

Client Alert

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Supreme Court's Decision Helps Protect Wholesale Energy Contracts from Regulatory Interference

On January 13, 2010, the Supreme Court of the United States in *NRG Power Marketing, LLC v. Maine Public Utilities Commission*, 558 U.S. ____ (2010), held in an 8-1 decision authored by Justice Ginsburg that the Federal Energy Regulatory Commission (FERC) can only modify the rates, terms and conditions of a voluntarily negotiated wholesale energy contract if the contract will "adversely affect the public interest," regardless of whether such modification is sought by a party to the contract or a non-contracting third party.¹ The Court's decision makes clear that non-contracting third parties must satisfy the same heavy burden faced by parties seeking to undo wholesale electricity contracts. And while *NRG* arose in the context of a dispute over wholesale electricity contracts subject to FERC's jurisdiction under the Federal Power Act (FPA), the holding will apply equally to natural gas contracts subject to FERC's oversight under the Natural Gas Act (NGA).

NRG should reduce the threat of regulatory interference by FERC with the rates, terms and conditions of wholesale energy contracts arising from challenges to such contracts brought by non-contracting third parties, such as State utility regulators and attorneys general, and consumer advocates.

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Background

Section 205 of the FPA requires FERC to ensure that all rates for wholesale sales of electricity are "just and reasonable." At the same time, any person may file a complaint with FERC seeking to change an existing rate, and Section 206 of the FPA gives FERC the authority to modify on a prospective basis any rates that are found to be "unjust, unreasonable, unduly discriminatory or preferential," and to order limited refunds for past sales.

The longstanding "*Mobile-Sierra*" doctrine limits FERC's ability to use its authority under the FPA to modify voluntarily negotiated electricity contracts.² As the Supreme Court recently reaffirmed in *Morgan Stanley Capital Group Inc. v. Public Utility District No. 1 of Snohomish County*, 554 U.S. ____, 128 S. Ct. 2733 (2008),³ *Mobile-Sierra* creates a presumption that the rates, terms and conditions in a freely negotiated wholesale energy contract are just and reasonable under the FPA, and the presumption "may be overcome only if FERC concludes that the contract seriously harms the public interest." This "public interest" standard under *Mobile-Sierra* makes it much more difficult for FERC to modify a contract rate than a non-contract rate, and in particular establishes that modification

of a contract rate is not warranted simply because market conditions have changed and/or the contract is no longer profitable or advantageous to one of the contracting parties.

Buyers and sellers in the wholesale electricity industry have traditionally relied on the *Mobile-Sierra* presumption to protect their contracts from undue regulatory interference. That reliance was jeopardized when the US Court of Appeals for the District of Columbia Circuit issued a decision — *Maine Public Utilities Commission v. FERC*, 520 F.3d 464 (D.C. Cir. 2008) — unequivocally holding that the *Mobile-Sierra* presumption “simply does not apply” in circumstances where “a rate challenge is brought by a non-contracting third party.” If left standing, the D.C. Circuit’s decision would have reversed the normal state of affairs — under which nonparties have no standing under contract law to challenge the terms of others’ contracts — and made it far easier for State utility regulators and attorneys general, consumer advocates or any other non-contracting third party to successfully challenge before FERC the rates, terms and conditions of existing wholesale energy contracts than it would be for the parties themselves.

The Supreme Court’s Decision in *NRG*

The Supreme Court reversed the D.C. Circuit’s holding that the *Mobile-Sierra* presumption does not apply to contract challenges brought by non-contracting third parties.⁴ The Court held that “the *Mobile-Sierra* presumption does not depend on the identity of the complainant who seeks FERC investigation” of a contract rate and applies regardless of whether a contract challenge is initiated by a contracting or non-contracting party.

The Court reasoned that *Mobile-Sierra* requires that FERC (itself a non-contracting third party) presume the rates, terms and conditions in a

freely negotiated contract are just and reasonable, and there is no reason why other non-contracting third parties should not be bound by the same presumption. The Court further reasoned that the applicability of *Mobile-Sierra* does not mean that non-contracting third parties are unprotected, as FERC retains its authority to modify a contract that “seriously harms the consuming public.” Finally, the Court reasoned that *Mobile-Sierra* is intended to protect the integrity of wholesale energy contracts, which is necessary for the long-term development of, and investment in, the electricity and natural gas industries. That important contract stability would be severely threatened if the D.C. Circuit’s non-contracting third party exception to the *Mobile-Sierra* presumption were permitted to stand.

The authors of this *Client Alert* represented a group of prominent economists in an amici curiae brief in support of the petitioners in the *NRG* case. The authors were also directly involved in the *Morgan Stanley* case before FERC, the US Court of Appeals for the Ninth Circuit and the Supreme Court. The authors’ detailed summary and analysis of the Court’s decision in *Morgan Stanley* can be found in “*A Deal is Still a Deal: Morgan Stanley Capital Group v. Public Utility District No. 1*,” *2007-2008 Cato Supreme Court Review* (2008).

Endnotes

- ¹ Justice Stevens dissented.
- ² The *Mobile-Sierra* doctrine takes its name from the Supreme Court’s twin decisions in *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956).
- ³ *Morgan Stanley* was a 5-2 decision by Justice Scalia, with Justice Ginsburg joining in part and concurring in part. Justice Stevens and Justice Souter dissented.
- ⁴ The case was remanded to the D.C. Circuit for further consideration of whether the specific rates at issue qualify as “contract rates” or “fixed rates” subject to the *Mobile-Sierra* presumption.

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