

The Federal Energy Regulatory Commission Can Only Invalidate a Freely Negotiated Contract for Wholesale Electricity by Finding that it Seriously Harms the Public Interest, thereby Overcoming the *Mobile-Sierra* Presumption, Except Where it is Shown that Unlawful Market Manipulation Directly Affected the Contractual Rate, in which Case the *Mobile-Sierra* Presumption Should Not Apply: *Morgan Stanley Capital Group Inc. v. Public Utility Dist. No. 1 of Snohomish County*

ADMINISTRATIVE LAW AND PROCEDURE – UTILITY LAW – ELECTRICITY – PROCEEDINGS BEFORE COMMISSIONS – FEDERAL POWER ACT – The Supreme Court of the United States affirmed the Ninth Circuit on alternative grounds and remanded to the Federal Energy Regulatory Commission to evaluate whether the contractual rates were harmful to the public interest, and whether unlawful market manipulation existed.

Morgan Stanley Capital Group Inc. v. Public Utility Dist. No. 1 of Snohomish County, 128 S. Ct. 2733 (2008).

Morgan Stanley Capital Group Inc. v. Public Utility Dist. No. 1 of Snohomish County (“*Morgan Stanley*”) came to the United States Supreme Court after a long and arduous path.¹ In this consolidated case, the main parties were Morgan Stanley Capital Group, representing energy sellers, and Snohomish County, representing energy buyers, during the western United States energy crisis.² The United States Supreme Court faced two major issues in *Morgan Stanley*.³ First, the Court had to determine whether the *Mobile-Sierra* presumption exclusively applied to energy contracts that were first reviewed by the Federal Energy Regulatory Commission (FERC) without applying the presumption.⁴ Second, the Court was faced with whether the *Mobile-Sierra* presumption established a stronger standard of review for challenges by buyers of electricity as opposed to actions initiated by sellers.⁵ The Supreme Court held that the FERC may invalidate a valid energy con-

1. 128 S. Ct. 2733, 2743 (2008).

2. *Morgan Stanley*, 128 S. Ct. at 2743.

3. *Id.* at 2737.

4. *Id.*

5. *Id.*

tract only when it harms the public interest.⁶ Further, the Court held that this standard of review applied equally to energy buyers and sellers.⁷

In 2000 and 2001, the price of electricity in the western United States increased dramatically due to extreme volatility in the energy markets.⁸ The origin of this volatility began in 1996 when California deregulated⁹ its power industry.¹⁰ California required its three largest investor-owned utilities to divest their electricity-generation facilities and transfer operational control of their transmission facilities.¹¹ California then created a short-term market (“spot market”) for electricity.¹² On a daily basis, the deregulated utilities were required to transact all sales and purchases of electricity on the spot market.¹³ In 1999, auction sales utilizing forward contracts were allowed on the spot market.¹⁴ However, California’s law largely proscribed its utilities from entering into forward contracts to purchase electricity.¹⁵

In the summer of 2000, the price of electricity rose precipitously due to a combination of factors.¹⁶ Restrictions placed on the utilities prevented them from entering into forward contracts, and exposed those utilities to turmoil resulting in rolling blackouts across California.¹⁷ Ultimately, the FERC took emergency steps to stabilize the energy market.¹⁸ The FERC eliminated the requirement that utilities buy and sell electricity daily on the spot market, and instead encouraged utilities to lock into rates by entering into forward

6. *Id.* at 2747.

7. *Morgan Stanley*, 128 S. Ct. at 2747.

8. *Id.* at 2743.

9. *Id.* at 2742. For *Morgan Stanley*, deregulation is defined as the “reduction or elimination of governmental control of business, especially to permit free markets and competition.” BLACK’S LAW DICTIONARY 475 (8th ed. 2004).

10. *Id.* See 1996 Cal. Stat. ch. 854 (codified at Cal. Pub. Util.Code Ann. §§ 330-398.5 (West 2004 and Supp.2008)).

11. *Id.* See also *Pacific Gas & Elec. Co. v. FERC*, 464 F.3d 861, 864 (9th Cir. 2006).

12. *Morgan Stanley*, 128 S. Ct. at 2742. The market was named the California Power Exchange (CalPX). *Id.*

13. *Id.* See *Public Util. Dist. No. 1 of Snohomish Cty. v. FERC*, 471 F.3d 1053, 1068 (9th Cir. 2006). For *Morgan Stanley*, spot market is defined as “[a] market (esp. in commodities) in which payment or delivery is immediate.” BLACK’S LAW DICTIONARY 810 (8th ed. 2004).

14. *Id.* Forward contracts are “contracts in which sellers promise to deliver electricity more than one day in the future,” sometimes for many years. *Id.*

15. *Id.* at 2742-43. See also *Snohomish*, 471 F.3d at 1068.

16. *Id.* at 2742. The increase in the price of electricity “jumped dramatically more than fifteenfold” and “was the result of a combination of natural, economic, and regulatory factors: flawed market rules; inadequate addition of generating facilities in the preceding years; a drop in available hydropower due to drought conditions; . . . strong growth in the economy and in electricity demand; unusually high temperatures; an increase in unplanned outages of extremely old generating facilities; and market manipulation.” *Id.* See also *Californians for Renewable Energy, Inc. v. Sellers of Energy and Ancillary Servs.*, 119 FERC 61,058, pp. 61,243, 61,246 (2007).

17. *Morgan Stanley*, 128 S. Ct. at 2742-43. See 1996 Cal. Stat. ch. 854 (codified at Cal. Pub. Util.Code Ann. §§ 330-398.5 (West 2004 and Supp.2008)).

18. *Id.* at 2743.

contracts.¹⁹ The FERC also placed price controls on wholesale electricity, as this market volatility spread beyond California into neighboring states.²⁰

To prevent further price increases, the Respondents, Public Utility District No. 1 of Snohomish County (“Snohomish”) like other local utilities,²¹ entered into long-term contracts with Petitioners, Morgan Stanley Capital Group (“Morgan Stanley”) and other suppliers.²² Specifically, Snohomish contracted with Morgan Stanley to purchase electricity for nine years at a rate of \$105 per megawatt hour.²³ This rate was historically higher than normal.²⁴ However, Snohomish’s rate was significantly lower than the current rate of electricity on the spot market.²⁵ After the volatility in the energy markets stabilized, the rates fell below Snohomish’s contractual rate of electricity.²⁶

Accordingly, Snohomish asked the FERC to exercise its authority under the Federal Power Act (FPA)²⁷ and set aside the contractual rates in favor of current lower rates.²⁸ Snohomish argued its contractual rates were not “just and reasonable” and that these rates violated the public interest.²⁹ The FERC ordered an Administrative Law Judge (ALJ) to consider whether the contractual rates should be modified.³⁰ As such, the ALJ had to determine whether the *Mobile-Sierra* presumption could be overcome.³¹ Under the *Mobile-Sierra* presumption,³² the FERC created the presumption that freely nego-

19. *Id.*

20. *Id.* *Morgan Stanley* is a consolidated case arising from the Ninth Circuit Court of Appeals and its decision in favor of several utilities in California, Nevada and Washington State. *Id.* at 2733.

21. *Id.* at 2736, 2743. Additional Respondents include Southern California Water Company, Nevada Power Company, Sierra Pacific Power Company, Golden State Water Company, Mirant Energy Trading LLC, the Office of the Nevada Attorney General, and the Bureau of Consumer Protection. *Id.* See also *Snohomish*, 471 F.3d at 1053.

22. *Morgan Stanley*, 128 S. Ct. at 2736, 2743. Additional Petitioners are American Electric Power Services Corporation, Allegheny Energy Supply Company, LLC, and Calpine Energy Services, L.P. *Id.*

23. *Id.* at 2743.

