

ORAL ARGUMENT NOT YET SCHEDULED

**Case Nos. 05-1402, 06-1246
(Consolidated)**

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

**CITY OF VERNON, and
TRANSMISSION AGENCY OF NORTHERN CALIFORNIA, *et al.***

Petitioners,

v.

**FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.**

**JOINT REPLY BRIEF
FOR INTERVENOR/AMICI IN SUPPORT OF PETITIONERS**

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GLOSSARY

CAISO	California Independent System Operator Corporation
FERC	Federal Energy Regulatory Commission
ISO	Independent System Operator
MAPP	Mid-Continent Area Power Pool
SUPPORTING INTERVENORS	Southern California Edison Company, California Independent System Operator Corporation, California Electricity Oversight Board and Pacific Gas and Electric Company
TCA	Transmission Control Agreement
TRR	Transmission Revenue Requirement

SUMMARY OF ARGUMENT

FERC defends its decision to order Vernon, a non-jurisdictional utility, to make refunds on grounds that the refund obligation arises from a contract that is subject to its jurisdiction and that, since Vernon “freely entered” into it, FERC can enforce that obligation. FERC Br. at 37. But this argument runs headlong into FERC’s twin concessions: it has no jurisdiction to regulate Vernon’s rates; and Vernon cannot “volunteer” for FERC rate jurisdiction. *Id.* at 32. FERC also correctly acknowledges that, under this Court’s decision in *Columbia Gas Transmission Corp. v. FERC*, 404 F.3d 459 (D. C. Cir. 2005), it “could not assert Natural Gas Act jurisdiction over provisions in an *otherwise* jurisdictional natural gas transmission tariff purporting to regulate statutorily-exempt natural gas gathering facilities.” *Id.* at 31. (emphasis added). For the same reason, FERC cannot order a non-jurisdictional entity like Vernon to make refunds even if Vernon has agreed to add a refund obligation to an “*otherwise* jurisdictional” contract.

FERC’s contention that *Columbia* must be read “in harmony with *PG&E*”¹ gains it no ground. This court’s decision in *PG&E* did not give FERC authority to regulate non-jurisdictional utilities. Rather, it reaffirmed long settled precedent describing FERC’s responsibility to consider non-jurisdictional cost factors in

¹ *Pacific Gas and Electric Co. v. FERC*, 306 F.3d 1112 (D. C. Cir. 2002).

setting jurisdictional rates - - in this case the rates charged by the California ISO. FERC might well conclude that the cost of Vernon's transmission, like any other non-jurisdictional component of the ISO's costs, was too high, but its authority extends only to adjusting the ISO's rates, not to regulating the non-jurisdictional cost components of those rates and ordering associated refunds.

Whether or not the ISO has a contractual claim against Vernon for refunds is not an issue this court need reach. FERC itself held in *Mid-Continent Area Power Pool*, 89 FERC ¶ 61,135 at 61,387-88 (1999) (*MAPP*) that addressing a non-jurisdictional utility's contractual obligations to make refunds was outside its responsibility and authority. On brief, FERC tellingly makes no effort to distinguish *MAPP* from the instant case.

FERC and Supporting Intervenors claim that there are instances where the Commission has indeed regulated the rights of non-jurisdictional utilities under FERC-filed tariffs and contracts. But their examples illustrate solely FERC's undisputed authority to regulate the terms and conditions of jurisdictional service provided *to* non-jurisdictional utilities. None involve instances where FERC has attempted to regulate the rates or terms of service provided *by* non-jurisdictional entities.

Finally, Supporting Intervenors invoke this Court's recent decision in *National Ass'n of Regulatory Utility Commissioners v. FERC*, 2007 WL 79054

(D. C. Cir. Jan. 12, 2007) referencing FERC’s position that its regulation of jurisdictional services may lawfully have “*incidental* effects on non-jurisdictional entities.” They cite that observation as support for FERC’s action in this case. But while an agency’s regulation of jurisdictional entities may have an incidental effect on unregulated ones, it cannot directly regulate the rates of non-jurisdictional entities. In this case FERC’s command that Vernon provide refunds could not have been more direct.

ARGUMENT

A. A Non-Jurisdictional Utility Cannot Volunteer To Be Regulated, Whether Or Not Its Agreement To Accept FERC Regulation Is Embodied In An Otherwise Jurisdictional Contract.

