

**POWER GRAB and FUMBLE:**  
How FERC Has Greatly Expanded Its Reach  
While Illegally Abdicating Its Duty to Regulate Rates  
and  
Why We Have to Make FERC Do Its Job Now  
by Lynn N. Hargis<sup>1</sup>

I. THE FEDERAL ENERGY REGULATORY COMMISSION (FERC) IS BREAKING THE LAW.<sup>2</sup>

A. FERC Has Waived the Statutorily Mandated Filing of All Rates and Charges, a Waiver It Lacks Authority to Grant; As a Result, FERC Cannot and Does Not Review Rates.

- The law FERC is violating is the Federal Power Act (FPA) which requires FERC to ensure that all electricity sales for resale are “just and reasonable;” otherwise, the FPA says they are unlawful.<sup>3</sup>
- The U.S. Supreme Court has found that this law is designed to provide consumers a “complete, effective and permanent bond of protection from excessive rates.”<sup>4</sup> The D.C. Circuit said: “The Federal Power Act’s primary purpose [is] protecting the utility’s customers.”<sup>5</sup>
- In order for FERC to do its job, the FPA requires that all rates and charges must be filed at FERC for public and agency review.<sup>6</sup> FERC has unlawfully waived this statutory requirement.
- The purpose of FPA rate filings was long ago described by the U.S. Supreme Court in interpreting how rates subject to FERC review can be changed. These cases still control interpretation of the FPA.

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<sup>2</sup> This is the thrust of the appeal in *Colorado Office of Consumer Counsel v. FERC*, D.C. Cir. No. 04-1238, oral argument scheduled for March 14, 2007.

<sup>3</sup> FPA Section 205(a), 16 U.S.C. 824d(a).

<sup>4</sup> *Atlantic Ref. Co. v. PSCNY*, 360 U.S. 378, 388 (1959).

<sup>5</sup> *Electrical Dist. No. 1 v. FERC*, 774 F.2d 490, 493 (D.C. Cir. 1985)(Scalia).

<sup>6</sup> FPA Sections 205(c) and (d), 16 U.S.C. 824d(c) and (d).

- The Supreme Court found that the *purpose* of advance notice and rate filings in the FPA is to permit the agency to REVIEW the rates and determine whether, in the case of initial rates, to set them for hearing under Section 206, or in the case of changed rates or charges, whether to suspend rate increases, set them for hearing with the burden of proof on the seller, and make them subject to refund.<sup>7</sup>
- Congress has not changed these provisions, except to *increase* FERC's review time and give FERC refund power under Section 206.
- In EPAct of 2005, FERC got authority to made 206 refunds earlier.
- Without notice by filing the proposed charges and any proposed changes to them, FERC *cannot, as a practical matter, initiate the consumer protection provisions of Sections 205(e)*, and must delay Section 206 protections until a complaint is filed, perhaps long after rates have been charged.
- The only case that FERC can cite in support of its substitution of after-the-fact "reporting" requirements for the statute's prior rate filing requirements is *California, ex rel., Lockyer v. FERC*, 383 F.3d 1006 (9<sup>th</sup> Cir. 2004)(*Lockyer*).
- However, *Lockyer* also found that FERC's elimination of the consumer protections of Section 205(e), as discussed above, "*comports neither with the statutory text, nor with the Act's 'primary purpose' of protecting consumers,*" and sent the case back for FERC to consider granting refunds. 383 F.3d at 1017.
- The electricity sellers in that case are trying to have *Lockyer* overturned on the refund remedy, while ignoring FERC's unlawful "substitution" of "reporting" requirements for FPA notice by filing.<sup>8</sup>
- Yet these same sellers are supporting FERC in Consumer Advocates' appeal, in which FERC is relying on the *Lockyer* case.
- As the *Lockyer* panel said, "FERC cannot have it both ways." p. 1016.
- In addition, subsequent 9th Circuit decisions have relied on *Lockyer* in part to overturn a FERC decision on contracts involved in the deregulation debacle in California in 2000-2001.<sup>9</sup>

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<sup>7</sup> *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp*, 350 U.S. 332, 342; *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956).

<sup>8</sup> *Coral Power, LLC, et al. v. People of the State of California ex rel Lockyer*, Pet. For Writ of Certiorari, filed Dec. 28, 2006.