24. *Id.* The price per mega watt hour in the “Pacific Northwest historically averaged \$24 [per mega watt hour].” *Id.*

25. *Id.* “The contract prices were substantially lower, however, than the prices that Snohomish would have paid in the spot market during the energy crisis, when prices peaked at \$3,300 [per mega what hour].” *Id.* See also *Snohomish*, 471 F.3d at 1069-70.

26. *Id.*

27. *Morgan Stanley*, 128 S. Ct. at 2743. See 16 U.S.C.A. § 824e(a).

28. *Id.*

29. *Id.* Specifically, Respondents “contended that the rates in the contracts should not be presumed just and reasonable under *Mobile-Sierra* because . . . the contracts had never been initially approved by the Commission without the presumption.” *Id.* Respondents further argued that “contract modification was warranted even under the *Mobile-Sierra* presumption because the contact rates were so high that they violated the public interest.” *Id.* See 16 U.S.C.A. § 824d(a).

30. *Id.*

31. *Id.* The ALJ considered “twelve different factors in deciding whether the *Mobile-Sierra* presumption could be overcome for the contracts, such as the terms of the contracts, the available alternatives at the time of sale, the relationship of the rates to [FERC] benchmarks, the effect of the contracts on the financial health of the purchasers, and the impact of contract modification on national energy markets.” *Id.*

32. *Morgan Stanley*, 128 S. Ct. at 2738-39. See *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332, 339-44 (1956) (“the filing requirement . . . is merely a precondition to changing a

tiated energy contracts meet the “just and reasonable” requirement of the FPA.³³ This presumption could only be overcome if the FERC found that the contract seriously harmed the public interest.³⁴ Upon review, the ALJ concluded that the contracts did not seriously harm the public interest and accordingly applied the *Mobile-Sierra* presumption.³⁵ Incidentally, after the ALJ’s decision, a report was released by the FERC indicating that “unlawful activities” of energy sellers affected the price of energy on the spot market.³⁶

After a formal hearing, the FERC affirmed the ALJ’s determination that the *Mobile-Sierra* presumption could not be overcome.³⁷ More specifically, the FERC held that to modify a contract under the public interest standard, it was not enough to display unjust and unreasonable prices due to spot market dysfunctions; rather, a showing must be made that the contracts are contrary to the public interest.³⁸ The FERC concluded that, under a totality-of-the-circumstances test, Snohomish failed to establish a threat to the public interest.³⁹ Snohomish was granted a rehearing, and again argued that their contractual rates were the product of market manipulation.⁴⁰ Again, the FERC found no evidence of market manipulation directly affecting Snohomish’s contract.⁴¹ Snohomish appealed.⁴²

The United States Court of Appeals for the Ninth Circuit remanded after finding two errors in the FERC’s analysis.⁴³ First, the court held that “market dysfunction” can render a contract unjust and unreasonable.⁴⁴ Second, assuming *arguendo* that the *Mobile-Sierra* presumption applied, the court held that the standard for reviewing a contract challenge by a purchaser is whether it “exceeds a zone of reasonableness.”⁴⁵ Accordingly, the FERC

rate, not an authorization to change rates in violation of a lawful contract (i.e., a contract that sets a just and reasonable rate.”) *See also* FPC v. Sierra Pac. Power Co., 350 U.S. 348, 352-53 (1956) (rate adversely affect[ed] the public interest).

33. *Id.* *See also* 16 U.S.C.A. § 824d(a).

34. *Id.* at 2737-40. *See also* In re Permian Basis Area Rate Cases, 390 U.S. 747, 767 (1968) (“the regulatory system created by the FPA is premised on contractual agreements voluntarily devised by the regulated companies; it contemplates abrogation of these agreements only in circumstances of unequivocal public necessity”). *Permian Basis Area Rate Cases*, 390 U.S. at 822.

35. *Id.* at 2743. The ALJ also concluded that “even if the *Mobile-Sierra* presumption did not apply, Respondents would not be entitled to have the contracts modified.” *Id.* *See also* 103 FERC at 62,390-92, 62,394.

36. *Id.* at 2743-44. *See* 103 FERC at 62,396.

37. *Morgan Stanley*, 128 S. Ct. at 2743-44.

38. *Id.* *See* 103 FERC at 62,397.

39. *Id.* at 2744. *See also* 103 FERC at 62,397-62,399.

40. *Id.*

41. *Id.*

42. *Morgan Stanley*, 128 S. Ct. at 2744.

43. *Id.* *See* *Snohomish*, 471 F.3d at 1053.

44. *Id.* at 2744-45. The Ninth Circuit agreed that “rates set by contract . . . are presumptively reasonable only where FERC has had an initial opportunity to review the contracts *without applying the Mobile-Sierra presumption*. . . [t]his initial review must include an inquiry into the market conditions in which the contracts at issue were formed, and market dysfunction is a ground for finding a contract not to be just and reasonable.” *Id.* (internal citations omitted)(emphasis added). *See also* *Snohomish*, 471 F.3d at 1085-87.

45. *Id.* at 2745. *See also* *Snohomish*, 471 F.3d at 1088-90.

was instructed to hold further proceedings in accordance with the circuit court's opinion.⁴⁶ Morgan Stanley petitioned for a writ of certiorari, which was granted by the United States Supreme Court.⁴⁷

Two issues were raised on appeal, both of which surrounded the scope of the *Mobile-Sierra* presumption.⁴⁸ The first issue was whether the *Mobile-Sierra* presumption applied exclusively when the FERC had an "initial opportunity" to review energy contracts without applying the presumption.⁴⁹ The second issue presented to the Court was whether *Mobile-Sierra* established a stronger standard of review for challenges by buyers of electricity as opposed to actions initiated by sellers.⁵⁰ The majority held that the 'venerable *Mobile-Sierra* doctrine' will not be disfigured to allow a challenge to the current framework of FERC review.⁵¹ The majority also held that the FERC may invalidate an otherwise valid contract 'only if it harms the public interest.'⁵² Finally, the majority held that the Ninth Circuit's 'zone of reasonableness' test failed to provide appropriate protection for energy contracts.⁵³ However, notwithstanding the majority's disagreement with the Ninth Circuit's analysis, the Court found two errors in the FERC's analysis and ordered the case to be remanded.⁵⁴ Therefore, the judgment of the court of appeals was affirmed on alternative grounds.⁵⁵

Justice Antonin Scalia delivered the opinion of the Court.⁵⁶ Initially, the Court reviewed the statutory background of the FPA and the FERC's authority to regulate the energy market.⁵⁷ To provide further background, the

46. *Id.* See *Snohomish*, 471 F.3d at 1090.

47. *Morgan Stanley*, 128 S. Ct. at 2745. See also Petition for Writ of Certiorari, *Morgan Stanley*, 128 S. Ct. 30 (No. 06-1457). A writ of certiorari was also granted in the case of *Calpine Energy Services, L.P., et al., v. Public Utility District No. 1 of Snohomish County Washington*, 471 F.3d 1053 (9th Cir. 2006), which was consolidated with *Morgan Stanley*. See Petition for Writ of Certiorari, *Calpine*, 128 S. Ct. 31 (No. 06-1462).

48. *Id.* at 2737.

49. *Id.* The Ninth Circuit found "the rates set by contracts . . . are presumptively reasonable only where FERC had had an initial opportunity to review the contracts without applying the *Mobile-Sierra* presumption." *Id.* at 2744.