In defense of its directive that Vernon make refunds, FERC argues that “...unlike in cases cited by Vernon, a non-jurisdictional party specifically agreed to comply with a FERC refund order in a jurisdictional contract.” FERC Br. at 19. This echoes FERC’s holding in Opinion No. 479-A² at P 79 that “Vernon’s obligation to make refunds in this proceeding *does not arise from any statutory requirement*, but from [Vernon’s] contractual obligation” (emphasis added).

² *City of Vernon, California, et al.*, 112 FERC ¶ 61,207 (2005) (Opinion 479-A).

FERC's position is fundamentally wrong. Its jurisdiction to compel refunds *is* statutory and cannot be conferred upon the Commission by contract.³

The flaws in FERC's formulation are found in its own brief. FERC concedes that it lacks jurisdiction over the rates municipal utilities charge (FERC Br. at 32). It further concedes that non-jurisdictional utilities cannot waive limitations on FERC's authority "by volunteering for jurisdiction." *Id.* If FERC's order that Vernon make refunds derives from Vernon's "contractual obligation" and "does not arise from any statutory requirement" FERC is, by definition, acting beyond its authority.

FERC attempts to reconcile the orders on review and its concessions regarding the statutory limits of its authority with the following argument: Vernon's refund obligation is included in "an FPA-jurisdictional agreement" (FERC Br. at 19) and overturning FERC's refund order would therefore restrict FERC's exercise of its authority. *Id.* "Vernon," FERC maintains, "freely entered into a contract which was subject to FPA jurisdiction and approved by the Commission, holding it liable for any refunds ordered by the Commission." *Id.* at 37. The intervenors supporting FERC (Supporting Intervenors) advance a similar

³ Had FCC based its refund order on Section 205, it would still have lacked authority to order refunds. Even if Vernon were a jurisdictional utility, its TRR was for a new service to a new customer and, under Section 205, FERC cannot order refunds of initial rates for new services. *Middle South Energy Services, Inc. v. FERC*, 747 F.2d 763, 772 (D.C. Cir. 1984).

argument: “Because the Agreement is a FERC-jurisdictional rate schedule, FERC can determine the rights and obligations of the parties to the Agreement.”

Supporting Intervenor Br. at 3.

The obvious problem with FERC’s argument is what it has already conceded: a party cannot volunteer to be regulated by FERC. Indeed, FERC’s assertion that Vernon “freely entered into the contract” runs headlong into this Court’s decision in *Columbia Gas Transmission Corp. v. FERC*, 404 F.3d 459 (D. C. Cir. 2005). FERC is correct when it says that *Columbia* “held that the Commission could not assert Natural Gas Act jurisdiction over provisions *in an otherwise jurisdictional* natural gas transmission tariff purporting to regulate statutorily-exempt natural gas gathering facilities.” FERC Br. at 31 (emphasis added). For the same reason, Vernon cannot volunteer to accept the Commission’s refund jurisdiction, even as part of an “otherwise jurisdictional” agreement.

Supporting Intervenor similarly argue that “FERC has the authority to determine the rights and obligations of all parties to a contract over which it has jurisdiction.” Supporting Intervenor Br. at 4. But the notion that FERC could determine the contractual rights of *any* party to a FERC-jurisdictional agreement, regardless of the nature of the contractual provision, would read the jurisdictional exemptions for municipal and foreign utilities right out of the statute. FERC has itself acknowledged that it requires public utilities to file their agreements to

exchange power with non-jurisdictional utilities only because it has authority over the jurisdictional sales that public utilities make under those agreements. *See Prior Notice and Filing Requirements Under Part II of the Federal Power Act*, 64 FERC ¶ 61,139 at 61,992 (1993). That authority plainly does not give the Commission power to regulate non-jurisdictional sales that happen to be made under those same exchange agreements.

The breadth of Supporting Intervenors' argument, if accepted, would extend FERC's jurisdictional reach to *any* activity covered by an otherwise jurisdictional contract. Suppose, for example, that a municipality entered a contract to purchase transmission service from a regulated utility and also agreed, in the same contract, to supply the utility with garbage collection services. By their logic FERC could even regulate these non-utility services. As with FERC, Supporting Intervenors' position runs directly afoul of this court's holding in *Columbia* that adding non-jurisdictional obligations to a jurisdictional contract or tariff cannot thereby empower FERC to regulate non-jurisdictional services or entities.

