

D.C. Circuit Upholds FERC's Decision That Rates Resulting from a Capacity Auction are Presumed to be Just and Reasonable

Howard Shapiro, Evan Reese, and Patrick Daugherty

The D.C. Circuit has sustained the Federal Energy Regulatory Commission's (FERC) decision to review rates resulting from a forward capacity auction conducted by an Independent System Operator (ISO) by applying the *Mobile-Sierra* public interest standard. *New England Power Generators Ass'n v. FERC*, No. 11-1422 (D.C. Cir. Feb. 15, 2013). As a result, challenges seeking to revise such rates will have a higher burden than applies under the traditional just and reasonable standard. The *Mobile-Sierra* doctrine presumes that rates in freely negotiated contracts for electricity or natural gas are "just and reasonable" as required by sections 205 and 206 of the Federal Power Act (FPA), and sections 4 and 5 of the Natural Gas Act. FERC may alter such rates only if the presumption is rebutted by evidence establishing that the contract rate impairs the public interest. Although rates created via an ISO auction were not considered to be traditional, freely negotiated contract rates, the Court upheld FERC's decision to apply the "just and reasonable" presumption for the resulting rates in this context.


THE MOBILE-SIERRA DOCTRINE

The *Mobile-Sierra* doctrine originated with twin decisions in 1956 rejecting attempts by regulated utilities to avoid previously agreed contract rates by unilaterally filing rate schedules increasing those rates. *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332; *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348. The two cases held that FERC may set aside a negotiated contract only if it finds that its rates, or terms and conditions affecting those rates, are inconsistent with the public interest, i.e. impair the financial ability of the selling public utility to provide service, place an excessive burden on other consumers, are unduly discriminatory, or are traceable to market dysfunction caused by one of the parties.

In 2008, the Supreme Court ruled that the *Mobile-Sierra* cases establish a rebuttable presumption that contract rates freely negotiated between sophisticated business entities meet the statutory "just and reasonable" standard. *Morgan Stanley Capital Group, Inc. v. Pub. Util. Dist. No. 1 of Snohomish County, Washington*, 554 U.S. 527 (2008). The Court held that *Mobile-Sierra* did not establish an exception to the statutory "just and reasonable" standard. Instead, it ruled, the public interest standard defines "what it means for a rate to satisfy the just-and-reasonable standard in the contract context." *Id.* at 546.

THE NEW ENGLAND ISO'S FORWARD CAPACITY AUCTIONS

In 2004, the New England ISO responded to FERC's request that it develop a new market structure for the procurement of generating capacity in the region. Ultimately, FERC approved a contested settlement that created a Forward Capacity Auction in which generators commit, three years in advance, to supply a certain amount of a capacity at a particular price determined by auction procedures set forth in the ISO's tariff.



While reviewing an earlier challenge to its approval of the Forward Capacity Auction, FERC determined (on remand from [NRG Power Mktg v. Me. Pub. Util. Comm'n, 558 U.S. 165 \(2010\)](#)) that the rates resulting from the Forward Capacity Auction were more like tariff rates than traditional contract rates because utilities buying capacity do not participate in the auction. Nevertheless, FERC concluded that the auction was a “market-based mechanism” which tended to assure just and reasonable rates. FERC cited the Forward Capacity Market’s ability to “to appropriately value capacity resources based on their location,” to “provide appropriate signals to investors when infrastructure resources are necessary,” and to target new infrastructure “where reliability problems are most imminent.” *Devon Power, LLC*, 134 FERC ¶61,208 at P 19 (2011). Therefore, FERC determined that, in the exercise of its statutory discretion over rates, it would review such auction rates under *Mobile-Sierra*’s presumption that the rates are just and reasonable, and would change them only if they were inconsistent with the public interest.

THE COURT’S DECISION

Parties petitioned for review of FERC’s 2011 *Devon Power* decision arguing that only negotiated contract rates may be reviewed under *Mobile-Sierra*’s presumption and that rates set through an auction are not eligible for review under the *Mobile-Sierra* standard. The D.C. Circuit disagreed. It held that the FPA’s requirement in sections 205(a) and 206 that rates be “just and reasonable” is “obviously incapable of precise judicial definition.” Therefore, it concluded, FERC’s interpretation of those provisions is entitled to judicial deference under *Chevron, U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837 (1984). In sum, FERC’s decision to apply the *Mobile-Sierra* public interest standard to the capacity auction rates in the settlement was well within its discretion and a “reasonable choice within the gap left open by Congress.”

SIGNIFICANCE OF THE DECISION

The Court’s decision signals that FERC is free to use the more limited *Mobile-Sierra* standard of review outside of traditional, freely negotiated contract rates when it reasonably believes conditions under which the rates will be determined, such as market-based auctions, will result in just and reasonable rates. This decision could have wide-ranging implications for participants in organized energy markets as well as capacity markets because the question that now will be asked as to each organized market (*i.e.*, day-ahead, real-time energy markets, ancillary services markets, other capacity markets, open seasons) is whether particular auction results will be reviewed under the *Mobile-Sierra* standard or not. FERC has indicated that it will approach these questions case-by-case.

FOR ADDITIONAL INFORMATION

For assistance or additional information, please contact [Gary Bachman](#), [Evan Reese](#) or [David Yaffe](#) at (202) 298-1800 in Washington, D.C. We also invite you to follow Van Ness Feldman’s Electric Practice at <http://twitter.com/VNFelectric>.

In February 2012, Van Ness Feldman expanded its capabilities by combining practices with the Seattle law firm of GordonDerr LLP, a preeminent real estate, land use, water law, and civil litigation firm in the Pacific Northwest. Learn more at www.vnf.com.

© 2013 Van Ness Feldman, LLP. All Rights Reserved.

This document has been prepared by Van Ness Feldman for informational purposes only and is not a legal opinion, does not provide legal advice for any purpose, and neither creates nor constitutes evidence of an attorney-client relationship.