50. *Id.* at 2737. The Ninth Circuit found that "even assuming that the *Mobile-Sierra* presumption applied, the standard for overcoming that presumption is different for a purchaser's challenge to a contract, namely, whether the contract rate exceeds a "zone of reasonableness." *Id.* at 2745. See also *Snohomish*, 471 F.3d at 1088-90.

51. *Id.* at 2747. The Court held that any challenge to the statutory structure of FERC review of contract rates is "properly addressed in a challenge to the scheme itself" . . . and that the "FERC may abrogate a valid contract only if it harms the public interest." *Id.*

52. *Morgan Stanley*, 128 S. Ct. at 2749.

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.* at 2736. Justices Kennedy, Thomas, and Alito joined. Justice Ginsburg joined as to Part III and filed an opinion concurring in part and concurring in the judgment. Justice Stevens filed a dissenting opinion, in which Justice Souter joined. Chief Justice Roberts and Justice Breyer took no part in the consideration or decision of the cases. *Id.*

57. *Morgan Stanley*, 128 S. Ct. at 2737-38.

Court next discussed the inception and prior development of the *Mobile-Sierra* doctrine.⁵⁸ The majority then focused on the FERC's efforts since the 1970s to deregulate the power industry and open wholesale electricity markets.⁵⁹ Justice Scalia concluded the overview with a thorough review of the genesis of this case, including California's deregulation policies, the use of a spot market to purchase daily electric,⁶⁰ the facts surrounding the disputed contractual rates,⁶¹ as well as the procedural history of the case.⁶²

The Court examined the Ninth Circuit's first holding regarding the FERC's initial opportunity to review a contract.⁶³ The Court agreed with the circuit court's premise that the just and reasonable standard should be used to assess wholesale electricity rates.⁶⁴ The majority, however, disagreed with the lower court's interpretation of the foundational case of *Mobile-Sierra*.⁶⁵ The Court reaffirmed that the FERC may declare a negotiated contract unjust and unreasonable only where the contract seriously harmed the public interest.⁶⁶ The majority also reiterated that the FERC's passive permission that allowed a rate to take effect does not constitute a finding that the rate is just and reasonable.⁶⁷ The majority further determined that the FERC was not required to assess an environment of market dysfunction surrounding a contract's formation before applying *Mobile-Sierra*.⁶⁸ Therefore, the Court concluded that the Ninth Circuit's holding was not supported by case law, and directly undermined the role of contracts under the FPA's regulatory scheme.⁶⁹ Justice Scalia further noted that the FERC is authorized to

58. *Id.* at 2738-40. The Court recognized that the *Mobile-Sierra* doctrine was created in 1956 from two cases, *United Gas Pipe Line Co. v. Mobile*, 350 U.S. 322, and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348. The Court further summarized how in the past 50 years, the *Mobile-Sierra* doctrine was "refined to allow greater freedom of contract." *Morgan Stanley*, 128 S. Ct. at 2739.

59. *Id.* at 2740-42.

60. *Id.* at 2742-43.

61. *Id.* at 2743.

62. *Morgan Stanley*, 128 S. Ct. at 2743-45.

63. *Id.* at 2745. While reviewing this issue, the Court quickly dismissed the application of the *Chenery* doctrine, *SEC v. Chenery Corp.*, 318 U.S. 80, 94-5 (1943), because the FERC was "required to apply the *Mobile-Sierra* presumption in its evaluation. . . ." *Morgan Stanley*, 128 S. Ct. at 2745.

64. *Id.* Both courts recognized that the plain text of the FPA states "[a]ll rates . . . shall be just and reasonable." *Id.* See also 16 U.S.C.A. §§ 824d(a), 824e(a).

65. *Id.* at 2746. Specifically, Justice Scalia stated that the Ninth Circuit misread *Sierra*, 350 U.S. at 352-53. *Id.* The Ninth Circuit took the position that "as long as the [FERC] concludes (pursuant to a hearing or passively allowing the rate to take effect) that a contract rate is just and reasonable when initially filed, the rate will be presumed just and reasonable in future proceedings." *Morgan Stanley*, 128 S. Ct. at 2745. Justice Scalia interpreted the lower court's position as "essentially read[ing] *Sierra* as the equivalent of an estoppel doctrine, whereby an initial [FERC] opportunity for review prevents the [FERC] from modifying the [future] rates . . ." *Id.* at 2746.

66. *Id.*

67. *Morgan Stanley*, 128 S. Ct. at 2746.

68. *Id.* The Supreme Court disagreed with the Ninth Circuit's analysis requiring an investigation into "market dysfunction" recognizing that "markets are not perfect" and that entering into wholesale-power contracts hedges against such market imperfections. *Id.*

69. *Id.* at 2746-47. Justice Scalia ardently disagreed with the Ninth Circuit's conclusion, writing that "[i]t would be a perverse rule that rendered contracts less likely to be enforced when there is volatility in the market . . . enabling sophisticated parties who weathered market turmoil by entering long-term contracts to renounce those contracts once the storm has passed. . . ." *Id.*

set aside a contract, even without applying *Mobile-Sierra*, if it finds evidence of fraud or duress or if the market dysfunction was the result of illegal actions.⁷⁰

Next, Justice Scalia focused on the Ninth Circuit's second holding regarding the zone of reasonableness test for a buyer's challenge.⁷¹ The Court readily determined that this test failed to adequately protect contracts.⁷² In reaching this conclusion, the Court explained that the standard for a challenge, by either a buyer or a seller, required a showing of serious harm to the public interest.⁷³ Justice Scalia noted that the Ninth's Circuit standard of reasonableness would increase volatility in energy markets by undermining stability arising from contracts.⁷⁴ Again, the Court reiterated that the FPA permits the FERC to abrogate a contract in those extraordinary circumstances where the public will be severely harmed.⁷⁵

Despite the Court's disagreement with the Ninth Circuit's analysis, two errors in the FERC's analysis required a remand.⁷⁶ First, the Court discovered that the FERC's determination as to whether the contracts at issue were harmful to the public was flawed.⁷⁷ Specifically, the majority noted that the FERC did not properly assess the disparity of rates into the future.⁷⁸ As such, the possibility existed that the contracted rates may be so inflated that serious harm to the public exists.⁷⁹ Second, the Court was unable to determine whether the FERC found sufficient evidence of alleged unlawful

70. *Id.* at 2747. Specifically, Justice Scalia found that the "FERC has ample authority to set aside a contract where there is unfair dealing at the contract formation stage – for instance, if it finds traditional grounds for the abrogation of the contract such as fraud or duress." *Id.* "In addition, if the dysfunctional market conditions under which the contract was formed were caused by illegal action of one of the parties, [the] FERC should not apply the *Mobile-Sierra* presumption." *Id.* (internal citations omitted). Justice Scalia cautioned, however, that "the mere fact that the market is imperfect, or even chaotic, is no reason to undermine the stabilizing force of contracts that the FPA [has] embraced" *Id.* (internal citations omitted).

71. *Id.* at 2747.

72. *Morgan Stanley*, 128 S. Ct. at 2747.

73. *Id.* Specifically, "[t]he standard for a buyer's challenge must be the same generally speaking, as the standard for a seller's challenge: The contract must seriously harm the public interest." *Id.* The Court found that this standard was applied by the FERC in its proceedings. *Id.*

74. *Id.* at 2749. The Court recognized the FERC's statement that "its first and foremost duty is to protect consumers from unjust and unreasonable rates; however, . . . uncertainties regarding rate stability and *contract sanctity* can have a chilling effect on investments and a seller's willingness to enter into long-term contracts [which] . . . can harm the [public] in the long run." (quoting Market Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities, 72 Fed. Reg. 39904-01 (July 20, 2007)(to be codified at 18 C.F.R. pt. 35)). *Id.* at 2749 (emphasis added).

