The *Mobile-Sierra* Doctrine

A RETURN TO ITS STATUTORY ROOTS

The 9th Circuit's *Snohomish* and *PUC* decisions rationalize what has been a confusing, conflicted area of law.

By Scott H. Strauss and Jeffrey A. Schwarz

In "The *Mobile-Sierra* Doctrine, Part Deux" (*March 2007, p. 26*), Stephen L. Teichler and Ilia Levitine report on two recent 9th Circuit decisions[1] that they characterize as "a dramatic shift of prevailing precedent" with respect to *Mobile-Sierra* jurisprudence.[2] As evidence of the "shift," the authors highlight the court's characterization of the "public-interest" test as a "presumption as opposed to a standard of review separate and apart from the just and reasonable standard." But in fact, the 9th Circuit decisions simply work a needed correction to a "doctrine" that, over time, has slipped further and further from its statutory moorings.

The 9th Circuit rulings are "dramatic" only because of the extent to which courts stretched and distorted the original *Mobile-Sierra* rule, which one court called "refreshingly simple,"[3] so that it became, in Teichler and Levitine's words, "incredibly nuanced and complex over time."

The fundamental error that took the doctrine far off course was misinterpreting *Sierra's* distinction between public and private interests under the just-and-reasonable standard as establishing a separate, "practically insurmountable"[4] "public-interest" standard to which contracting parties could bind not only themselves but, also, non-parties and the commission.[5] One searches the Federal Power Act (FPA) in vain to find such a standard. Snohomish reconnects the *Mobile-Sierra* doctrine with its statutory foundation.

As the 9th Circuit observed:

> There is but one statutory standard addressing the lawfulness of wholesale electricity rates. That standard requires that *all* rates be "just and reasonable" … . The

unreasonable (by definition), but (apparently) not so egregiously unjust as to contravene the public interest. There is no way to reconcile that outcome with Congress' command that "all rates … be just and reasonable" and its declaration that "any … rate that is not just and reasonable is … unlawful."

The 9th Circuit properly recognized that the FPA does not permit even a little unjustness to consumers in jurisdictional rates. The commission's "primary task" under the FPA is to "guard the consumer from exploitation by non-competitive electric power companies,"[6] and "Congress's central concern with exploitation is … reflected in the statute's emphasis on just and reasonable prices."[7] *520 F.2d at 438*. The FPA, like the companion Natural Gas Act, "was … framed as to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges."[8]

Teichler and Levitine criticize the 9th Circuit for "conflat[ing]" the just-and-reasonable standard with the "previously distinct (and more stringent) 'public interest' review under *Mobile-Sierra*." Yet any permitted divergence between the two "standards" would sever the critical link between the *Mobile-Sierra* doctrine and the language of the FPA. The only way to resolve this tension is to construe the so-called "public-interest" test as a means of measuring whether the contract at issue is unjust and unreasonable as to ultimate consumers, as opposed to the contracting parties themselves, who have bound themselves to the terms of the agreement.

Understanding *Mobile-Sierra* in this way also answers the newly controversial question of whether contracting parties can bind non-parties and the commission to a "public-interest" standard more resistant to contract modification than the just and reasonable standard. Until recently, the answer was

> statute will admit of no other conclusion, and the Supreme Court case law supports it. *471 F.3d at 1074* (emphasis in original).

The FPA could not be clearer on this point. FPA 205(a) requires that "all rates and charges made, demanded, or received by any public utility … shall be just and reasonable," and it declares that "any such rate or charge that is not just and reasonable is hereby declared to be unlawful."