B. This Court’s Decision In *PG&E v. FERC* Did Not Give FERC Authority To Regulate Non-Jurisdictional Utilities, It Simply Reaffirmed Long Settled Precedent Describing FERC’s Responsibility To Consider Non-Jurisdictional Cost Factors In Setting Jurisdictional Rates.

FERC attempts to avoid the implications of *Columbia* by asserting that *Columbia* must still be “read in harmony with *PG&E*.”⁴ FERC Br. At 32. *PG&E*, it notes, had accepted FERC’s authority to “review[] Vernon’s filing in order to comply with its jurisdictional mandate to review the *California ISO’s* jurisdictional rate.” *Id.* (emphasis added). But FERC’s response is its own rejoinder. *PG&E* did permit FERC’s review of Vernon’s transmission changes to the ISO “to the extent necessary to ensure that the *CAISO’s* rates are just and reasonable.” *PG&E*, 306 F.3d at 1116 – 1117 (emphasis added). In this respect, *PG&E* reaffirms the long-settled proposition that, in determining a *jurisdictional* utility’s just and reasonable rate FERC is empowered, and may even be obligated to *review* non-jurisdictional factors related to or affecting the jurisdictional rate. *See FPC v. Conway Corp.*, 426 U.S. 271, 276-78, 280 (1976); *Panhandle Eastern Pipe Line Co. v. FPC*, 324 U.S. 635, 647 (1945). *PG&E* does not remotely suggest, however, that FERC could then go on to regulate the rates of a non-jurisdictional entity. Nor could it, if *PG&E* and *Columbia* are to be read “in harmony.”

⁴ *Pacific Gas and Electric Co. v. FERC*, 306 F.3d 1112 (D.C. Cir. 2002).

But in this case FERC did not simply review Vernon's transmission revenue requirements in order to set the *California ISO's* rates. It went much farther, ordering Vernon, a non-jurisdictional entity, to make refunds. As this court noted in *PG&E* at 1116, "the TRR of each participating transmission owner can be conceptualized not as its own rate but rather *as a cost of the CAISO.*" (emphasis added). FERC could determine whether Vernon's TRR or, for that matter any of the CAISO's other cost components were excessive, but its authority is limited to reducing the *ISO's* rates to a just and reasonable level.⁵ FERC might conclude that the ISO has paid too much, for example, for pencils or stationery, but it cannot order the non-jurisdictional seller of these supplies to make refunds -- it can only order the ISO to reduce *its* rates.⁶

FERC's attempt to distinguish this case from *Bonneville Power Administration v. FERC*, 422 F.3d 908 (9th Cir. 2005) (*BPA*) is equally unavailing.

⁵ To be sure, a FERC order disallowing ISO expenses for some good or service as unreasonable might pressure the vendor to lower its price *in the future* to retain the ISO's patronage, but FERC could not order the vendor to make refunds of its past charges to the ISO.

⁶ Supporting Intervenors also make the argument that somehow this court's decision in *PG&E* already disposed of the question whether FERC could order refunds from Vernon. As they put it, "PG&E established FERC's legal authority and responsibility to review and revise Vernon's TRR as necessary to ensure that the CAISO Access Charge is just and reasonable." Supporting Intervenors Br. at 14. But like FERC, Supporting Intervenors confuse FERC authority to assess the reasonableness of the California ISO's charge, including the reasonableness of the amounts it pays to Vernon, with the authority to regulate the rates that Vernon itself charges.

FERC asserts that, in this case, “unlike the parties in *Bonneville Power*, Vernon is specifically contractually obligated to make the refund here.” FERC Br. at 36. Even if the distinction were valid,⁷ it would be irrelevant. FERC maintains that “Vernon freely entered into a contract, which was subject to FPA jurisdiction and approved by the Commission, holding it liable for any refunds ordered by the Commission.” FERC Br. at 37. But as explained above, FERC does not acquire authority to regulate non-jurisdictional provisions of a jurisdictional contract, whether or not “freely entered.”