75. *Id.*

76. *Id.* at 2749.

77. *Morgan Stanley*, 128 S. Ct. at 2750.

78. *Id.* The Court concluded that ". . . the disparity between the contract rate and the rates consumers would have paid (but for the contracts) further down the line, when the open market was no longer dysfunctional . . . could amount to an "excessive burden." *Id.* The Court recognized the possibility that the "rates had increased so high during the energy crisis because of dysfunction in the spot market that, even with the acknowledged decrease in rates, consumers still paid more under the forward contracts than they otherwise would have." *Id.* See also *Snohomish*, 471 F.3d at 1090.

79. *Id.*

market manipulation directly affecting the contracts at issue.⁸⁰ The Court emphasized that the FERC should not presume the contract to be just and reasonable where unlawful activity is present.⁸¹ The Court warned that before abrogating a contract, the FERC must find a causal connection between the illegal activity and the contractual rate.⁸² However, if a causal connection is found, the *Mobile-Sierra* presumption should not apply.⁸³

Therefore, the Court affirmed the judgment of the Ninth Circuit Court of Appeals on alternative grounds, and remanded the case for proceedings consistent with its opinion.⁸⁴

Justice Ruth Ginsburg drafted a concurring opinion in which she agreed with the majority's decision to remand after finding errors in the FERC's determination.⁸⁵ Justice Ginsburg argued that the Court should have remanded to the FERC and waited for a more complete record of the FERC's evaluation of the contracts at issue under *Mobile-Sierra*.⁸⁶

A dissenting opinion authored by Justice John Stevens disagreed with the majority's analysis and found it to be improper policymaking.⁸⁷ Justice Stevens reasoned that Congress intended for the FERC to modify contracts without qualification or exception and without a mandatory presumption.⁸⁸ The dissent believed that if Congress intended to impose such a presumption as *Mobile-Sierra*, it would have done so explicitly.⁸⁹ In a forceful recount of

80. *Id.* at 2750-51.

81. *Id.* The Court concluded that "if it is clear that one party to a contract engaged in such extensive unlawful market manipulation as to alter the playing field for contract negotiations, the [FERC] should not presume that the contract is just and reasonable." *Id.* "Like fraud and duress, unlawful market activity that directly affects contract negotiations eliminates the premise on which the *Mobile-Sierra* presumption rests: that the contract rates are the product of fair, arms-length negotiations." *Id.*

82. *Morgan Stanley*, 128 S. Ct. at 2751. The Court emphasized that "the mere fact of a party's engaging in unlawful activity in the spot market does not deprive its forward contracts of the benefit of the *Mobile-Sierra* presumption." *Id.* Furthermore, "[t]here is no reason why [the] FERC should be able to abrogate a contract on these grounds without finding a causal connection between unlawful activity and the contract rate." *Id.*

83. *Id.*

84. *Id.*

85. *Id.* (Ginsburg, J. concurring). Specifically, Justice Ginsburg stated "I think it plain, however, that the [FERC] erred in the two respects identified by the Court." *Id.*

86. *Id.* (Ginsburg, J. concurring). Justice Ginsburg stated that "the [FERC] called our attention to 'new measures' it has taken, as well as recent enactments by Congress, bearing on the evaluation of contracts under *Mobile-Sierra*." *Id.* Justice Ginsburg continued, "[i]n view of these developments, the [FERC] suggested, this Court should await 'the better-developed record that would be produced by [the] FERC on remand.'" *Id.* Finally, Justice Ginsburg stated "the Court would have been better informed had it awaited the [FERC]'s decision on remand." *Id.*

87. *Morgan Stanley*, 128 S. Ct. at 2751-59 (Stevens, J., dissenting).

88. *Id.* at 2752 (Stevens, J., dissenting). Justice Stevens stated that "even if the *Mobile-Sierra* presumption were not tantamount to a separate standard, nothing in the [FPA] mandates differing application of the statutory standard to rates set by contracts." *Id.* Justice Stevens continued, "[s]ection 206(a) of the FPA provides 'without qualification or exception,' that the FERC may replace any unjust or unreasonable contract with a lawful contract." *Morgan Stanley*, 128 S. Ct. at 2752. Finally, Justice Stevens states that "[t]he statute does not say anything about a mandatory presumption for contracts . . ." *Id.* See also 16 U.S.C.A. §206(a).

89. *Id.* (Stevens, J., dissenting).

the underpinning statutes and case law,⁹⁰ Justice Stevens concluded that the Court lacked any ground to conclude the *Mobile-Sierra* presumption was necessary as a matter of law.⁹¹ Justice Stevens believed the FERC's flexibility to review contractual rates in changing market conditions is no longer present.⁹² He praised the Ninth Circuit Court of Appeals for their effort to reign in the freewheeling *Mobile-Sierra* doctrine.⁹³ Further, the dissent firmly argued that the Court is not authorized to stipulate energy policy through presumptions or prerequisites.⁹⁴

The *Mobile-Sierra* doctrine was derived from a pair of companion cases decided on the same day in 1956.⁹⁵ In *United Gas Pipe Line Co. v. Mobile Gas Services Corp.*⁹⁶ and *FPC v. Sierra Pacific Power Co.*,⁹⁷ the Supreme Court reviewed the Federal Power Commission's (FPC)⁹⁸ authority to modify contracts under the Natural Gas Act (NGA)⁹⁹ and the FPA.¹⁰⁰ Ultimately, the Court created the *Mobile-Sierra* doctrine through its determination that the FPC could not modify contractual rates unless those rates harmed the public interest.¹⁰¹ *Mobile* and *Sierra* were decided under traditional cost based regulation and were considered a step towards quasi-deregulation, well before deregulation of the energy industry and the use of market-oriented transactions.¹⁰² As such, a review of the statutory framework of the FPA is necessary to establish *Mobile-Sierra*'s venerability in preserving the integrity of contracts and its continued importance to energy regulation.¹⁰³

Congress' regulation of the energy industry began when it passed the Public Utility Act of 1935.¹⁰⁴ Congress established a comprehensive scheme of

90. *Id.* at 2753-56. (Stevens, J., dissenting).

91. *Id.* at 2756. (Stevens, J., dissenting).

92. *Morgan Stanley*, 128 S. Ct. at 2759 (Stevens, J., dissenting).

93. *Id.* (Stevens, J., dissenting).

94. *Id.* (Stevens, J., dissenting).

95. *Id.* at 2739. See also Carmen L. Gentile, *The Mobile-Sierra Rule: Its Illustrious Past and Uncertain Future*, 21 ENERGY L.J. 353 (2000); David G. Tewksbury & Stephanie S. Lim, *Applying the Mobile-Sierra Doctrine to Market-Based Rate Contracts*, 26 ENERGY L.J. 437 (2005).

96. *Mobile*, 350 U.S. 322.

97. *Sierra*, 350 U.S. 348.

98. *Mobile*, 350 U.S. at 334. See also *Sierra*, 350 U.S. at 353. The Federal Power Commission was the predecessor to the FERC. See Gentile, *supra* note 95, at 353; Tewksbury & Lim, *supra* note 95, at 437.

99. The Natural Gas Act, 15 U.S.C.A. § 717, § 717(a)-717(w) (2005). It is important to note that the pertinent provisions of the NGA (§§ 4(c), (d), (e), and 5(a)) are substantially identical to the provisions of the FPA (§§ 205(c), (d), (e), and 206(a)). See *Sierra*, 350 U.S. at 353; *Mobile*, 350 U.S. at 346.

