330 F.3d at 499 & n. 8 ("The very purpose of rehearing is to give the Commission the opportunity to review its decision before facing judicial scrutiny.")

**B. Constellation's Collateral Requirement Was Calculated In Accordance With The PX Tariff.**

In its Complaint, Constellation showed that it had paid its final invoice from the PX for its short-term PX Core market transactions, and its long-term PX Block Forward market contracts had expired. *See* 02-1367 R. 1 at 6, JA 246. Thus, its

only potential remaining liability arising from these transactions was its obligation to pay refunds. *Id.* at 20, JA 260. Accordingly, Constellation contended that, under the PX tariff, its collateral requirement should be no more than that necessary to cover its maximum potential refund exposure, which was currently estimated at \$3.7 million. *Id.* at 3, 15-16, 20, JA 243, 255-56, 260 (citing PX Tariff Schedule 2, § 2.2 requiring a participant to maintain “sufficient collateral to cover *its aggregate outstanding liabilities*”) (emphasis in Constellation Complaint). On September 20, 2002, the Commission granted Constellation’s request that its collateral requirement be limited to the amount required to cover Constellation’s potential refund liability in the Refund Proceeding. Constellation Rehearing Order I at P 14, JA 71.

Edison is incorrect, *see* Edison Br. at 30-31, that the Commission, in requiring that Constellation maintain only \$10 million in collateral, disregarded the method for calculating the collateral requirement prescribed by the PX tariff. The PX tariff only required a participant to “maintain sufficient collateral to cover its aggregate outstanding liabilities,” PX Tariff, Schedule 2, § 2.2, which, as Edison agrees, *see* Edison Br. at 26, includes Constellation’s refund liabilities. Because Constellation had no outstanding liabilities to the PX other than potential refund liabilities (because the PX had long ceased operations and Constellation had paid all of its bills), that section could not require Constellation to maintain collateral

beyond the amount necessary to cover those refund liabilities. As shown below, the required \$10 million was well in excess of Constellation's estimated refund liability.

The fact that Constellation had \$66.5 million in collateral posted with the PX at the time the PX ceased operations in 2001 is irrelevant to the issue of how much collateral Constellation should be required to maintain now. Under PX Tariff Schedule 2, §§ 2.3, 2.4 and 2.5, the amount of collateral that had to be maintained with the PX when its markets were active was based on a participant's market activities (quantities multiplied by the prices of its purchases). Once the market ceased operations, and Constellation was unable to make future purchases, nothing in those sections compelled Constellation to retain the same amount of collateral as it did when it was making purchases. Indeed, the PX tariff makes clear that a participant's collateral requirement should be reduced as its liabilities are reduced. *See* PX Tariff Schedule 2, § 2.5 (permitting PX participants to request distribution of excess collateral); PX Tariff § 18.3 (Upon termination of a participation agreement PX shall return monies or credit support "within thirty (30) days of being satisfied that the PX participant who has terminated the participation agreement owes no amount under this Tariff.").

**C. The Commission Provided Ample Justification For Setting Constellation's Collateral Requirement At \$10 Million.**

At the time of Constellation's complaint, the combined refund claims of the PX and the ISO against it equaled approximately \$3.7 million. 02-1367 R. 72 at 3, JA 385. Constellation's collateral retained by the PX, on the other hand, totaled \$66.5 million. Based upon Constellation's estimated refund liability, the Commission determined that Constellation should maintain collateral with the PX in the amount of \$10 million, which, by the Commission's conservative estimate, would be sufficient to cover Constellation's estimated refund liability resulting from Constellation's transactions in the PX and ISO markets. Constellation Rehearing Order I P 14, JA 71.

Edison and PG&E sought rehearing of this determination, arguing that the Commission had no evidence on which to base its determination. They also argued that the Commission failed to consider changes to the refund methodology proposed by Commission staff, and the production of additional evidence of market manipulation in the Market Manipulation Proceedings, which might increase Constellation's exposure. 02-1367 R. 89 at 2, JA 576; 02-1367 R. 88 at 3-4, JA 560-61.