C. Vernon’s Contractual Obligation To The California ISO, If Any, Is Not Before This Court.

The ISO may or may not have contractual recourse against the supplier (in this case, Vernon). That, however, is a matter of private contract that FERC itself recognized is beyond its jurisdiction. The *MAPP* case cited by both Vernon and Intervenors makes this very point. *Mid-Continent Area Power Pool*, 89 FERC ¶ 61,135 at 61,387-88 (1999). (“[W]e need not and do not address whether nonpublic utility members of MAPP are nevertheless bound to take or refrain from taking any actions, including providing refunds, under the terms of any agreement.”)

⁷ Buyers have, in fact, filed state and federal court claims for breach of contract against the municipal and rural electric cooperative utilities that were parties to the *BPA* case. *Pacific Gas and Electric Co. et al. v. Arizona Electric Power Cooperative, Inc., et al.*, Case No. 2:06-CV-00559-MCE-KJM (E.D. Calif. 2006).

Tellingly, FERC’s brief does not even refer to its decision in *MAPP*, much less try to distinguish it.⁸ Nor does FERC address the holding in *Regents of the Univ. Sys. of Georgia v. Carroll*, 338 U.S. 586, 600 (1950), which makes clear the distinction between an agency’s authority to consider non-jurisdictional factors in regulating jurisdictional entities and its lack of authority to regulate directly the activities of entities outside its jurisdiction.

D. Cases Involving FERC’s Undisputed Authority To Regulate The Terms And Conditions Of Jurisdictional Service Provided To Non-Jurisdictional Utilities Provide No Support For FERC’s Assertion Of Authority To Regulate Services Provided By Non-Jurisdictional Utilities.

FERC cites its own decision in *Ohio Power Co.*, 63 FERC ¶ 61,325 (1993) for the proposition that it has previously ordered municipal customers “to refund excess amounts of prior refunds.” FERC Br. at 40. This case, too, is irrelevant to the fact situation here. As FERC itself describes, the *Ohio Power* case involved refunds initially provided *to* municipal utilities for overcharges by their

⁸ Supporting Intervenors make the argument that Section 16.2 of the TCA “was added to ensure that a non-jurisdictional Participating TO would conform its TRR to the level found proper by FERC and to make refunds of excess revenues despite the Commission’s lack of Section 205 jurisdiction.” Supporting Intervenors Br. at 9. According to Supporting Intervenors, “the need for such a provision was driven by *Mid-Continent Area Power Pool*, 91 FERC ¶ 61,353 (2000).” *Id.* But this argument defeats, rather than supports, FERC’s orders. What the discussion of Section 16.2 of the TCA suggests is a recognition that under *MAPP*, the parties to the agreement would only have recourse, if any, to challenge Vernon’s rates contractually in a court, not before FERC.

jurisdictional supplier. FERC’s refund order was later overturned by an appellate court and, on remand, it ordered the municipal utilities to return the previously-provided refunds. 63 FERC at 63,169. No party to that case disputed FERC’s authority to do so. FERC plainly has the ancillary authority to issue orders necessary to correct its prior error. *United Gas Improvement Company et al. v. Callery Properties (Callery)*, 382 U.S. 223, 229 (1965) (“judicial review at times results in the return of benefits received under the upset administrative order.”). But that is a far cry from FERC’s assertion here that it can order refunds of the rates charged by municipal utilities - even in the face of an express statutory exemption – just because the obligation is included in an otherwise jurisdictional contract.

Supporting Intervenors similarly confuse FERC’s authority to regulate jurisdictional services rendered to non-jurisdictional entities with non-jurisdictional services provided by non-jurisdictional entities that, by definition, FERC cannot regulate. Citing *Transmission Agency of Northern California v. Sierra Pacific Power Co.*, 295 F.3d 918, 931-32 (9th Cir. 2002), for example, they offer this correct, but irrelevant proposition: “That non-jurisdictional entities may be parties to the contract does not alter the Commission’s authority over the contract.” Supporting Intervenors Br. at 21. At issue in *Transmission Agency of Northern California* were the terms and conditions of service provided by a jurisdictional

entity to several municipal utilities, *not* the terms and conditions of service that the municipal utilities provided.