100. 16 U.S.C.A. § 824 et. seq. Importantly for *Morgan Stanley*, despite several natural gas topics being referenced, the *Mobile-Sierra* doctrine will mainly be considered in relation to the electric industry. *Morgan Stanley*, 128 S. Ct. at 2737-38. For a meticulous review of *Mobile-Sierra* in the electric industry, see Tewksbury & Lim, *supra* note 95, at 437.

101. *Mobile*, 350 U.S. at 343-46; *Sierra*, 350 U.S. at 355.

102. Tewksbury & Lim, *supra* note 95, at 437; Gentile, *supra* note 95, at 357.

103. *Morgan Stanley*, 128 S. Ct. at 2747; *Mobile*, 350 U.S. at 343-44. See also Tewksbury & Lim, *supra* note 95, at 437.

104. Stephen L. Teichler & Ilia Levitine, *Long-Term Power Purchase Agreements in a Restricted Electricity Industry*, 40 WAKE FOREST L. REV. 677 (2005). "Congress passed the Public Utility Act of 1935 (Wheeler-Rayburn Act) . . . which is now known as the Federal Power Act of 1935 (FPA)." *Id.* at

federal regulation by giving the FPC jurisdiction over the transmission and wholesale sales of electric energy in interstate commerce.¹⁰⁵ Under the FPA, utilities were able to negotiate and enter into bilateral contracts for the purchase of wholesale electricity.¹⁰⁶ Regulated utilities were required under the FPA to file these contracts, or any rate schedules, with the FPC.¹⁰⁷ The most important aspect of the FPA was the FPC's ability to modify contracts between regulated utilities.¹⁰⁸ Under the FPA, all wholesale rates for electricity must be just and reasonable.¹⁰⁹ Furthermore, when a rate is filed with the FPC, it has the ability to decline investigation of the rate, and defer until after the rate is in effect as well as the authority to suspend rates for a period of five months.¹¹⁰

In *Mobile*, the Supreme Court attempted to determine whether a regulated utility may unilaterally change its contractual rate by filing a new rate schedule with the FPC.¹¹¹ *Mobile* entered into a contract with United Gas to obtain natural gas at a rate of 10.7 cents per million cubic feet ("MCF") for ten years.¹¹² Thereafter, and without *Mobile*'s consent, United Gas filed a new rate of 14.5 cents per MCF with the FPC.¹¹³ *Mobile* petitioned the FPC to reject the new rate, which the FPC refused to do.¹¹⁴ *Mobile* appealed the FPC's decision to the Third Circuit Court of Appeals, which reversed the FPC.¹¹⁵ The Supreme Court granted certiorari, and held that the NGA did not give utility companies the ability to unilaterally change their rate con-

681. "The new FPA became one of the principle pillars of federal electricity regulation in the United States . . ." *Id.* See also Pub. L. No. 74-333, 49 Stat. 803 (1935).

105. 16 U.S.C.A. § 824(a). See also Teichler & Levitine, *supra* note 104, at 681.

106. 16 U.S.C.A. §§ 824c, 824d. For *Morgan Stanley*, a bilateral contract is defined as "a contract in which the parties obligate themselves reciprocally, so that the obligation of one party is correlative to the obligation of the other." BLACK'S LAW DICTIONARY 272 (8th ed. 2004).

107. *Id.*

108. 16 U.S.C.A. § 824d(e).

109. 16 U.S.C.A. § 824d(a).

110. 16 U.S.C.A. § 824d(e). See 18 C.F.R. § 35.4 (2007). See also *Morgan Stanley*, 128 S. Ct. at 2738 (discussing the operation of the FPA); *Papago Tribal Utility Authority v. Federal Energy Regulatory Commission*, 723 F.2d 950 (D.C. Cir. 1983):

The Federal Power Act provides two routes for changing electricity rates: The seller may initiate rate changes under § 205 [16 U.S.C.A. § 824(d)] of the Act, by filing a new schedule, which is subject to Commission review for justness and reasonableness, but which takes effect immediately (after the sixty-day notice period required by subsection (d)), subject to Commission suspension of no more than five months pending investigation; and the Commission itself may initiate rate changes (usually, of course, upon application of one of the parties to the contract) under § 206 [16 U.S.C.A. § 824e(a)], but only upon finding that the existing rates are unjust, unreasonable, unduly discriminatory or preferential.

Id. at 953.

111. *Mobile*, 350 U.S. at 333-34.

112. *Id.* at 335-37. *Mobile* obtained this long-term contract because it wanted to ensure a sufficiently low rate before entering a contract with Ideal Cement Company to supply natural gas to a new cement plant under construction. *Id.* at 335-36. *Mobile* entered a long term supply contract with Ideal at a rate of 12 cents per MCF. *Id.*

113. *Id.* at 336.

114. *Id.*

115. *Id.* at 337.

tracts.¹¹⁶ The Court determined that the NGA plainly states that a change cannot be made without proper notice to the FPC.¹¹⁷ The *Mobile* Court recognized that the basic power of the FPC, under the NGA, is to adjust any contract determined to be unjust, unreasonable, unduly discriminatory, or preferential.¹¹⁸ In the Court's opinion, this interpretation preserved the supply arrangements essential to the natural gas industry, as well as the integrity of contracts.¹¹⁹

In *Mobile*'s companion case, *Sierra*, the Supreme Court addressed whether a regulated utility could unilaterally change its contractual rate by filing a new rate schedule with the FPC under the FPA.¹²⁰ *Sierra* entered into a fifteen year contract with Pacific Gas and Electric ("PG&E") to purchase wholesale electricity at a special low rate.¹²¹ After the contract was filed with the FPC, PG&E filed a rate increase with the FPC.¹²² *Sierra* petitioned the FPC to reject the rate increase, which was denied.¹²³ *Sierra* then petitioned the Circuit Court of Appeals for the District of Columbia for review of the FPC's denial.¹²⁴ The Circuit Court reversed and set aside the FPC's order.¹²⁵ The Supreme Court granted certiorari, and held that the FPA did not give utility companies the ability to unilaterally change their rate con-

116. *Mobile*, 350 U.S. at 337.

117. *Id.* at 339-40. Specifically, Justice John Marshall Harlan stated:

The provision of the [NGA] directly in issue here is [§] 4(d), which provides that 'no change shall be made by any natural-gas company in such (filed) rate . . . or contract . . . except after thirty days' notice to the [FPC]' On its face [§] 4(d) is simply a prohibition, not a grant of power The section says only that a change cannot be made without the proper notice to the [FPC] Absent the Act, a unilateral announcement of a change to a contract would be of course a nullity To find in the section a further purpose to empower natural gas companies to change their contracts unilaterally requires reading into it language that is neither there nor reasonably to be implied.

Id.

118. *Id.* at 341. The *Mobile* Court recognized that this "is neither a 'rate-making' nor a 'rate-changing' procedure . . . [i]t is simply the power to review rates and contracts . . . and if they are determined to be unlawful, to remedy them." *Id.* Sections 4 and 5 of the NGA are codified at 15 U.S.C. § 717(c)-(d) (2000).

119. *Id.* at 344. The *Mobile* Court stated "[b]y preserving the integrity of contracts, it permits the stability of supply arrangements which all agree is essential to the health of the natural gas industry." The Court recognized that industrial consumers "would be unwilling to make [substantial investments] without long-term commitments from the distributor, and the distributor can hardly make such commitments if its supply contracts are subject to unilateral change by the natural gas company whenever its interests so dictate." *Id.*

120. *Sierra*, 350 U.S. at 352-53. Justice Harlan began by emphasizing that the pertinent provisions of the NGA (§§ 4(c), (d), (e), and 5(a)) are substantially identical to the provisions of the FPA (§§ 205(c), (d), (e), and 206(a)). *Id.* at 349-51. Importantly, FPA § 205 and § 206 are codified at 16 U.S.C.A. § 824(d)-(e) (2000).