<sup>9</sup> *Public Utility Dist. No. 1 of Snohomish Co. Wash*, No. 03-72511; *PUC of California, et al. v. FERC*, No. 03-74207 (9<sup>th</sup> Cir. Dec. 19, 2006).

- The sellers challenging *Lockyer* have already indicated in their petition for a writ that they disagree with these decisions as well.
- Consumer Advocates argue that *Lockyer* is wrong in finding that FERC can “substitute” reporting requirements for prior “notice by filing” of charges; the law is clear that only Congress can do that.

**Summary:** *Lockyer*, the only case that supports FERC’s elimination of the FPA’s mandate that sellers must file *all rates and charges* for FERC and public review, is itself being challenged by Consumer Advocates *and* by the very sellers who support FERC in Consumer Advocates’ appeal.

B. FERC Claims it Need Not Review Rates, Only Whether Sellers Are “Competitive” and Behave Well. But The Supreme Court Has Held That Federal Agencies Lack Authority to Substitute Competition for Rate Regulation.

- FERC contends in Consumer Advocates’ appeal that it need only determine whether sellers are “competitive” to know if rates are “just and reasonable.” This is not only nonsense, as the “market” experiment in California and the West demonstrated, but it also directly conflicts with Supreme Court and other cases.
- The Supreme Court has repeatedly held that federal agencies *cannot* “detariff” or “flexibly reduce” statutory rate filing requirements even if the goal is to encourage competition. *MCI Telecomms. Corp. v. AT&T*, 512 U.S. 218, at 234 (1994); *Maislin Indus. U.S. v. Primary Steel Inc.*, 497 U.S. 116, 135 (1990).
- Since *Maislin* predates *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866 (D.C. Cir. 1993), the case which the *Lockyer* court cites in finding that FERC can rely on “the market” to set rates if in FERC’s determination sellers are “competitive,” the D.C. Circuit case is clearly wrong to the extent it finds that FERC may choose to eliminate rate filings and rate regulation under the FPA.
- As then-Judge Scalia held in a prior D.C. Circuit case, “without a rate contained in a tariff...it would be monumentally difficult to enforce the requirement that rates be reasonable and nondiscriminatory...and *virtually impossible* for the public to assert its right to challenge the lawfulness of existing or proposed rates.”<sup>10</sup>

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<sup>10</sup> *Regular Common Carrier Conf. v. United States*, 793 F.2d 376, 379 (D.C. Cir. 1986)(emphasis added).

- FERC and the *Lockyer* court claim these are different statutes, but they do not show why that changes the result. Indeed, it is *more* important for FERC to review rate levels to determine whether they are lawful when such rates are allowed to be individually negotiated than where they must only conform to a standard tariff.
- To the extent that the panel in *Elizabethtown Gas* intended to permit FERC to do away with rate review regulation without Congressional changes to the statute, the D.C. Circuit clearly lacks such authority.
- And, ironically, a case which *Elizabethtown* cites for FERC’s ability to rely on markets is *Farmers Union*,<sup>11</sup> a case under the Interstate Commerce Act as is *Maislin*.
- Another case on which *Elizabethtown* relies is *Tejas Power*,<sup>12</sup> where the panel in fact explained why FERC cannot rely on wholesale buyers to negotiate “just and reasonable” rates because such buyers can simply pass along their prices as legitimate “costs” under the Supremacy Clause.<sup>13</sup>

**Summary:** The U.S. Supreme Court held, well before *Elizabethtown Gas*, that federal agencies cannot do away with statutory rate filing regulation, even if their goal is to promote competition.

C. Why a “Just and Reasonable” Rate Standard Must be Tied To Cost of Service and To Consumer Protection, Neither of Which FERC considers in Approving “Market-Based Rates.”

- Although courts have held FERC need not be tied to a particular ratemaking method, they have also held that any departure from traditional cost-based ratemaking must be supported by “empirical proof” that consumers are protected thereby.<sup>14</sup>
- The courts have also said that rates must remain within a “zone of reasonableness,” and have defined that zone as being where rates are neither “less than compensatory” nor “excessive.” 734 F.2d at 1502.

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<sup>11</sup> *Farmers Union Cent. Exch. Inc. v. FERC*, 747 F.2d 1486 (D.C. Cir. 1984).

<sup>12</sup> *Tejas Power Corp. v. FERC*, 908 F.2d 998 (D.C. Cir. 1990).

<sup>13</sup> *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 966 (1986).

