

# Ninth Circuit Modifies Mobile-Sierra Review, Eases Test for Repricing Power Sales Contracts

December 22, 2006

On December 19, the United States Court of Appeals for the Ninth Circuit issued two related decisions – *Public Utility District No. 1 of Snohomish County, Washington, v. FERC*, Nos. 03-72511 (*Snohomish*), et al. and *Public Utilities Commission of the State of California v. FERC*, No. 03-74207 (*Cal PUC*) – that comprehensively reconsider both the applicability of the Mobile-Sierra doctrine to power sales contracts executed under the Federal Energy Regulatory Commission’s (FERC) current market-based rate regime, and the appropriate “public interest” standard to be used where the Mobile Sierra doctrine is found to apply. The Court establishes a “modified form of Mobile-Sierra review,” and holds that the Mobile-Sierra doctrine will not apply to contracts executed in markets that are not “sufficiently well-functioning.” The decisions substantially increase the risks to sellers that rates set by contract will be subject to later review and reduction under section 206 of the Federal Power Act.

## Background - The Mobile-Sierra Doctrine

The Mobile-Sierra Doctrine – which takes its name from the Supreme Court’s decisions in *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956) and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) – permits parties to enter into contractual arrangements that have the effect of prohibiting FERC from later modifying the terms of a filed agreement unless FERC finds that the “public interest” so requires.

## Ninth Circuit Decisions

The *Snohomish* and *Cal PUC* decisions address complaints seeking to modify, under § 206 of the Federal Power Act (FPA), long-term contracts executed in the Western Interconnection during the energy crisis of 2000 and 2001. FERC rejected those complaints, holding that they were precluded by the Mobile-Sierra doctrine’s public interest standard. In remanding these FERC orders, the Ninth Circuit decisions fundamentally alter the Mobile-Sierra analysis.

## Prerequisites for Applicability of Mobile-Sierra Doctrine

The *Snohomish* and *Cal PUC* decisions establish three prerequisites that must exist in order for the public interest standard under the Mobile-Sierra doctrine to apply: “(1) the contract by its own terms must not preclude the limited Mobile-Sierra review; (2) the regulatory scheme in which the contracts are formed must provide FERC with an opportunity for effective, timely review of the contracted rates; and (3) where, as here, FERC is relying on a market-based rate-setting system to produce just and reasonable rates, this review must permit consideration of all factors relevant to the propriety of the contract’s formation.” The second and third prerequisites are new, having not been previously articulated by the courts or FERC.

Under the first prerequisite, the decisions establish a default rule that – as long as the other two prerequisites are also met – the Mobile-Sierra doctrine will apply “unless there is a specific indication in the contract that the parties reserved the right to unilaterally modify the contract under the applicable provisions of the FPA and NGA.”

Second, citing *Lockyer v. FERC*, 383 F.3d 1006 (9th Cir. 2006), the Court holds that Mobile-Sierra review will not apply to a contract unless there is an opportunity for an initial review of the contract by FERC. The Court holds further that FERC’s existing market-based rate regime, including the submission of electronic quarterly reports, does not satisfy this prerequisite because any modification of market-based rate authority based on a quarterly report would not provide any relief with respect to the contracts already entered into. According to the Court, the system “offers no protection to purchasers

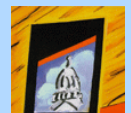
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victimized by the abuses of sellers or dysfunctional market conditions that FERC itself only notices in hindsight.”

Third, the Court requires that “[n]ot only must FERC have an opportunity for some initial review of rates, but the scope of that review must permit consideration of the factors relevant to the propriety of the contract’s formation.” The ultimate question is “whether the original negotiations occurred in a functional marketplace such that we may presume the contracted rates were originally just and reasonable.”

### **Nature of Public Interest Standard**

For those circumstances where the Mobile-Sierra doctrine is found to apply, the Ninth Circuit provides a new interpretation of the public interest standard itself. The Ninth Circuit distinguishes between two different circumstances in which the public interest standard might apply – a “low-rate challenge,” where the seller is attempting to increase an existing rate, and a “high-rate challenge,” where the buyer is seeking to decrease an existing rate.

The Court holds that in a “low-rate challenge,” the “primary ‘public interest’ . . . is in keeping utilities in operation so the public is not deprived of services” and ensuring that third party wholesale customers are not subject to excessive rate burdens. By contrast, “the key ‘public interest’ in a high-rate challenge . . . is assuring that the consuming public pays fair rates for the very energy covered by the challenged contracts.” Specifically, the Court held that the “proper standard for the Mobile-Sierra ‘public interest’ mode of review in a high-rate challenge is . . . whether the wholesale energy contract is outside the ‘zone of reasonableness’ and results in retail rates higher than would be the case if that zone were not exceeded.”

### **Implications for Market-Based Rate Sales**

The Ninth Circuit approach poses serious questions regarding the stability of existing commercial arrangements. In particular, it facilitates purchaser requests to reprice both existing and future market-based rate sales under the FPA’s just and reasonable standard.

### **Additional Information**

Van Ness Feldman has extensive experience advising clients on Federal Power Act and Natural Gas Act issues, and has litigated numerous cases involving the Mobile-Sierra doctrine. If you would like more information on the Ninth Circuit decisions, please contact Howard Shapiro, John Burnes, Brian Zimmet, or any member of our Electricity or Natural Gas Practices at (202) 298-1800.

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