Spring 2007

The Ninth Circuit Confronts the Aftermath of the Western Energy Crisis

Lucy Wiggins

Sustainable Development Law & Policy

Volume 7
Issue 3 *Spring 2007: Sustainable Energy*

Article 23

The Ninth Circuit Confronts the Aftermath of the Western Energy Crisis

Lucy Wiggins

Litigation Update

The Ninth Circuit Confronts the Aftermath of the Western Energy Crisis

*by Lucy Wiggins**

Introduction

In December 2000, the Federal Energy Regulatory Commission ("FERC") responded to the rising Western Energy Crisis by issuing an order encouraging local utilities to enter into long-term contracts, while promising to monitor the market-based rates ("MBR") on which the contracts were based to ensure that the rates met the statutory "just and reasonable" standard.[1] The order resulted in a pressurized environment requiring local utilities to hastily negotiate expensive five-to-ten year supply contracts or risk having to shut down.[2] Following stabilization of the western energy markets, the local utilities petitioned FERC to permit alteration of their long-term contracts to obtain lower rates, arguing that the rates obtained during the crisis were unjust and unreasonable.[3] FERC denied their petitions and the utilities subsequently filed complaints in federal court pursuant to Section 206(a) of the Federal Power Act ("FPA").[4] At the end of last year, the Ninth Circuit issued two opinions that overturned FERC's decision and have the potential to significantly influence the way FERC addresses the aftermath of the Western Energy Crisis.[5]

In rejecting the utilities' petition, FERC based its decision largely on the *Mobile-Sierra* doctrine.[6] Taken together, the *Mobile-Sierra* cases establish a presumption that energy contracts are just and reasonable under the FPA, which may be rebutted by a showing that the contract is against the public interest.[7] Because this presumption is "practically insurmountable,"[8] FERC's application of the *Mobile-Sierra* doctrine to the utilities' long-term energy contracts made it virtually impossible for the local utilities to overcome the public interest presumption.

The Ninth Circuit's December 2006 companion cases limit FERC's application of the Mobile-Sierra doctrine to the contracts arising from the long-term MBR contracts.

The Ninth Circuit Cases

The Ninth Circuit's December 2006 companion cases limit FERC's application of the *Mobile-Sierra* doctrine to the contracts arising from the long-term MBR contracts. In *Public Utility District No. 1 of Snohomish County v. Federal Energy Regulatory Commission* ("PUD") and *Public Utilities Commission v. Federal Energy Regulatory Commission* ("PUC"), the court held that the *Mobile-Sierra* presumption comes into play only when three "prerequisites" exist: (1) the contract cannot have a clause that permits unilateral changes; (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) the just and reasonable analysis must include a consideration of the market conditions at the time of the MBR contract formation.[9] Applying the prerequisites to the MBR contracts, the court quickly dispatched the first prerequisite and then turned to examine FERC's regulatory review.[10] By failing to fulfill its promise to the local utilities to oversee the MBR contracts and then peremptorily applying the tough *Mobile-Sierra* presumption, "without any direct inquiry into whether the resulting rates were in fact 'just and reasonable,'" FERC committed a "fundamental procedural error."[11] The lack of "meaningful opportunity to institute a challenge" to the rates that the sellers charged the local utilities before they entered into the disputed contracts con-

* *Lucy Wiggins is a JD candidate, May 2007, at American University Washington College of Law and an MA candidate, December 2007, at American University, School of International Service.*

stituted "the fatal flaw in FERC's approach to 'oversight' . . . preclude[ing] timely consideration of sudden market changes and offer[ing] no protection to purchasers victimized by the abuses of sellers or dysfunctional market conditions that FERC itself only notices in hindsight."[12] Next, the court examined market conditions at the time the contracts were formed and found fault with FERC's lack of consideration of the relationship between the high "spot" market prices and the pressure brought to bear on the utilities to enter into long-term MBR contracts to obtain lower rates.[13]