However, while Edison and PG&E's requests for rehearing of Constellation Rehearing Order I were pending, Edison and PG&E protested a complaint filed by another energy marketer, PG&E Energy Trading-Power, L.P., also seeking release of collateral. *See* Motion to Intervene and Protest of Southern California Edison Company (January 6, 2003 Docket No. EL03-29, Accession No. 20030106-5030); Pacific Gas and Electric Company's Motion to Intervene and Protest (January 6, 2003 Docket No. EL03-29, Accession No. 20030106-5032). Edison reiterated its argument that no participant collateral should be released, but also argued that PG&E Energy should be distinguished from Constellation. *Unlike Constellation*, PG&E Energy would likely owe far more in refunds than the amount of its collateral. Edison Motion at 9. Although PG&E Energy's collateral equaled \$19 million and its potential refunds obligations to the PX were estimated at only \$716,546,<sup>9</sup> Edison pointed out that PG&E Energy's estimated refund liability to the ISO was approximately \$26 million. Edison Motion at 9. *See also* PG&E Motion at 3 (stating that the Commission limited the collateral to be held for Constellation "based on the unique circumstances of Constellation.")

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<sup>9</sup> *See* Complaint of PG&E Energy at 13 (Dec. 10, 2002 Docket No. EL03-29-000, Accession No. 20021211-0201).

On January 30, 2003, the Commission agreed with Edison and PG&E that no collateral of PG&E Energy should be released. *PG&E Energy Trading*, 102 FERC ¶ 61,091 at PP 14, 16. Accepting Edison and PG&E's arguments, the Commission distinguished the result reached in *Constellation* on the ground that the refunds claimed to be owed by Constellation for both PX and ISO transactions [approximately \$3.7 million] were several times less than the amount of collateral Constellation was required to leave with the PX [\$10 million]. *Id.* at P 16. In contrast, PG&E Energy's potential refund liability for both PX and ISO transactions [approximately \$27 million] substantially exceeded the total amount of collateral it had posted [\$19 million]. *Id.*

Similarly, Edison and PG&E protested Powerex's February 20, 2003 Complaint seeking release of its collateral. 03-1285 R. 8, 9, JA 709, 725. PG&E argued that the Commission should distinguish Powerex from Constellation based upon the same reasoning the Commission used in *PG&E Energy Trading*. 03-1285 R. 8 at 5-6, JA 713-14. PG&E argued that, *unlike Constellation*, Powerex's own estimated refund liability was \$178 million, far in excess of its \$67 million in retained collateral, and likely to increase due to allegations in the Market Manipulation Proceedings. *Id.* The Commission agreed with Edison and PG&E that none of Powerex's \$67 million in collateral should be released where Powerex

owed approximately \$178 million in the Refund Proceeding, and other pending proceedings threatened to further increase Powerex's refund liability. Powerex Complaint Order at P 10, JA 81. Indeed, Powerex's estimated refund liability was premised upon a range of issues that were subject to challenge, and therefore Powerex's potential refund liability could far exceed its collateral and, in fact, far exceed any amounts purportedly owed to Powerex by the PX. Powerex Rehearing Order at n. 11, JA 89.

Accordingly, in Constellation Rehearing Order II, the Commission rejected Edison's and PG&E's contention that requiring Constellation to maintain \$10 million in collateral was based on no evidence. Constellation Rehearing Order II at P 10, JA 76. The Commission noted that the potential refund calculations, on which the \$10 million number was based, were available in the public, redacted version of Constellation's filing. *Id.* Taking into account the fact that the estimated refunds might increase as a result of proposed changes to the refund methodology, the Commission "used the most conservative estimates" and concluded that \$10 million of collateral would be sufficient to cover Constellation's potential refund liability. *Id.* The Commission contrasted its decisions requiring the retention of all collateral in *PG&E Energy Trading*, 102 FERC ¶ 61,091; the Powerex Complaint Order; and *La Paloma Generating Co., LLC*, 110 FERC ¶ 61,386 (2005), because

the specific facts of those cases did not warrant the release of collateral, where potential refund liability exceeded the PX collateral. Constellation Rehearing Order II at P 14, JA 77.

Thus, the Commission did not arbitrarily select \$10 million as Constellation's collateral requirement as Edison and PG&E contend. Rather, it rather selected that number as a multiple of Constellation's reasonably estimated refund liability, as a means of assuring collateral for potential increases in refund liability as a result of, *inter alia*, any change in the Commission's refund methodology. Constellation Rehearing Order II at P 10, JA 76. Claiming that the Commission "cited no record evidence" and engaged in "mere speculation," Edison Br. at 28, 30, simply ignores this evidence in the record and the Commission's express reference to it as the basis for its determination. For this reason, Edison's reliance, *id.* at 29-30, on cases such as *City of Centralia, Washington v. FERC*, 213 F.3d 742 (D.C. Cir. 2000), and *Bangor Hydro-Electric Co. v. FERC*, 78 F.3d 659 (D.C. Cir. 1996), is misplaced. Further, Edison and PG&E also ignore their own representations in *PG&E Energy Trading* and *Powerex*, in which the Commission agreed to their proposed distinction between Constellation and the other marketers, allowing Constellation, unlike the other marketers, to recover a portion of its collateral held by the PX when sufficient collateral remained to cover Constellation's potential refund liabilities.