121. *Id.* at 352.

122. *Id.*

123. *Id.*

124. *Id.*

125. *Sierra*, 350 U.S. at 352. Specifically, the circuit court held that "the contract rate could be changed only upon a finding by the Commission that it was unreasonable." *Id.* The circuit court "set aside the Commission's order and remanded the case with instructions to the Commission to dismiss the . . . proceeding." *Id.*

tracts.¹²⁶ Additionally, the Court recognized that, in cases where rates produce less than a fair return, the FPC must determine if the rate is so low that it harms the public interest by impairing the utility.¹²⁷ The Court instructed that the FPC's concern would be to assess whether the rate was so low as to harm the public interest.¹²⁸ However, the mere fact that a contract is unprofitable to a public utility does not necessarily mean it is unjust or unreasonable, thereby requiring the FPC's modification.¹²⁹

Two years after *Mobile* and *Sierra* were decided, the Supreme Court revisited the *Mobile-Sierra* doctrine in *United Gas Pipe Line Co. v. Memphis Light*.¹³⁰ In *Memphis Light*, the Court reviewed an FPC determination regarding two contracts between public utilities that established a going rate for natural gas.¹³¹ The Court determined that the contracted going rate was lawful.¹³² The Court also indicated that United Gas was not unilaterally changing its contractual obligations when it filed for a new rate increase, but simply exercised its rights reserved by contract.¹³³ After *Memphis Light*, the

126. *Id.* at 352-53. The Supreme Court stated “[w]e brought the case here because of the importance of the questions involved in the administration of the Federal Power Act.” *Id.* The Court recognized that “the provisions of the Federal Power Act relevant to this question are in all material respects substantially identical to the equivalent provisions of the Natural Gas Act” which was construed in *Mobile* as “not authorizing unilateral contract changes, and that interpretation is equally applicable to the [FPA].” *Id.*

127. *Id.* at 354-55. The *Sierra* Court recognized that while the FPC “may not normally impose upon a public utility a rate which would produce less than a fair return, it does not follow that the public utility may not itself agree by contract to a rate affording less than a fair return” thereby being relieved of its improvident bargain. *Id.* at 355.

128. *Id.* at 355. “In such circumstance the sole concern of the [FPC] would seem to be whether the rate is so low as to adversely affect the public interest – as were it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory.” *Id.*

129. *Id.* at 355. The *Sierra* Court stated “the purpose of the power given the Commission by [the FPA] is the protection of the public interest, as distinguished from the private interests of the utilities . . . it is clear that a contract may not be said to be either ‘unjust’ or ‘unreasonably’ simply because it is unprofitable to the public utility.” *Id.*

130. 358 U.S. 103 (1958). See also *Tewksbury & Lim*, *supra*, note 95, at 443.

131. *Memphis Light*, 358 U.S. at 105. Memphis entered into a contract with United Gas for a supply of natural gas. *Id.* The contract specifically stated that the gas “shall be paid for by Buyer under Seller’s Rate Schedule . . . or any effective superseding rate schedules, on file with the [FPC]” *Id.* Thereafter, United Gas filed a new rate with the FPC, together with supporting data, which raised the price on all contracts. *Id.* at 106. Memphis claimed that the new rate was unlawful pursuant to *Mobile*. *Id.* at 107-08. The FPC, distinguishing *Mobile*, and determined these contracts to establish the “going rate” and refused to reject the new rate. *Memphis Light*, 358 U.S. at 108. The court of appeals reversed, holding that *Mobile* did not allow for a new rate since the rate was not mutually agreed upon. *Id.* at 108-09. The Supreme Court granted certiorari. *Id.* at 109.

132. *Id.* at 110-11. The Supreme Court recognized that the contract “is vitally different from that in *Mobile* . . . [it was] not at a single fixed rate . . . but at what in effect amounted to [United Gas’s] current going rate. Contractually this left United free to change its rates. . . .” *Id.* at 110.

133. *Id.* at 112. The Court stated “[t]he importance and indeed decisive difference between this case and *Mobile*, is that in *Mobile* one party to a contract was asserting that the [NGA] . . . gave it the right unilaterally to abrogate its contractual undertaking, whereas here [United Gas] seeks simply to assert rights expressly reserved to it by contract.” *Id.* Furthermore, that “*Mobile*, affirmatively establishes that . . . ‘the initial rate-making and rate-changing powers of [utilities] remain undefined and unaffected by the [NGA].’” *Id.* at 113. Finally, the Supreme Court stated “United [Gas] . . . has the right in the first instance to change its rates as it will, unless it has undertaken by contract not to do so.” *Id.*

2008 Morgan Stanley Cap. Group v. Public Utility Dist.No.1 103

FPC as well as the courts, have struggled to resolve issues stemming from *Mobile-Sierra's* application.¹³⁴

In 1968, the Court reviewed an FPC order that established maximum just and reasonable rates between utilities in specific geographical areas.¹³⁵ In deciding that the FPC's rates did not prohibit utilities from receiving revenues comparable with just and reasonable rates, the Court reaffirmed that the regulatory scheme was premised on contractual agreements that can only be modified by the FPC in circumstances of unequivocal public necessity.¹³⁶ This decision led to a period of time where the *Mobile-Sierra* doctrine was strictly enforced by the FPC and various courts of appeals.¹³⁷

In *Richmond Power and Light v. Federal Power*, the Circuit Court of Appeals for the District of Columbia reviewed rate contracts that tied together changes in wholesale and retail rates of electricity, and determined *Mobile-Sierra* protection applied to prevent modification.¹³⁸ The *Richmond* court recognized that *Mobile-Sierra* was refreshingly simple in its application, and admonished the FPC for not abiding by *Mobile-Sierra's* principles.¹³⁹ *Mobile-Sierra* was also strictly applied by the D.C. Circuit Court in *Papago Trial Utility Authority v. FERC ("Papago I")*.¹⁴⁰

134. Tewksbury & Lim, *supra*, note 95, at 444-45. See also Gentile, *supra*, note 95, at 386.

135. *Permian Basin*, 390 U.S. at 747-57.

136. *Id.* at 820-23. The Supreme Court stated "[t]he regulatory system created . . . is premised on contractual agreements voluntarily devised by the regulated companies; it contemplates abrogation of these agreements only in circumstances of unequivocal public necessity." *Id.*

137. Gentile, *supra*, note 95, at 358.

138. 481 F.2d 490 (D.C. Cir. 1973).

139. *Richmond Power*, 481 F.2d at 493. The circuit court stated "[t]he rule of *Sierra, Mobile*, and *Memphis* is refreshingly simple: The contract between the parties governs the legality of the filing. Rate filings consistent with contractual obligations are valid; rate filings inconsistent with the contractual obligations are invalid." *Id.* (internal citations omitted). The circuit court continued:

By ensuring that contractual obligations cannot be circumvented by one party to the contract unilaterally filing with the Commission a new tariff inconsistent with those obligations, the *Mobile-Sierra-Memphis* doctrine "[preserves] the integrity of contracts" and "permits the stability of supply arrangements which all agree is essential to the health of . . . industry." These principles apply whether the parties agree to a specific rate or whether they agree to a rate changeable in a specific manner. In either case the contract is binding, and a unilateral filing is ineffective to change it

[The decision by the FPC] shows that the Commission simply does not understand, or more likely is not willing to abide by, the fundamental principle of the *Sierra-Mobile-Memphis* decisions.

Id. at 497 (internal citations omitted). See also Gentile, *supra*, note 95, at 358-59.

