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LEGAL ALERT

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Supreme Court Holds Third Parties to Public Interest Standard

The U.S. Supreme Court has affirmed once again the protections afforded to wholesale energy contracts under the *Mobile-Sierra* Doctrine. In a decision issued on January 13 in *NRG Power Marketing v. Maine Public Utilities Commission*, the Supreme Court held that the application of the *Mobile-Sierra* Doctrine does not depend on who is seeking to modify a wholesale contract. The Court held that the Doctrine applies to challenges by non-contracting parties, including consumers, advocacy groups, state utility commissions, and elected officials, as well as the contracting parties.

The Supreme Court's decision arose from an appeal of a 2006 Federal Energy Regulatory Commission (FERC) order approving a settlement that established how ISO New England (ISO-NE) would secure generation capacity. Based on the settlement terms, ISO-NE would procure capacity through forward capacity auctions that would set the price for annual capacity three years into the future. In addition, the settlement established a transition payment that existing generation resources would receive as ISO-NE phased into the new program. ISO-NE would spread the resulting rates and transition payments from the forward capacity auctions across New England utilities. In order to protect the rate structure agreed to by 97 of the 115 parties involved, the settlement stated that any challenges to the settlement, including the auction rates and transition payments, would be subject to the public interest test.

The Maine Public Utilities Commission and the attorneys general for Massachusetts and Connecticut (the "Petitioners") sought review of FERC's settlement order in the U.S. Court of Appeals for the D.C. Circuit. Although the D.C. Circuit rejected the majority of the arguments raised on appeal, it agreed with the Petitioners that the *Mobile-Sierra* Doctrine's public interest test does not apply when a contract is challenged by non-parties. NRG, one of the parties supporting the settlement, petitioned the Supreme Court to review the D.C. Circuit's interpretation of the scope of the *Mobile-Sierra* Doctrine.

In an 8 to 1 decision, Justice Ruth Bader Ginsburg wrote in *NRG* that the D.C. Circuit erred when it found that non-parties to a contract are not bound to the public interest test when challenging the rates, terms or conditions in a wholesale contract, noting "that the D. C. Circuit's negative answer misperceives the aim, and diminishes the force, of the *Mobile-Sierra* doctrine."

The *Mobile-Sierra* Doctrine was created 50 years ago through two Supreme Court cases, *United Gas Pipe Line Co. v. Mobile Gas Services Corp.* and *Federal Power Commission v. Sierra Pacific Power Co*. Those cases rejected attempts by regulated utilities to unilaterally try to change the rates in negotiated natural gas and power contracts and found that unilateral contract modification is warranted when the existing terms are inconsistent with the public interest. According to the Court, a contract would violate the public interest if it impairs the financial ability of the public utility to continue its service, casts upon other consumers an excessive burden, or is unduly discriminatory.

More recently, the Supreme Court in *Morgan Stanley Capital Group v. Public Utility Dist. of Snohomish* (2008) confirmed that FERC must apply the public interest test when a party to a contract subsequently seeks to change that contract unless the parties have included an express contract provision that would allow contract modification under a less stringent test.

The Court's *NRG* opinion is a logical extension of its holding in *Morgan Stanley*: FERC "must presume that the rate set out in a freely negotiated wholesale-energy contract meets the 'just and reasonable' requirement imposed by law. The presumption may be overcome only if FERC concludes that the contract seriously harms the public interest." Justice Ginsburg then explains that the public interest standard defines "what it means for a rate to satisfy the just-and-reasonable standard in the contract context." Applying this long-held precedent to the D.C. Circuit's opinion related to the ISO-NE capacity market settlement, Justice Ginsberg states that "the D.C. Circuit's confinement of *Mobile-Sierra* to rate challenges by contracting parties diminishes the animating purpose of the doctrine: promotion of 'the stability of supply arrangements which all agree is essential to the health of the [energy] industry'" and concludes that "a presumption applicable to contracting parties only and inoperative as to everyone else…could scarcely provide the stability *Mobile-Sierra* aimed to secure."

The Court did not reach the question presented by the Petitioners of whether the rates at issue in the ISO-NE capacity market (namely the auction rates and transition payments set forth in a settlement agreement) are contract rates bound by the *Mobile-Sierra* Doctrine or, instead, rates of general applicability to which the *Mobile-Sierra* Doctrine may not apply. The D.C. Circuit can consider that question, if properly raised on appeal, on remand from the Court's decision.

More generally, it remains to be seen what impact the Court's decision in *NRG* will have on other existing contracts. After the D.C. Circuit's decision giving rise to *NRG*, a common practice among contracting parties was to specify the public interest standard of review for challenges to their contract or, if that standard of review was held to be inapplicable, the "most stringent standard permissible under applicable law." FERC has approved these provisions, and the *NRG* decision instructs that the public interest standard would be held to apply.

In sum, the *NRG* decision highlights that, unless the parties to an agreement expressly provide otherwise, unilateral challenges to the rates, terms and conditions of a contract will be governed by the public interest standard.

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If you have any questions regarding this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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