The court also questioned whether *Mobile-Sierra* applied at all. However, if *Mobile-Sierra* applies, the Ninth Circuit found that FERC incorrectly applied "low-rate" challenge factors to "high-rate" cases because the public interest in each type is profoundly different.[14] In "low-rate" challenges, such as *Mobile* and *Sierra*, the public interest "is in keeping utilities in operation so that the public is not deprived of services;" whereas in "high-rate" challenges, the public interest lies in making sure the "public pays fair rates for the very energy covered by the challenged contracts."[15] Therefore, where a contract at issue "imposes any significant cost on ultimate customers because of a wholesale rate too high to be within a zone of reasonableness, that contract affects the public interest."[16] With these new instructions, the court remanded back to FERC for a determination as to whether the *Mobile-Sierra* prerequisites exist, and if so, to consider the correct "high-rate" public interest factors.[17]

Taken to the extreme, the decisions might even require FERC to return to a case-by-case review of electricity supply contracts.

Conclusion

The decisions are likely to have wide-ranging implications. For example, close to two hundred MBR contract appeals are still pending in the Ninth Circuit and the decisions will likely induce some cases to settle.[18] Taken to the extreme, the decisions might even require FERC to return to a case-by-case review of electricity supply contracts.[19] The decisions could also have implications beyond MBR cases: to date, at least one FERC Administrative Law Judge has applied the *PUD/PUC* prerequisites in a settlement context, finding that the parties' energy-related agreement violated the third prerequisite because it did not properly account for potential changes in market conditions.[20] However, the full implications of the court's decisions have not yet fully materialized.

Endnotes: Litigation Update

[1] *See* Pub. Util. Dist. No. 1 of Snohomish County v. Fed. Energy Regulatory Comm'n, 471 F.3d 1053, 1069 (9th Cir. 2006) [hereinafter PUD]; Jeffrey McIntyre Gray, *Reconciling Market-Based Rates with the Just and Reasonable Standard*, 26 Energy L. J. 423, 424 (2005).

[2] PUD, *supra* note 1, at 1058 (detailing the federal versus state regulatory authority); Jeffrey McIntyre Gray, *supra* note 1, at 425 (summarizing FERC's December 2000 order).

[3] Joel Kirkland & Esther Whieldon, *Court Rejects FERC Orders on Western Energy Crisis Contracts, Sees Oversight Failure*, Inside F.E.R.C., Dec 25, 2006, at 1. Pursuant to sections 205 and 206 of the Federal Power Act ("FPA"), FERC must ensure that wholesale rates are "just and reasonable." 16 U.S.C. §§ 824d, 824e (2006).

[4] Kirkland & Whieldon, *id.*

[5] Kirkland & Whieldon, *id.*

[6] The two companion cases that form the *Mobile-Sierra* doctrine are *United Gas Pipe Line Co. v. Mobile Gas Services Corp.*, 350 U.S. 332 (1956) and *Federal Power Comm'n v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956).

[7] Cal. Pub. Util. Comm'n v. Fed. Energy Regulatory Comm'n, 474 F.3d 587, 590 (9th Cir. 2006).

[8] Daniel G. Tewksbury & Stephanie S. Lim, *Applying the Mobile-Sierra Doctrine to Market-Based Rate Contracts*, 26 Energy L. J. 437, 445 (2005) (quoting Potomac Elec. Power Co. v. FERC, 210 F.3d 403, 407 (D.C. Cir. 2000)).

[9] PUD, 350 U.S. at 1061, 1075, 1077.

[10] PUD, *id.* at 1077.

[11] PUD, *id.* at 1082, 1086.

[12] PUD, *id.* at 1084, 1086.

[13] PUD, 350 U.S. at 1086.

[14] PUD, *id.* at 1087.

[15] PUD, *id.* at 1088-89.

[16] PUD, *id.* at 1089 (internal citation omitted).

[17] PUD, 350 U.S. at 1091.

[18] Kirkland & Whieldon, *supra* note 3.

[19] *Court Shakes Up FERC Power Contracts Rule*, Coal Energy Trader, Dec. 21, 2006, at 11.

[20] In re Bridgeport Energy, LLC, 118 F.E.R.C. P63, 018, at *38 (Jan. 23, 2007).