140. 610 F.2d 914, 929-30 (D.C. Cir. 1979) ("We hold that the agreements, properly construed, authorize rate revisions only by an appropriate order of the Commission in a Section 206(a) proceeding"). See also Gentile, *supra*, note 95, at 358-59. In a thorough summary, Gentile stated:

Whereas Richmond [Power] determined that parties could negotiate contracts that would tie wholesale rate changes to retail rate changes, Papago I recognized parties could also agree by contract to an FPA rate change mechanism that would prohibit the utility from filing rate increases under section 205, but would allow it to seek rate increases under section 206 Since Commission rate adjudications often require years to complete, Papago I preserved a drastic contract limitation on the Commission's ability in periods of rapidly rising costs to allow utilities to charge rates which it viewed as compensatory.

Id. at 359 (internal citations omitted).

In 1983, Justice Scalia decided two cases on the same day, which allowed greater judicial deference to the FERC's determination as to the applicability of the *Mobile-Sierra* doctrine.¹⁴¹ In *Papago Tribal Utility Authority v. FERC* ("Papago II"),¹⁴² the D.C. Circuit Court again reviewed the contract in *Papago I* and rejected the argument that the just and reasonable standard did not apply to future rate changes.¹⁴³ In doing so, the Court recognized three types of contractual arrangements for rate revision under *Mobile-Sierra*: (1) unilateral rate revision subject to FERC review under the just and reasonable standard; (2) a contractual agreement to allow the rate to be set by the FERC under *Mobile-Sierra*'s public interest standard; and (3) an agreement to disallow unilateral rate revision, yet still allowing for FERC adjustment under the just and reasonable standard.¹⁴⁴ Concurrently, in *Kansas City v. FERC*,¹⁴⁵ the Circuit Court deferred to the FERC's approval of electricity rates, made conditionally effective pending resolution of a price squeeze claim, under the just and reasonable standard.¹⁴⁶

In the 1990s, the United States Supreme Court decided two appeals pursuant to *Northeast Utilities Service Co. v. FERC*.¹⁴⁷ In these complex rate review cases, the Court determined that *Mobile-Sierra* applied in circumstances where rates were increased as well as decreased.¹⁴⁸ It was recognized, in the *Northeast* cases, that the Supreme Court modified the third standard of review from *Papago II*, and gave a more expansive definition of "public interest considerations."¹⁴⁹ Also during this timeframe, the energy

141. Gentile, *supra* note 95, at 358, 360. Notably, Justice Scalia also authored the Court's opinion in *Morgan Stanley*. See *Morgan Stanley*, 128 S. Ct. at 2733.

142. 723 F.2d 950 (D.C. Cir. 1983).

143. *Id.* at 954 (recognizing that "the possibility of future rate change is virtually meaningless unless [the agreement] envision[ed] a just-and-reasonable standard. The public-interest standard is practically insurmountable; the Commission itself is unaware of any case granting relief under it Future rate changes would be a dim prospect, hardly worthy of recognition, if the parties did not intend the just-and-reasonable standard to govern). See Gentile, *supra*, note 95, at 360.

144. *Papago*, 723 F.2d at 953. See also Gentile, *supra* note 95, at 360-61.

145. 723 F.2d 82, 88-89, 96 (D.C. Cir. 1983).

146. *Id.* (noting "[t]he obstacle that the public-interest standard presents to a rate change is almost insurmountable, see *Papago Tribal Utility Authority v. FERC*, *supra*, at 954 (decided today)"). See also Gentile, *supra*, note 95, at 360-63. Gentile observed:

Kansas Cities added still another twist to the *Mobile-Sierra* doctrine by holding that contractual regulatory approval clauses . . . given certain language and certain circumstances, contemplated rate changes under the just and reasonable standard rather than the strict *Mobile-Sierra* public interest standard. . . . In *Kansas Cities*, the court recognized that the *Mobile-Sierra* rule was rate neutral in that *Mobile-Sierra* protections lock-in not only low rates in times of high costs, but also high rates in times of low costs In fact, the principle difference between the *Richmond* and *Papago I* decisions and the *Papago II* and *Kansas Cities* decisions may be that [the later two] reflect greater deference to the regulator. . . . *Kansas Cities* and *Papago II* emphasize the need for agency deference and for the agency to determine within reasonable bounds how best to implement the *Mobile-Sierra* mandate.

Id. at 361, 362-63 (internal citations omitted).

147. 993 F.2d 937 (1st Cir. 1993). See also *Northeast Utilities Service Co. v. F.E.R.C.*, 55 F.3d 686 (1st Cir. 1995); Gentile, *supra*, note 95, at 365-73.

148. Gentile, *supra*, note 95, at 364-65.

149. *Id.* at 373. Gentile opined that:

industry was being restructured under the FERC to promote the use of market-oriented transactions,¹⁵⁰ which ushered in the modern era for *Mobile-Sierra* analysis.¹⁵¹ Courts used the *Mobile-Sierra* doctrine to continue to preserve contractual agreements and allow for efficient FERC regulation.¹⁵² With the complexity of market-based regulation, along with the associated contractual agreements, it has been suggested that litigation involving the *Mobile-Sierra* doctrine will be reduced.¹⁵³ Yet shortly thereafter, the western energy crisis had already begun and would introduce the *Mobile-Sierra* doctrine into the twenty-first century.¹⁵⁴

California's restructuring of the energy market, by mandating an energy spot market while restricting private utilities from entering into long-term rate contracts, was a failed policy that significantly contributed to the energy crisis.¹⁵⁵ In the midst of the crisis, the FERC reversed California's efforts by abolishing the utilities' reliance on California's spot market, and encouraging utilities to enter into long-term rate contracts.¹⁵⁶ The FERC's reversal specifically showed that contractual relations between utilities are necessary to effectuate efficient regulation, as well as to promote the industry's efficient operation.¹⁵⁷ Such contracts are needed to reduce risks of volatility in wholesale energy markets, to protect expectations of utilities, and to attract and encourage large investments into the energy industry.¹⁵⁸ Ultimately, in the era of deregulation, the role of contracts in the electricity industry re-

The Northeast decisions represent watershed developments in Mobile-Sierra Analysis. They constitute the most significant interpretations of the Mobile-Sierra doctrine since Papago II and Kansas Cities, and are perhaps the most significant since the Supreme Court promulgated the doctrine in its Mobile and Sierra decisions. [The Northeast decisions] represent a sharp change in FERC and judicial contract reformation analysis and drastically revise the Mobile-Sierra doctrine. . . . After the Northeast decisions, three standards of review apply to contract reformation: the "just and reasonable" standard, the classic "practically insurmountable" public interest standard, and the more lenient Northeast standard, which affords an expansive definition of the public interest considerations that would justify reformation of a bilateral contract.

Id. See *Northeast*, 55 F.3d at 692.

150. *Id.* at 373-81.

151. *Id.* at 381. For a thorough analysis of the FERC's regulation in a market-based regulatory structure, see *Tewksbury & Lim*, *supra*, note 95, at 447-72.

152. See *Texaco, Inc. v. FERC*, 148 F.3d 1091 (D.C. Cir. 1998). See also *Louisiana Energy and Power Auth. v. FERC*, 141 F.3d 364 (D.C. Cir. 1998) (approval of market-based rates extended to sales of electricity); *Potomac Elec. Power Co. v. FERC*, 210 F.3d 403 (D.C. Cir. 2000) (recognizing that "it is reasonable for [the] FERC to require parties 'to live with their bargains as time passes and various projections about the future are proved correct or incorrect.'"); *Boston Edison Co. v. FERC*, 233 F.3d 60 (1st Cir. 2000) (FERC reviewing utility contract under Mobile-Sierra's public interest standard.); *Verizon Commc'ns Inc. v. FCC*, 535 U.S. 467 (2002); *Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361, 1363 (D.C. Cir. 2004); *Gentile*, *supra* note 95, at 381-88.