Conceiving of *Mobile-Sierra* as creating a separate "public-interest standard" for contract modification, which is more difficult to satisfy than the just-and-reasonable standard, leads inexorably to untenable results. To judge contract modification claims by a standard "higher" than the just-and-reasonable standard is to insulate against change contracts that fall between the two standards—contracts that are unjust and

an unequivocal "no." Contracting parties could waive their own rights to seek contract modifications but could not impair the commission's ability to modify contracts *sua sponte* or on complaint by a non-party.[9] As the Supreme Court explained in *Mobile*, the court's decision in that case (and the resulting doctrine) "*in no way* impairs" the commission's regulatory power. *350 U.S. at 344* (emphasis added). Phrased differently, contracting parties have no right to waive the statutory rights of non-signatories.

Nonetheless, this point is now unsettled. In some recent cases, the Federal Energy Regulatory Commission (FERC) has accepted contract provisions purporting to bind non-parties and the commission to a "public interest" standard for contract modification.[10] In others, FERC has rejected such provisions.[11] And, in two recent cases, an administrative law judge recommended that FERC condition its acceptance of otherwise-uncontested settlements upon the elimination of provisions purporting to bind non-parties to a "public interest" test for future challenges to the underlying reliability must-run (RMR) contracts.[12]

Non-parties frequently are affected by FERC-jurisdictional contracts, and their interests are not necessarily represented by the contracting parties.

The *PSEG Certification* remains pending before FERC. The commission recently rejected the *Bridgeport* settlement provision purporting to bind the commission and non-parties to a public-interest standard,[13] but did so on grounds that, while arguably narrower than the judge's reasoning, still are potentially broad. FERC rested its decision on the purpose of the RMR agreement at issue, which "is not simply to allow one party to buy electricity or capacity from another for resale but to ensure the reliable operation of the regional transmission grid for the benefit of users of the grid" and which results in costs that are borne by all market participants in the area.[14] Commissioner Suedeen Kelly, concurring with the majority, stated that "the same reasoning applies" in assessing the standard of review "in other types of agreements that impact non-party market participants and the operation of the market."[15]

Although the 9th Circuit's *Snohomish* and *PUC* opinions did not reach the question whether contracting parties could bind non-parties or the commission—because FERC's orders were remanded on other grounds[16] —the decisions' logic compels a negative answer. If, as the 9th Circuit held, the *Mobile-Sierra* "public-interest" test is not substantively different from the just-and-reasonable standard, but simply focuses on the contract's effects on different entities (namely, the consuming public rather than the contracting parties), then *Mobile-Sierra* cannot preclude non-parties from seeking to assert their statutory rights.

The decisions' emphasis on the just-and-reasonable standard's statutory basis also suggests further reasons why *Mobile-Sierra* cannot enable contracting parties to bind non-parties and the commission to a higher contract-modification standard. As noted, FPA 205(a) demands that "all rates … be just and reasonable" and declared unjust and unreasonable rates to be "unlawful." FPA 306 gives "any person" the right to file a complaint objecting to "anything done or omitted to be done by any licensee or public utility in contravention of the provisions of this act." FPA 206 works in tandem with sections 205 and 306, providing that "whenever the commission … shall find that any rate… is unjust, unreasonable, unduly discriminatory or preferential, the commission shall determine the just-and-reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order."

These provisions operate together to establish both a substantive legislative command that jurisdictional rates be just and reasonable and a procedural mechanism for "any person" to seek changes to rates that are not just and reasonable. Neither contracting parties nor the commission has any power to deprive non-parties of "rights provided by a statute enacted by both houses of Congress and signed into law by the president."[17]

The D.C. Circuit's decision in *Atlantic City Electric Co. v. FERC*[18] reinforces this point, holding unequivocally that the commission lacks the power to deprive parties of rights that Congress gave them by statute. While contracting parties may waive their rights by private agreement, they may only waive "*their*" rights. *Id*. at 11 (emphasis added). "It goes without saying that a contract cannot bind a nonparty." *EEOC v. Waffle House Inc., 534 U.S. 279, 294 (2002)*. For similar reasons, Judge Silverstein found it "troubl[ing]" that the settling parties in *Bridgeport* sought to bind non-parties to settlement provisions that would deprive them of statutory rights that they did not agree to waive.[19]