**D. Edison And PG&E's Objections To The Commission's Analysis Are Without Merit.**

Edison and PG&E fault the Commission's determination that Constellation should maintain \$10 million in collateral for failure: (1) to consider the effects of the revision of the refund methodology to reflect a new gas price proxy, Edison Br. at 36; (2) to consider potential expansion of refund liability as a result of the submission of additional evidence in the Market Manipulation Proceedings, *id.*; and (3) to consider the potential impact on refunds of the Ninth Circuit's decision in *California ex rel. Lockyer v. FERC*, 383 F.3d 1006 (9<sup>th</sup> Cir. 2004) ("*Lockyer*"), *reh'g pending*, No. 02-73093. Edison Br. at 37.

The first objection lacks merit because the Commission expressly considered "the fact that potential refunds may increase as a result of the proposed changes to the refund methodology." Constellation Rehearing Order II at P 10, JA 76. Taking this potential increase in liability into account, the Commission concluded that the \$10 million in collateral would be sufficient even under the "most conservative estimates," *id.*, as it was several times Constellation's estimated refund liability. *See PG&E Energy*, 102 FERC ¶ 61,091 at P 16 (distinguishing treatment of Constellation). The Commission's reasonable prediction regarding the potential magnitude of increases to Constellation's estimated refund liability, arising out of

matters pending before the Commission, should be afforded deference. *See, e.g., Process Gas Consumers Group v. FERC*, 292 F.3d 831, 838 (D.C. Cir. 2002).

The second issue lacks merit because, by the time the Commission issued Constellation Rehearing Order II on May 5, 2005, there was no need to consider potential increases to Constellation's refund liability arising from the Market Manipulation Proceedings. In response to the allegations raised and evidence submitted in that proceeding, the Commission established a series of show cause proceedings against various sellers of energy (including Constellation) in dockets separate from the Refund Proceeding. *Enron Power Marketing, Inc., et al.*, 103 FERC ¶ 61,346 (2003). After investigation, the Commission ultimately dismissed Constellation with no finding of wrongdoing or imposition of refunds or penalties. *See Colorado River Commission, et al.*, 106 FERC ¶ 61,022 (2004). Following that decision -- which preceded Constellation Rehearing Order II by more than a year -- there was no need to consider any additional refund exposure to Constellation arising from the Market Manipulation Proceedings.

In contrast, the Commission did consider potential liability arising from the Market Manipulation Proceedings in the Powerex Complaint orders, as allegations of market manipulation were still pending against Powerex. *See Powerex Complaint Order at PP 25-26, JA 83; Powerex Rehearing Order at PP 12, 13, JA 89.*

This fully explains why the Commission considered potential liability arising from the Market Manipulation Proceedings in Powerex, while it did not in Constellation Rehearing Order II. *See* Edison Br. at 39-40.

On the third issue, *Lockyer* issued on September 9, 2004, after Edison and PG&E had filed for rehearing of Constellation Rehearing Order I, and the *Lockyer* decision was never raised to the Commission on rehearing for its consideration. Accordingly, consideration of Edison's and PG&E's arguments regarding *Lockyer* are barred.

In any event, the Commission would have had no need to consider any potential increase in refund liability arising from *Lockyer* with regard to Constellation. On April 22, 2002, Constellation entered into a settlement with the State of California that resolved a number of pending litigations, one of which was the underlying Commission proceeding (Docket No. EL02-71) that was appealed to the Ninth Circuit and resulted in the *Lockyer* decision. As a result of this settlement, the California Attorney General (*i.e.*, Bill Lockyer) agreed "to withdraw with prejudice, as to the Constellation California Entities only, the AG Complaint."<sup>10</sup> In accordance with this agreement, the State of California *ex rel* Bill

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<sup>10</sup> Constellation's settlement with Bill Lockyer and the State of California can be found in the California Department of Water Resources website at

Lockyer filed a Notice with FERC in Docket No. EL02-71 on May 6, 2002 to withdraw its complaint in that proceeding as it applied to Constellation.<sup>11</sup> On May 31, 2002, FERC issued an order in Docket No. EL02-71 in which it, among other things, granted the withdrawal of Constellation as a Respondent in that proceeding “with prejudice.” *State of California ex rel. Bill Lockyer v. British Columbia Power Exchange Corp.*, 99 FERC ¶ 61,247 at 62,061 (2002). Therefore, nearly three years prior to Constellation Rehearing Order II, Constellation had been dismissed with prejudice from the *Lockyer* proceeding before the Commission.