153. *Gentile*, *supra*, note 95, at 388.

154. Lucy Wiggins, *The Ninth Circuit Confronts the Aftermath of the Western Energy Crisis*, 7 SUSTAINABLE DEV. L. & POL'Y. 63 (2007).

155. *Morgan Stanley*, 128 S. Ct. at 2742-43.

156. *Id.* at 2743. The FERC also instituted wholesale price caps. *Id.* See also Wiggins, *supra*, note 154, at 63.

157. Teichler & Levitine, *supra*, note 104, at 683.

158. *Id.* at 683, 706.

mains an indispensable component to the reliable functioning of competitive wholesale markets.¹⁵⁹

Accordingly, as long as negotiated contracts play an indispensable role in the current regulatory scheme, the *Mobile-Sierra* doctrine will continue to protect the sanctity of those contracts.¹⁶⁰ The *Mobile-Sierra* doctrine will continue to stand for the proposition that conventional regulation must give way to contracts that are the product of negotiation and market forces.¹⁶¹ Moreover, such regulation will only be allowed to encroach upon these private contracts in circumstances of unequivocal public necessity.¹⁶² By rejecting the Ninth Circuit's zone of reasonableness standard, the majority reaffirmed *Mobile-Sierra's* role in holding parties to their contractual obligations, even in a market-based regulatory scheme.¹⁶³ At a minimum, *Mobile-Sierra* is a fundamental principle that will continue to influence regulatory policy, as well as its interpretation by the FERC and the courts.

However, the majority explicitly delineated an exception to *Mobile-Sierra's* application in cases where a direct causal connection is established between unlawful market activity and a contracts formation.¹⁶⁴ Undoubtedly, upon remand to the FERC, the parties will likely focus their efforts on establishing such a causal connection in an attempt to subvert *Mobile-Sierra's* presumption.¹⁶⁵ As recognized by the Supreme Court, this will be a complicated task for the FERC to undertake.¹⁶⁶ There also remains a slim possibility that the FERC will find the contractual rates to be so inflated that they evidence serious harm to the public interest, thereby disallowing the rate. Regardless of the FERC's findings, and given the amount of litigation invested in the outcome of this issue, the legal fallout from the energy crisis is still far from over.¹⁶⁷

The future impact that *Morgan Stanley* will have on deregulation cases is difficult to predict. Certainly, *Morgan Stanley* will join the long line of cases interpreting the *Mobile-Sierra* doctrine. This case will be used in any attempt to subvert the *Mobile-Sierra* presumption due to illegal market activities influencing energy contracts. Furthermore, *Morgan Stanley* will also speak

159. *Id.* at 677-78.

160. *See Mobile*, 350 U.S. at 344. *See also* Tewksbury & Lim, *supra*, note 95, at 437.

161. Teichler & Levitine, *supra*, note 104 at 683-84. *See also* Gentile, *supra*, note 95, at 358 (quoting *Permian Basin*, 390 U.S. at 822).

162. *Id.*

163. *Morgan Stanley*, 128 S. Ct. at 2747-49. The Court stated "besides being wrong in principle, in its practical effect the Ninth Circuit's rule would impose an onerous new burden on the Commission, requiring it to calculate the marginal cost of the power sold under a market-based contract." *Id.* at 2749.

164. *Id.* at 2747, 2751.

165. *Id.* Importantly, the FERC will likely have to reassess the possible causal connection of identified unlawful activities in the spot market on remand. *Id.* at 2743-44.

166. *Id.* at 2747. The majority stated, "that evaluating market 'dysfunction' is a very difficult and highly speculative task-not one that the FPA would likely require the agency to engage in before holding sophisticated parties to their bargains." *Id.*

167. Jeffrey McIntyre Gray, *Reconciling Market-Based Rates with the Just and Reasonable Standard*, 26 ENERGY L. J. 423 (2005).

to the various courts of appeal as to the continued viability of the *Mobile-Sierra* doctrine. However, *Morgan Stanley* did not specifically address the lawfulness of the FERC's current regulatory scheme.¹⁶⁸ In retrospect, such market-based regulation was a significant contributing factor to the western energy crisis.¹⁶⁹ Interestingly enough, some held the viewpoint that that *Mobile-Sierra* had no application in a market-based regulatory scheme.¹⁷⁰ Possibly in response to such viewpoints, given the majority's adamant protection of the *Mobile-Sierra* doctrine, it is likely that *Morgan Stanley* will be viewed as a prominent pronouncement to *Mobile-Sierra*'s applicability in any regulatory scheme, specifically one based on the wholesale market. Caution must be taken by utilities entering into long-term energy contracts during a volatile market, especially since such volatility often subsides and regulatory oversight may be ineffective, since the utilities will likely be bound to their contractual obligations absent a direct showing of illegal influence.¹⁷¹

Mobile-Sierra's role in safeguarding energy contracts, as well as the public interest, is an indispensable component to energy regulation in the United States. Although regulators will strive to prevent a reoccurrence, the western energy crisis gave them valuable insight into the complexities of the energy markets.¹⁷² As such, a fundamental lesson is that *Mobile-Sierra*'s principles

168. *Morgan Stanley*, 128 S. Ct. at 2741-42, 2747. Specifically, the Court stated “[w]e have not hitherto approved, and express no opinion today, on the lawfulness of the market-based-tariff system, which is not one of the issues before us.” *Id.* at 2741-42.

169. Gray, *supra*, note 167, at 423-24, 426. As Gray discussed: In the western electricity markets, regulatory reform exposed deep market imperfections that regulators failed to adequately address. As FERC Chairman Kelliher recently stated, the FERC has struggled to “find the right balance between competition and regulation” and “develop market rules to govern competition in wholesale power markets in a manner consistent with its legal duties.” More bluntly, former FERC Chairman Wood recently stated that the “FERC was giving out deregulation certificates without doing . . . an intellectually honest job of saying, ‘Is this really a competitive market or not?’” Further, he opined that “[y]ou don’t bet on a competitive market by giving deregulation [authority] and hoping [competitive markets] will come, but unfortunately . . . that’s what we did in the mid-90s” . . . In retrospect, the western electricity markets were not mature markets that could efficiently self-correct after an external shock. They were nascent and deeply undeveloped markets with structural flaws that could be gradually corrected only through diligent regulatory oversight and strategic intervention
Id. (internal citations omitted).

170. Gray, *supra*, note 167, at 428. This point is highlighted through the dissent of a former FERC Commissioner, as recognized by Gray in his article:

In the aftermath of the western electricity crisis, [Former FERC] Commissioner Massey recognized that the FERC is free to disregard *Mobile-Sierra* when reviewing requested modifications to the long-term supply contracts: “[t]he *Mobile-Sierra* case law involves contracts negotiated under a cost-of-service regime, and thus we do not know how the courts would instruct the Commission to address contracts negotiated in a market-based regime, especially under market conditions characterized by dysfunctional market rules, widespread manipulative conduct, and a lack of effective regulatory oversight. We are on new ground here, and the Commission is free to decide what circumstances give rise to the public interest.”]

Id. (emphasis added). See also Pub. Utils. Comm’n of Cal., 103 F.E.R.C. P 61,354, 62,446 (2003) (Massey, Comm’r, dissenting).

171. *Morgan Stanley*, 128 S. Ct. at 2747, 2751.

172. Gray, *supra*, note 167, at 423-24, 426.

must be adhered to by utilities, regulators, and legislatures alike, as failure to do so will result in substantial energy market disruption.

Joseph L. Smith