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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 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-

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stituted “the fatal flaw in FERC’s approach to ‘oversight’ . . . pre-
clude[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 con-
tracts were formed and found
fault with FERC’s lack of con-
sideration 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 pro-
fundy 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 “pub-
lic 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 inter-
est factors.17

**Conclusion**
The decisions are likely to
have wide-ranging implications.
For example, close to two hun-
dred 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 deci-
sions might even require FERC
to return to a case-by-case
review of electricity supply con-
tracts.19 The decisions could
also have implications beyond MBR cases: to date, at least one
FERC Administrative Law Judge has applied the PUD/PUC pre-
requisites 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 condi-
tions.20 However, the full implications of the court’s decisions
have not yet fully materialized.

### Endnotes: Litigation Update

Comm’n, 471 F.3d 1053, 1069 (9th Cir. 2006) [hereinafter PUD]; Jeffrey
McIntyre Gray, Reconciling Market-Based Rates with the Just and Reasonable

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

590 (9th Cir. 2006).

8 Daniel G. Tewksbury & Stephanie S. Lim, Applying the Mobile-Sierra Doc-
trine to Market-Based Rate Contracts, 26 Energy L. J. 437, 445 (2005) (quot-
ing 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.