**V. THE COMMISSION REASONABLY REQUIRED RETENTION OF THE \$15 MILLION IN CHARGEBACK PAYMENTS PENDING RESOLUTION OF THE REFUND PROCEEDING.**

Complaints were filed in three Commission dockets challenging the PX’s implementation of chargeback procedures in response to the massive defaults of Edison and PG&E. *See supra* pp. 20-23 (describing chargeback mechanism).

PG&E owed the PX approximately \$1.7 billion while Edison owed approximately \$820 million (excluding interest), and the PX owed approximately \$520 million to

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[http://www.cers.water.ca.gov/pdf\\_files/power\\_contracts/high\\_desert/042202\\_cnstln\\_hghdsrt\\_set\\_agmt.pdf](http://www.cers.water.ca.gov/pdf_files/power_contracts/high_desert/042202_cnstln_hghdsrt_set_agmt.pdf). The relevant provision of this settlement is Section 4.4 (pages 6-7).

<sup>11</sup> “Notice of Partial Withdrawal with Prejudice of Complaint as to Constellation Power Source, Inc.,” Docket No. EL02-71 (filed May 6, 2002, Accession No. 20020506-5010).

participants and \$2.4 billion to the ISO. Chargeback Order at P 20, JA 105. All complaints asserted that implementation of the chargeback mechanism in these circumstances would irreparably injure PX participants. Chargeback Order at PP 8-10, JA 103.

The Commission agreed that, while it had approved the PX chargeback mechanism, assessment of the chargebacks under the circumstances of the California energy crisis would cause virtually all PX participants to default, thereby compounding adverse market conditions throughout the entire Western region. *PG&E*, 95 FERC at 61,040. Accordingly, the Commission directed the PX to rescind all prior chargeback actions related to PG&E's and Edison's liabilities and refrain from taking any future chargeback actions related to PG&E's and Edison's liabilities. *Id.* at 61,045.

In response, the PX created Account Summary forms to provide participants with a summary of their account status, reflecting account activities since January 2001. Chargeback Order at P 31, JA 106. The PX reversed the chargeback invoices on all participant account summaries. *Id.* at P 32, JA 106. Petitioners assert that the PX is required to immediately refund \$15 million in chargeback receipts collected in cash based upon the fact that the Commission had required the

PX to “rescind” the chargeback transactions. Constellation Br. at 29 (quoting *PG&E*, 95 FERC at 61,040).

However, some chargebacks did not result in payments of cash, but rather in a reduction in the dollar amount of payments made by the PX to market participants. Chargeback Order at n. 1, JA 102. While the PX had collected approximately \$15 million in direct payments from 26 PX participants on chargeback invoices, Chargeback Order at P 32, JA 107, it had at the same time distributed to PX participants and the ISO approximately \$385 million on account of prior sales into markets administered by the PX, which distributions were based on allocations including the chargeback methodology. Chargeback Order at P 20, JA 105.

Mirant Americas Energy Marketing, L.P., Mirant California, LLC, Mirant Delta, LLC and Mirant Portero LLC charged that immediate release of the chargeback cash payments would discriminate against those participants that paid their chargeback shortfall allocations through receiving less money from the PX, rather than paying the chargeback shortfall allocation directly. Chargeback Order at P 24 n. 15, JA 105. *See* 05-1094 R. 87, JA 819. As the Mirant entities explained, when Edison defaulted in January 2001, its shortfall was allocated to market participants based on the gross sales methodology approved by the Commission in

July 2000. 05-1094 R. 87 at 4, JA 822. Where a participant had net amounts owed to it by the PX during the applicable billing cycle, its share of the shortfall was netted against its gross receipts and, accordingly, it was simply paid less than it was owed based on its sales to the PX. *Id.* Where, however, a participant was not due, on net, any funds from the PX during that billing cycle, the participant was issued a shortfall invoice requiring the participant to directly pay the PX for its share of Edison's default. *Id.*

These two types of participants – those who paid their shortfall allocation directly and those who paid through receiving less money from the PX – both lost money as a result of Edison's default. *Id.* Nevertheless, the immediate distribution of the chargeback cash collected would result in those who paid directly receiving full reimbursement without similarly returning the shortfall payments made to PX participants through offsets of their net receivables. *Id.* Further, those required to await completion of the Refund Proceedings might receive only a partial recovery of their offsets while those paying directly would receive full reimbursement. *Id.* at 5, JA 823. Under these circumstances, the Mirant entities contended that all parties who suffered shortfall allocations should be treated in an equitable manner. *Id.* See Chargeback Order at P 24 n. 15, JA 105.