Moreover, these decisions entirely are consistent with FERC's historic (and, until more recently, settled) understanding of the *Mobile-Sierra* doctrine's intrinsic limitations:

> *Mobile-Sierra* does not speak to situations … where a non-party to [a contract] … seeks changes under section 206. Under [one] interpretation, parties to a contract who agree among themselves not to seek rate changes would be able to bind not only one another, but also other entities who are not parties to that contract (and did not receive the contractual benefits in exchange for which the parties traded away their right to seek rate changes). This result is not what the Supreme Court intended in *Mobile-Sierra*.[20]

Much of the outcry regarding nonparties' rights to seek changes to unjust and unreasonable contracts seems premised on traditional buyer/seller paradigms and a fear that remorseful buyers will use non-parties as proxies to end-run *Mobile-Sierra* restrictions on their own ability to seek to modify their agreements. However, non-parties frequently are affected, sometimes profoundly, by FERC-jurisdictional contracts, and their interests are not necessarily represented by the contracting parties. For example, in some regions, RTOs negotiate RMR agreements with generators that are needed for reliability but the RTO does not pay the resulting bills and has little incentive to minimize costs.[21]

Indeed, in many cases, the contracting parties' interests are not unaligned merely with those of the ultimate consumers but are actively opposed to them. For example, public utilities' buying power or other services from affiliated entities may have incentives to maximize the costs they incur and pass through to other parties. Yet agreements among affiliated entities are among the most likely to restrict unilateral contract modification by parties and non-parties, because the contracting parties can be confident that their own interests are aligned and that they will be able to agree among themselves on any changes that are in their interests.

In construing and applying the *Mobile-Sierra* doctrine, the commission must not turn a blind eye to the nature of the contracts at issue or the circumstances under which they were entered. Nor is the 9th Circuit alone in suggesting that the commission is required to do so. Although Teichler and Levitine accuse the 9th Circuit of "discover[ing] new prerequisites to the initial application of the *Mobile-Sierra* doctrine" and cutting new conditions "from whole cloth," courts routinely emphasize that *Mobile-Sierra* depends on validly formed agreements that were just and reasonable when they were entered.

As the D.C. Circuit explained, "The purpose of the *Mobile-Sierra* doctrine is to preserve the benefits of the parties' bargain as reflected in the contract, *assuming that there was no reason to question what transpired at the contract formation stage*."[22] To put it bluntly, a doctrine so frequently associated with notions of sanctity of contract cannot sanctify contracts that are products of fraud, abuse, undue discrimination, or the exercise of market power. Almost 25 years before *Atlantic City,* the D.C. Circuit drew the salient distinction: "When there is no reason to question what occurred at the contract formation stage, the parties may be required to live with their bargains as time passes and various projections about the future are proved correct or incorrect.[23] However, where "allegations … go to the fairness and good faith of the parties at the contract formation stage," *Mobile-Sierra* does not "permit a utility to use a fixed-rate contract as a device to render unassailable" otherwise prohibited conduct. *Id. at 1313*.

Teichler and Levitine accept as "settled law" the 9th Circuit's first prerequisite for application of a *Mobile-Sierra* presumption: The contract must not preclude such a presumption. However, they ignore the reason for that prerequisite. "*Mobile-Sierra* presumes that private parties have negotiated an agreement that they view as just and reasonable over the time period covered."[24] Improprieties at the contract-formation stage undermine the basis for *Mobile-Sierra* just as

surely as does a *Memphis* clause.

