

Energy Regulatory Alert

Court of Appeals Again Upholds FERC's Market-Based Rate Policy

October 18, 2011

On October 13, 2011, the United States Court of Appeals for the 9th Circuit [denied the petition](#) of Montana Consumer Counsel; Public Citizen, Inc.; the Colorado Office of Consumer Counsel; Public Utility Law Project of New York, Inc.; and the state attorneys general for Connecticut, Illinois and Rhode Island (collectively, "Petitioners"), making a facial challenge to the Federal Energy Regulatory Commission's (FERC or "Commission") Order No. 697, finding that the Commission's market-based rate policy embodied in Order No. 697 does not exceed its authority as conferred by the Federal Power Act (FPA).¹

The Petitioners claimed (i) that the Commission, by relying solely on the market to regulate rates, has violated its obligation under the FPA to ensure "just and reasonable" rates;² and (ii) that the Commission's market-based rate policy, which allows sellers to file a market-based rate and does not require sellers to give 60 days' advance notice of changes in market prices, violates the terms of the FPA.³ However, the court found that the Commission's policy in Order No. 697 does not violate its obligation to ensure just and reasonable rates or the FPA's notice requirement.

In response to the Petitioners' first claim—that "FERC cannot outsource its regulatory duties to the 'Invisible Hand' of the market"—the court rejected each of Petitioners' reasons why reliance on the market fails to ensure just and reasonable rates.⁴

First, the court rejected Petitioners' claim that the Commission has an additional obligation, beyond screening individual sellers for market power, to assess the overall competitiveness of the market. The court found that the Commission need not evaluate the competitiveness of the market as a whole because, as the court previously found in the *Lockyer* case, "where neither buyer nor seller has significant market power, it is rational to assume that the terms of their voluntary exchange are reasonable, and specifically to infer that the price is close to marginal cost, such that the seller makes only a normal return on its investment."⁵

Second, the court rejected the Petitioners' argument that the Commission must conduct an "empirical analysis" or offer "substantial evidence" that competition among sellers will drive rates to reasonable levels. The court notes that *Tejas*, the D.C. Circuit opinion on which Petitioners' rely for this argument, did not require the Commission to prove that competition necessarily results in reasonable rates.⁶ Rather, the D.C. Circuit held in *Tejas* that "if buyers and sellers did not have market power, it would be 'rational to assume that the terms of their voluntary exchange are reasonable.'"⁷

¹ *Montana Consumer Counsel v. FERC*, Nos. 08-71827, *et al.* (9th Cir. Oct. 13, 2011).

² See 16 U.S.C. § 824d (2010).

³ See 16 U.S.C. § 824d(d) ("Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after sixty days' notice to the Commission and to the public.").

⁴ *Montana Consumer Counsel v. FERC*, Nos. 08-71827, *et al.*, slip op. at 3.

⁵ *California ex rel. Lockyer v. FERC*, 383 F.3d 1006, 1013 (9th Cir. 2004).

⁶ *Tejas Power Corp. v. FERC*, 908 F.2d 998 (D.C. Cir. 1990).

⁷ *Id.* at 1004-05.



Furthermore, the court noted that, even without a requirement to offer “substantial evidence,” the Commission has provided evidence to support its policy by adopting a rigorous screening process to detect market power.

Third, the court rejected Petitioners’ claim that the reporting requirements adopted by the Commission in Order No. 697, which (i) require authorized sellers to file updated market power analyses only every three years, and (ii) allow an exemption from filing for Category 1 sellers, are much less stringent than the reporting requirement approved in *Lockyer*, which assumed market-rate sellers would file every four months.⁸ The court noted that the Commission has “broad discretion to establish effective reporting requirements” and found that the triennial reporting requirement and Category 1 exemption are “not so substantial that they invalidate the policy we generally approved in *Lockyer*.”⁹

Fourth, in response to the Petitioners’ claim that Order 697 is deficient because, under that order, the Commission will review reports and data only to determine whether sellers have market power and not for whether the rates are, in fact, just and reasonable, the court held that the law permits the Commission’s approach. Specifically, the court held, “[w]here sellers do not have market power or the ability to manipulate the market (alone or in conjunction with others), it is not unreasonable for FERC to presume that rates will be just and reasonable.”¹⁰

Finally, the court held that use of market-based rates does not violate the FPA requirement that a utility file any change in rates 60 days in advance. Petitioners argued that, because the market price will fluctuate in ways that are unforeseeable, approval of market-based rates does not provide sufficient notice of actual prices. The court held that the “rate” filed by authorized power wholesalers is, in fact, the “market rate,” which does not “change” even though the prices charged may rise and fall with the market.¹¹

In sum, the court held, as it had in evaluating the earlier market-based rate regime in *Lockyer*, that Order No. 697 does not, on its face, violate the Commission’s obligation to ensure just and reasonable rates or the FPA’s notice requirement and, accordingly, that Order No. 697 does not violate the FPA. In so holding, the court recognized that the Supreme Court had not ruled with respect to the legality of the Commission’s market-based tariff system and had explicitly left that issue open in a recent opinion.¹² However, the court rejected the suggestion that the Supreme Court’s mention of the issue in any way undermined the vitality of the *Lockyer* opinion or the court’s duty to follow *Lockyer*.¹³

In closing, the court noted that the policy issues raised in the petition are of “exceptional importance” and that the court’s decision necessarily was limited to the legal issue of whether or not the Commission’s market-based rate rules violate the FPA, not “whether we think market based rates are a good idea.”¹⁴ The court also left open “the possibility that Petitioners or other parties will succeed in an as-applied challenge to FERC’s implementation of the order.”¹⁵

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⁸ *Lockyer*, 383 F.3d at 1013.

⁹ *Montana Consumer Counsel v. FERC*, Nos. 08-71827, *et al.*, slip op. at 5.

¹⁰ *Id.* at 6.

¹¹ *Id.* at 8.

¹² *Id.* at 7 (citing *Morgan Stanley Capital Grp. v. Pub. Util. Dist. No. 1 of Snohomish Cnty., Wash.*, 554 U.S. 527, 538).

¹³ *Id.*

¹⁴ *Id.* at 9.

¹⁵ *Id.*