<sup>14</sup> *INGAA*, 285 F.3d 18, 31 (D.C. Cir. 2002), quoting 747 F.2d at 1509.

- FERC thus cannot simply claim, as it does, that competition forces rates down into a zone of reasonableness; FERC must offer “empirical proof” of this fact.<sup>15</sup>
- FERC has come up with no objective standard for evaluating whether “market” rates fall within a “zone of reasonableness.”
- Unless it can do so, FERC must rely on cost of service as a determinant of whether, as the Court said in *Elizabethtown*, “the seller makes only a normal return on investment.” 10 F.3d at 870.
- In, for example, reverse auctions, there is no question that many sellers from depreciated, coal-fired plants are making far more than a “normal” return on investment.
- Utilities such as Constellation that bought their affiliates’ depreciated plants at below book, and are selling cheap energy into high-priced markets in NY and PJM, are making far above “normal” returns.
- In *Elizabethtown Gas*, FERC promised that it would monitor such returns, and the Court in *Elizabethtown Gas* relied on FERC’s promise. 10 F.3d 866. Instead, FERC, by its own admission, merely “monitors” whether markets are “competitive,” not whether rates are just, reasonable and non-discriminatory, *i.e.*, lawful.

**Summary:** FERC has failed to offer an objective standard to determine whether “competitive” forces *in fact* push rates down into a zone of reasonableness, as the courts have held they must. “But nothing in the regulatory scheme itself acts as a monitor to see if [competition has pushed rates down into the zone of reasonableness] or to check rates if it does not. That is the fundamental flaw in the Commission’s scheme.”<sup>16</sup>

## II. WHY CONSUMERS AND STATES MUST MAKE FERC ENFORCE THE FEDERAL POWER ACT NOW!

- Under the Supremacy Clause, as well as doctrines of federal preemption, FERC-allowed rates must be treated as legitimate costs for purposes of being passed through to retail consumers. *See, fn. 13*.
- States thus have no control over the level of wholesale rates; even under a state-approved auction, if all the wholesale bids are excessive,

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<sup>15</sup>*Farmers Union*, 734 F.2d at 1510.

<sup>16</sup>*Farmers Union*, 734 F.2d at 1509, citing *Texaco Inc. v. FPC*, 474 F.2d 416, 422 (D.C. Cir. 1972), *approved in relevant part*, 417 U.S. 380 (1974).

- the state will merely be choosing the least excessive prices among rates that may all be excessive and “unlawful” under the FPA.
- Several states that “restructured” and adopted electricity rate deregulation are now seriously regretting that decision and attempting to partially or fully undo it.
  - However, it turns out that allowing or requiring state utilities to sell their generating plants is a lot easier than getting them back. As a result, it will take time before many of these states can come close to regaining the retail generating resources that will allow the states to fully protect retail consumers from a deregulated wholesale “market.”
  - It is thus essential that consumers and states work *simultaneously* to not only reregulate state retail utilities, but also to force FERC to do its job and regulate electricity sales for resale to protect consumers as its enabling statute, the FPA, requires.<sup>17</sup>
  - Many states have already pursued litigation against FERC or are planning to do so, but many states appear to passively accept what FERC is doing, or more precisely, *not* doing: failing to regulate wholesale rates to protect ultimate consumers of electricity.
  - The FPA requires that all wholesale electric rates, whether set by the parties or determined by states in an auction, must be noticed *by filing* so that FERC and the public can determine whether they are lawful.
  - FERC cannot delegate this statutory authority and duty to the states any more than FERC can delegate them to the utilities themselves. *Miss. Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354, 371 (1988)(FERC’s jurisdiction over wholesale rates is exclusive.)
  - States must insist that such wholesale charges be filed, and that FERC and the public review them—*before they are charged*—to determine whether increases should be suspended, set for hearing with the burden of proof on the seller, and made subject to immediate refund protection.
  - In the coming presidential election, almost all voters will also be utility customers who pay monthly electric bills.

**Summary:** Any candidate or sitting official would be wise to learn something about utility regulation and the FPA. Former California Governor Gray Davis bemoaned, *after* his impeachment arising from the deregulation debacle in 2000-2001: “I knew nothing about electric rates.”

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<sup>17</sup> Four states are involved in our appeal, along with PULP in New York. The Connecticut AG has filed complaints with FERC. California is still fighting.