The 9th Circuit's *Snohomish* and *PUC* decisions provide an opportunity for the courts, the commission, and the energy bar to rationalize what has been a confusing, conflicted area of law. As the 9th Circuit correctly perceived, the surest way through the thicket of contradictory case law is to return to the language of the statute. Under the FPA, all jurisdictional rates must be just and reasonable, and any person may file a complaint seeking modification of an unjust and unreasonable rate. Mere unprofitability to one of the contracting parties is insufficient to render an existing contract unjust and unreasonable,[25] and contracting parties can waive by agreement their own rights to seek contract modifications. But nothing in the FPA permits contracting parties to foist undue burdens on non-parties or allows them to foreclose nonparties and the commission from rectifying contracts that are unjust and unreasonable as to others. The commission's obligation to ensure just and reasonable rates is indefeasible, and *Mobile-Sierra* "in no way impairs" it.[26]

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Endnotes

1. *Public Utils. Dist. No. 1 of Snohomish Cty., Wash. v. FERC*, 471 F.3d 1053 (9th Cir. 2006) (*Snohomish*); *Pub. Utils. Comm'n of Cal. v. FERC*, 474 F.3d 587 (9th Cir. 2006) (*PUC*).
2. See *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) (Mobile); *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956) (*Sierra*).
3. *Richmond Power & Light v. FPC*, 481 F.2d 490, 493 (D.C. Cir. 1973).
4. *Papago Tribal Util. Auth. v. FERC*, 723 F.2d 950, 954 (D.C. Cir. 1983) (*Papago*).
5. See *Notice of Proposed Rulemaking, Standard of Review for Modifications to Jurisdictional Agreements*, 71 Fed. Reg. 303 (Jan. 5, 2006), IV F.E.R.C. Stat. & Regs. ¶ 32,596, P 4 ("Although not clearly defined, the 'public interest' standard of review has been held to be higher or stricter than the 'just and reasonable' standard of review."); *Papago* at 954.
6. Hon. Joseph T. Kelliher, *Market Manipulation, Market Power, and the Authority of the Federal Energy Regulatory Commission*, 26 Energy L. J. 1, 1 & n.1 (2005) (quoting *NAACP v. FPC*, 520 F.2d 432, 438 (D.C. Cir. 1975)).
7. *NAACP v. FPC*, 520 F.2d at 438.
8. *Atlantic Ref. Co. v. Pub. Serv. Comm'n of N.Y.*, 360 U.S. 378, 388 (1959). Nor may the commission idly allow unjust and unreasonable rates to persist through inaction. The FPA "does not permit [the commission] to act as an umpire blandly calling balls and strikes for adversaries appearing before it; the right of the public must receive active and affirmative protection…" *Scenic Hudson Pres. Conference v. FPC*, 354 F.2d 608, 620 (2nd Cir. 1965); see also *Entergy Inc. v. Pub. Serv. Comm'n*, 539 U.S. 39, 41 (2003) ("FERC must ensure that wholesale rates are 'just and reasonable'"); *NAACP v. FPC*, 425 U.S. 662, 666, 668 (1976) (Obligation to establish just and reasonable rates is a "legislative command," which includes the "duty to prevent [public utilities] from charging rates based upon illegal, duplicative, or unnecessary labor costs").
9. See, *e.g.*, *Florida Power & Light Co.*, 67 F.E.R.C. ¶ 61,141, at 61,398 (1994) (holding that FERC "is not in any circumstance bound, absent its consent, to a public interest standard of review for future changes sought by non-parties to the contract or by the commission acting *sua sponte* to protect non-parties to the contract."); *Southern Co. Servs. Inc.*, 67 F.E.R.C. ¶ 61,080, at 61,227 (1994) (same). In *Carolina Power & Light Co.*, 67 F.E.R.C. ¶ 61,074 (1994), FERC rejected a contract provision that sought to bind the commission to a "public interest" standard with respect to non-parties. See also *Wisconsin Power & Light Co.*, 106 F.E.R.C. ¶ 61,112 (2004) (Comm'r Kelly, dissenting in part) (citing cases).
