

MEMORANDUM

To: WSPP

From: Arnold B. Podgorsky
Jennifer L. Hong

Date: January 19, 2010

Re: The U.S. Supreme Court's Most Recent *Mobile Sierra* Decision: *NRG Power Marketing, LLC v. Maine Public Utilities Commission*

The Federal Power Act (“FPA”)¹ requires that rates for the sale for resale of electricity in interstate commerce be “just and reasonable.” The Supreme Court held in *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*² and *FPC v. Sierra Pacific Power Co.*³ that the Federal Energy Regulatory Commission (“FERC”) must “presume that the rate set out in a freely negotiated wholesale-energy contract meets the ‘just and reasonable’ requirement imposed by law,” and that the “presumption may be overcome only if FERC concludes that the contract seriously harms the public interest.”⁴ Based on these two seminal 1956 cases, this principle is known as “*Mobile-Sierra* doctrine.” The *Mobile-Sierra* doctrine (also called the “public interest standard”) is important to persons defending or challenging an energy contract, because it creates a high hurdle for anyone later challenging the contract rate.

On January 13, 2010, the Supreme Court ruled in *NRG Power Marketing, LLC v. Maine Public Utilities Commission*, No. 08-674 (“*NRG Power*”), that the *Mobile-Sierra* doctrine – the presumption that rates established by a freely negotiated wholesale-energy contract are “just and reasonable” – applies to the challenge of a contractual rate by an entity that is not a party to the contract. The Supreme Court’s decision appears intended to promote contract stability and

¹ 16 U.S.C. §§ 791a, *et seq.*

² 350 U.S. 332 (1956).

³ 350 U.S. 348 (1956).

⁴ *Morgan Stanley Capital Group v. Pub. Util. Dist. No. 1*, 128 S. Ct. 2733, 2737 (2008) (“*Morgan Stanley*”).

certainty by continuing the high hurdle established by the *Mobile-Sierra* doctrine, even when the challenging party is not a counterparty.

The NRG Power Decision

NRG Power arose from efforts to resolve New England's electrical generation capacity shortage. After several attempts, FERC approved a comprehensive settlement agreement that established rate-setting mechanisms for sales of generating capacity. Several parties who objected to the settlement (including some state entities) petitioned for review in the United States Court of Appeals for the District of Columbia Circuit, and argued that rate challenges of non-settling parties should not be subject to the *Mobile-Sierra* doctrine, as the settlement agreement provided. The D.C. Circuit Court agreed, holding that "when a rate challenge is brought by a non-contracting third party, the *Mobile-Sierra* doctrine simply does not apply," that is, that the non-contracting third party need show that the rates fail the just and reasonableness standard, but that they need to reach the higher, public interest hurdle.⁵

The Supreme Court reversed the D.C. Circuit Court with a single dissent. The Supreme Court ruled that the *Mobile-Sierra* presumption applies not just to disputes between contracting parties, but to challenges brought by non-contracting parties as well. The Supreme Court concluded that the doctrine is not independent of the FPA's "just and reasonable" standard, but instead defines "what it means for a rate to satisfy the just-and-reasonable standard in the contract context."⁶ Because the doctrine directs FERC to reject a contract that "seriously harms the consuming public," the Supreme Court observed, application of the *Mobile-Sierra* doctrine does not neglect third-party interests.⁷ Finally, the Supreme Court reasoned, confinement of the doctrine to rate challenges by contracting parties would "diminish" the animating purpose of the doctrine: promotion of the stability of supply arrangements which all agree is essential to the health of the energy industry."⁸ In other words, the Court leans toward preserving sanctity of contract.

Justice Stevens, who dissented in the *Morgan Stanley* case (see n.4), dissented in *NRG Power*. Justice Stevens argued that the *Mobile-Sierra* doctrine should be applied as a presumption against letting a party out of its own contract, rather than a presumption reflecting faith in the fairness of market-set rates. In his view, application of the "serious harm" standard in this context imposes an unjustifiable burden on third parties exercising their statutory right to object to rates that they never agreed to. As a result, Justice Stevens stated that the ruling sets a higher bar for third-party challenges that hinders the primary goal of *Mobile-Sierra* – that of protecting the public interest. If the majority was protecting sanctity of contract, Justice Stevens was

⁵ *Maine PUC v. FERC*, 520 F.3d 464, 478 (D.C. Cir. 2008).

⁶ *NRG Power*, slip op. 8.

⁷ *Id.* at 9.

⁸ *Id.* (internal quotations omitted).

arguing that the mere fact that the rate was negotiated and contractually set should not trump the requirement that the rate be just and reasonable under the FPA.

The Supreme Court remanded an issue raised by the Solicitor General. The Solicitor General questioned whether the rates at issue were indeed “contract rates” that would qualify for the *Mobile-Sierra* presumption. The Solicitor General argued in its brief that the rates at issue – which were established by the settlement of a proceeding before FERC – were not contract rates, but FERC nonetheless had discretion to treat them as if they were. Rather than reaching that issue, the Supreme Court remanded that issue to the D.C. Circuit Court.⁹

Mobile-Sierra creates a high bar for anyone challenging a contract rate. In holding that the *Mobile-Sierra* presumption – that rates established by a freely negotiated wholesale-energy contract are “just and reasonable” – applies fully when a contractual rate is challenged by a non-contracting party, the Supreme Court has ruled to favor contract stability and certainty over regulatory flexibility. The Court stated, “[a] presumption applicable to contracting parties only, and inoperative as to everyone else – consumers, advocacy groups, state utility commissions, elected officials acting *parens patriae* – could scarcely provide the stability that *Mobile-Sierra* aimed to secure.”¹⁰

This decision will impact ongoing contract challenges now before FERC, as well as other rate challenges.

⁹ Note that in *Dominion Transmission, Inc. v. FERC*, 533 F.3d 845 (D.C. Cir. 2008), the D.C. Circuit vacated certain FERC orders modifying a settlement agreement on the basis that the challenged orders were inconsistent with the *Mobile-Sierra* doctrine. However, FERC was attempting to seek additional reports and information regarding the settlement rates rather than actually modifying the settlement rates themselves as is the issue in *NRG Power*.

¹⁰ *NRG Power*, slip op. at 10.