The Commission thus declined to find that, by failing to return immediately the \$15 million in cash payments, the PX was in violation of the Commission's order to rescind the chargeback transactions. Chargeback Order at PP 44, 47, JA 109; Chargeback Rehearing Order at PP 5-6, JA 112. The PX had rescinded the chargebacks by reversing the chargeback invoices on all participant account summaries. Chargeback Order at PP 31-32, JA 106-07.

The Commission determined instead that the \$15 million in chargeback cash should be retained by the PX as a potential offset to participant's refund liability, with any excess amount returned at the conclusion of the Refund Proceeding. Chargeback Rehearing Order at P 7, JA 112. The Commission found that this treatment would assure that those who paid their chargeback through receiving a reduced payment from the PX will be treated similarly to those who paid the chargeback in cash. Chargeback Order at P 47 n. 30, JA 109; Chargeback Rehearing Order at PP 3, 6, JA 112.

Petitioners contend that it was unlawful for the Commission to permit the PX to retain the chargeback cash, citing *Public Utils. Comm'n v. FERC*, 143 F.3d 610, 617-18 (D.C. Cir. 1998). Constellation Br. at 29. However, the Federal Power Act does not mandate that the Commission award refunds. *See Towns of Concord*, 955 F.2d at 72. Rather, the Commission has remedial discretion, "even in the face of an

undoubted statutory violation.” *Connecticut Valley*, 208 F.3d at 1044 (citing *Towns of Concord*, 955 F.2d at 72-73, 76 n. 8). The Court generally defers “to FERC’s decisions in remedial matters, respecting that the difficult problem of balancing competing equities and interests has been given by Congress to the Commission with full knowledge that this judgment requires a great deal of discretion.” *Koch Gateway*, 136 F.3d at 816 (internal quotation marks omitted). As a result, the Court does not ordinarily interfere with FERC’s exercise of its discretion so long as the agency’s determination has a rational basis. *Id.*

Here, the Commission has not denied refunds; every participant account has been adjusted to rescind the chargeback invoices. Thus, the question is not whether the Commission can deny refunds of chargeback payments, but whether the Commission abused its discretion in treating all participants who were subject to chargeback invoices equally rather than providing relief to those who paid cash in advance of those whose payments from the PX were reduced by chargeback amounts.

Given the rational grounds for the Commission’s decision and the considerable breadth of its discretion with regard to remedies, the Commission’s chargeback orders should be affirmed. *See Louisiana PSC v. FERC*, 174 F.3d 218, 224 (D.C. Cir. 1999) (recognizing that “when a federal court of appeals reviews an

administrative agency's choice of remedies to correct a violation of a law the agency is charged with enforcing, the scope of judicial review is particularly narrow") (quoting *National Treasury Employees Union v. FLRA*, 910 F.2d 964 (D.C. Cir. 1990) (*en banc*)). Indeed, "the breadth of agency discretion is, if anything, at [its] zenith when the action assailed relates primarily not to the issue of ascertaining whether conduct violates the statute, or regulations, but rather to the fashioning of policies, remedies and sanctions . . . in order to arrive at maximum effectuation of Congressional objectives." *Niagara Mohawk Power Corp. v. FPC*, 379 F.3d 153, 159 (D.C. Cir. 1967).

## CONCLUSION

For the reasons stated, the Commission's orders should be affirmed in all respects.

Respectfully submitted,

Robert H. Solomon  
Solicitor

Lona T. Perry  
Senior Attorney

Federal Energy Regulatory  
Commission  
Washington, D.C. 20426  
TEL: (202) 502-6600  
FAX: (202) 273-0901

March 24, 2006

**CERTIFICATE OF COMPLIANCE**

In accordance with Fed. R. App. P. 32(a)(7)(C)(i), and this Court's order of November 14, 2005 specifying that Respondent's Brief is not to exceed 20,000 words, I certify that the Brief of Respondent Federal Energy Regulatory Commission contains 14,606 words, not including the tables of contents and authorities, the glossary, the certificates of counsel and the addendum.

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Lona T. Perry  
Attorney for Federal Energy  
Regulatory Commission