United Distribution Companies v. FERC, 88 F.3d 1105 (D.C. Cir. 1996), *cert. denied sub nom. Assoc. Gas Distrib. v. FERC*, 520 U.S. 1224 (1997)(*UDC*), also cited by Supporting Intervenors (but not FERC), is irrelevant for similar reasons. They mischaracterize *UDC* when they contend that this court approved FERC’s assertion of “authority to regulate the rates under which non-jurisdictional LDCs sold *their* interstate pipeline capacity...” Supporting Intervenors Br. at 25-26. On the contrary, the capacity being regulated was owned by the jurisdictional pipeline; the municipality paid for *pipeline* service and “the capacity release regulations operate as a term or condition of *pipeline service*, with which its customers [including municipal utilities] must comply.” *UDC*, 88 F. 3d at 1152 (emphasis added). In other words, FERC was enforcing a resale condition of the original sale of pipeline service *by* the jurisdictional entity, the pipeline, when that service was subsequently resold by the customer. By contrast, FERC is here unlawfully regulating Vernon’s sales of its *own* transmission service over its own transmission facilities.

E. FERC’s Regulation Of Jurisdictional Transactions May Lawfully Have An Incidental Effect On Non-Jurisdictional Entities, But FERC’s Order That Vernon Provide Rate Refunds Is An Impermissible Direct Regulation Of Non-Jurisdictional Rates.

Supporting Intervenors misapprehend this court’s recent decision in *National Association of Regulatory Utility Commissioners v. FERC*, 2007 WL 79054 (D.C. Cir. January 12, 2007) (*NARUC*). Citing the court’s conclusion that FERC’s lawful exercise of authority “only to jurisdictional transactions” might still permissibly affect “facilities jointly owned with a municipal entity” (Supporting Intervenors Br. at 24), they make a leap of logic. FERC, they reason, was likewise empowered to order refunds in this case because “nothing in the Commission’s order affects Vernon's retail rates; the only affected rate is the jurisdictional Access Charge.” *Id.* at 25.

This argument is inaccurate. FERC’s order may not adjust Vernon’s retail rates, but it directly revises Vernon’s TRR – the transmission revenue requirement underlying the rate Vernon charges the California ISO for the use by third parties of Vernon’s transmission facilities. All that this court noted in *NARUC* was that the FERC interconnection rule it was reviewing did not go beyond FERC’s own observation in Order No. 888⁹ that “it had the authority to regulate a public utility,

⁹ *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities, Order No. 888*, FERC Stats. & Regs. ¶ 31,048 (1996).

notwithstanding *incidental* effects on nonjurisdictional entities.” *NARUC* at* 3. (emphasis added). But, while an agency’s regulation of jurisdictional entities may have an incidental effect on unregulated ones, it cannot *directly* regulate them. *See Regents of the Univ. Sys. of Georgia v. Carroll*, 338 U.S. 586, 600 (1950).

FERC’s orders in this case cannot plausibly be characterized as having only “*incidental* effects on nonjurisdictional entities.” *NARUC* at* 3. FERC did not simply set a just and reasonable California ISO rate based in part on a finding that Vernon’s TRR was too high. It ordered a change in Vernon’s own TRR and required it to pay refunds. FERC’s orders could hardly have a more direct – and unlawful - effect on a non-jurisdictional entity.

CONCLUSION

For the reasons stated herein and in Intervenor/Amici's opening brief, this court should reverse and vacate FERC's orders directing Vernon to provide rate refunds as being beyond FERC's statutory authority.

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**Certificate of Compliance Pursuant to
Fed. R. App. P. 32(a)(7)(c) and Circuit Rule 32
For Case Nos. 05-1402, 06-1246 (Consolidated)**

I hereby certify that pursuant to Fed. R. App. P. 32(a)(7)(c) and DC Circuit Rule 32, the attached Joint Reply Brief for Intervenor/Amici in Support of Petitioners is proportionately spaced, Times New Roman font, has a typeface of 14 points and contains 3,125 words, including all footnotes and citations, as reported by the word processing system on which it was prepared.

Dated at Washington, DC this 15th day of February 2007.

Respectfully submitted,

Harvey L. Reiter

CERTIFICATE OF SERVICE

Pursuant to Rule 25(d) of the Federal Rules of Appellate Procedure, I hereby certify that I have this day served two copies of the Joint Reply Brief for Intervenor/Amici in Support of Petitioners, by United States first-class mail, postage prepaid, upon each of the parties on the attached Service List.

Dated at Washington, DC this 15th day of February 2007.

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