10. *E.g.*, *PJM-New Jersey-Maryland Interconnection, et al.*, 105 F.E.R.C. ¶ 61,294 (2003), reh'g denied, 108 F.E.R.C. ¶ 61,032 (2004), pet. for review dismissed for lack of jurisdiction sub nom. *Old Dominion Elec. Coop. v. FERC*, No. 04-1307 (D.C. Cir. Dec. 7, 2005).
11. *PPL Wallingford Energy LLC*, 118 F.E.R.C. ¶ 61,242, P 7 (2007); *Williams Power Co. Inc.*, 117 F.E.R.C. ¶ 61,238, P 5 (2006); *Los Esteros Critical Energy Facility LLC*, 117 F.E.R.C. ¶ 61,350, P 3 (2006).
12. *Certification of Contested Offer of Settlement, Bridgeport Energy LLC*, 118 F.E.R.C. ¶ 63,018 (2007) (Silverstein, J.) (*Bridgeport Certification*); *Certification of Contested Offer of Settlement*, *PSEG Power Connecticut LLC*, 115 F.E.R.C. ¶ 63,071 (2006) (Silverstein, J.) (*PSEG Certification*).
13. Order on Contested Settlement Agreement, *Bridgeport Energy LLC*, 118 F.E.R.C. ¶ 61,243, P 42 (2007) (*Bridgeport*) (approving the settlement in part, on condition that the parties "file revisions to provide that the commission will be bound to the 'just and reasonable' standard and not the 'public-interest' standard for changes to the RMR Agreement.").
14. *Bridgeport* at P 41. The commission goes on to note that "[b]ecause of the uniquely broad applicability of RMR agreements to markets and market participants alike, … it would be inconsistent with our duty under the [FPA] to be bound to the higher 'public interest' standard when reviewing RMR agreements." *Id*. Interestingly, the commission appears to assume (without deciding, because its decision moots the issue) that the public-interest test remains a "higher … standard" than the just and reasonable standard. Id.
15. *Bridgeport* (Comm'r Kelly, concurring)
16. See *PUC* at 592 n.4.
17. *Bridgeport Certification* at P 29 (quoting *Atl. City Elec. Co. v. FERC*, 295 F.3d 1, 26 (D.C. Cir. 2002)). Because the commission decided the case on other grounds, it neither adopted nor rejected the judge's reasoning. *Bridgeport* at P 42 n.35.
18. 295 F.3d 1 (D.C. Cir. 2002), mandate enforced, 329 F.3d 856, 859 (D.C. Cir. 2003) (FERC "has no jurisdiction to enter limitations requiring utilities to surrender their rights under § 205 of the FPA.").
19. *Bridgeport Certification* at P 36.
20. *PJM Interconnection, LLC*, 96 F.E.R.C. ¶ 61,206, at 61,878 & n.13 (2001) (citing cases, footnote omitted), pet. for rev. dismissed sub nom. *PPL Elec. Utils. Corp. v. FERC*, Nos. 01-1369 et al. (D.C. Cir. Nov. 26, 2002) (unpublished).
21. See *NSTAR Elec. & Gas. Co. v. FERC*, No. 05-1362, slip op. at 18 (D.C. Cir. Mar. 9, 2007) ("Although the system operator plainly has an incentive to ensure that system-critical power is available to ensure grid stability and reliability, FERC neither in its decisions nor at oral argument was able to identify incentives driving ISO-NE to bargain for low prices."); *Bridgeport* (Comm'r Kelly, concurring).
22. 295 F.3d at 14 (emphasis added).
23. *Town of Norwood v. FERC*, 587 F.2d 1306, 1312 (D.C. Cir. 1978) (footnote omitted); cf. *Public Util. Dist. No. 1 of Grays Harbor County, Wash. v. FERC*, 379 F.3d 641, 652 & n.13 (9th Cir. 2004) (*Mobile-Sierra* not implicated by complaint focused on contract formation issues).
24. 471 F.3d at 1075.
25. *Sierra*, 350 U.S. at 355.
26. *Mobile*, 350 U.S. at 344.