

No. 08-674

In The
Supreme Court of the United States

—◆—
NRG POWER MARKETING, LLC, ET AL.,

Petitioners,

v.

MAINE PUBLIC UTILITIES COMMISSION, ET AL.,

Respondents.

—◆—
**On Writ Of Certiorari To The
United States Court Of Appeals
For The District Of Columbia Circuit**

—◆—
BRIEF FOR RESPONDENTS

—◆—
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QUESTION PRESENTED

Section 206 of the Federal Power Act (“FPA”), 16 U.S.C. § 824e(a), requires that all rates for the transmission and sale of electricity in interstate commerce be “just and reasonable.” Under the *Mobile-Sierra* doctrine, when sellers and purchasers enter into freely negotiated wholesale energy contracts, the Federal Energy Regulatory Commission (“FERC” or “Commission”) must presume that the negotiated rate is just and reasonable, and parties to the contract may overcome that presumption and avoid their contractual bargain only by showing that the contract rate seriously harms the “public interest.” In this case, the Respondents were parties to a contested FERC proceeding but objected to a settlement agreement agreed to by other parties and approved by FERC. The contested settlement purported to apply the restrictive *Mobile-Sierra* presumption to challenges by both settling and non-settling parties to rates that will be determined in the future. That is, the settling parties sought by contract to restrict non-contracting parties’ statutory right to challenge rates as unjust or unreasonable.

The question presented is:

Whether the Commission may approve a contested settlement agreement where the settling parties propose to deprive non-contracting participants of their statutory rights to challenge tariff rates as being unjust and unreasonable except under the much more stringent and “practically insurmountable” public interest mode of review.

CORPORATE DISCLOSURE STATEMENT

Richard Blumenthal, Attorney General for the State of Connecticut, hereby submits that the Office of the Attorney General is a governmental party exempt from any reporting requirement under Rule 29.6. The CTAG is the chief civil legal officer of the State of Connecticut and has no parent corporation or publicly held stock.

The Maine Public Utilities Commission hereby submits that it is a governmental party exempt from any reporting requirement under Rule 29.6. MPUC has no parent corporation or publicly held stock.

Martha Coakley, Attorney General for the Commonwealth of Massachusetts, hereby submits that the Office of the Attorney General is a governmental party exempt from any reporting requirement under Rule 29.6. The MassAG is the chief civil legal officer of the Commonwealth of Massachusetts and has no parent corporation or publicly held stock.

The Industrial Energy Consumer Group is a non-profit trade association incorporated under the laws of the state of Maine. The IECG has no parent company or affiliated companies. The IECG was created and exists to advance the interests of industrial users of electricity in Maine and other interested persons. There are no ownership interests associated with the IECG.

**CORPORATE DISCLOSURE
STATEMENT – Continued**

NEPOOL Industrial Customer Coalition is a continuing ad hoc association of large industrial and commercial end-users of electricity in New England operated for the purposes of representing the interests of industrial energy consumers before regulatory and legislative bodies. NICC does not issue securities to the public and is not owned by any publicly held company.

NSTAR Electric & Gas Corporation (“NSTAR”) is a wholly-owned subsidiary of NSTAR, a public utility holding company which has issued securities to the public. In addition, NSTAR Electric & Gas Corporation’s affiliate, NSTAR Electric Company, has issued preferred stock and debt securities to the public. No other affiliates of NSTAR Electric & Gas Corporation have outstanding securities to the public.

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STATEMENT

Over the objection of the Respondents, FERC approved a settlement agreement that “redesigned New England’s capacity market” for electricity. Pet. App. 1a. Among the terms of the settlement are a mechanism for establishing the future price of wholesale energy capacity through auctions and a set of fixed prices for wholesale energy capacity for a three-year transition period. Despite the Respondents’ objection, FERC approved the settlement, its auction mechanism, the resulting rates, and the transition rates that now define the terms of service for all wholesale customers in New England, including the Respondents. FERC may, of course, establish the terms and conditions for service to the Respondents, but only if it determines the rates are just and reasonable. The issue presented in this case is what form of just and reasonable review applies to a challenge by the Respondents to auction and transition rates that the settlement directly imposes upon them.

Critically, therefore, this case does not present the issue raised and argued by the Petitioners. The Petitioners act as though the rates in question were established by a run-of-the-mill bilateral wholesale energy contract and are being challenged by entities “indirectly affected by a contract rate,” such as “consumer[s]” who are members of the general public. Pet. Br. 3; *see also* Pet Br. 18, 24, 28, 29, 37, 41. The Petitioners then argue that excepting such challenges from the *Mobile-Sierra* doctrine would “see

the [doctrine] overwhelmed by hordes of motivated non-parties lying in wait not far behind,” making the Court’s *Mobile-Sierra* doctrine “an exercise in futility” that “provides no stability at all.” Pet. Br. 18. In fact, the Respondents are not indirectly affected members of the general public, but rather active participants in both the relevant wholesale market *and* parties to the contested FERC proceeding that resulted in approval of these rates. Indeed, Respondent NSTAR purchases 25 percent of New England’s capacity obligations. The settlement, however, purports to bind NSTAR to pay certain rates for that capacity. Thus, whether *Mobile-Sierra* public-interest review applies to a challenge by an indirectly affected member of the general public is an interesting question, but it is not one that is before this Court in this case.

When the status and interests of the parties are properly framed, it is apparent that the *Mobile-Sierra* presumption of reasonableness does not apply for two reasons. First, as FERC acknowledges, Br. 28-32, the rates produced by the settlement are not “contract” rates to which the *Mobile-Sierra* doctrine could apply in the first place. Second, even if those rates were treated like genuine contract rates, the *Mobile-Sierra* doctrine does not apply to challenges by a third party that, against its will, is subjected to rates agreed upon by others. The Petitioners are certainly free to agree to energy rates among themselves, and agree that they may not back out of that agreement if they later find it disadvantageous. But there is no basis in

statute, precedent, or logic for presuming that the rates to which they agreed are just and reasonable as applied to a third party whom they seek to bind to their bargain over its express objection. That directly affected third party is entitled to have FERC assess its challenge to the rates under the traditional just and reasonable standard of review. The decision of the Court of Appeals should be affirmed.

I. STATUTORY BACKGROUND

Under Section 205 of the Federal Power Act (“FPA”), all rates filed with FERC must be “just and reasonable.” 16 U.S.C. § 824d. Section 206 provides that “upon complaint” FERC must determine whether a challenged rate is “unjust, unreasonable, unduly discriminatory or preferential.” 16 U.S.C. § 824e.

In *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956) (“*Mobile*”) and *Federal Power Comm’n v. Sierra Pacific Power Co.*, 350 U.S. 348, 355 (1956) (“*Sierra*”), the Court recognized that buyers and sellers that have agreed to fix rates by contract do not have the right to seek to modify those rates by regulatory interdiction simply because it is in their private interest to do so.

Under the *Mobile-Sierra* doctrine, when sellers enter into freely negotiated wholesale energy contracts with purchasers, the Commission must presume that, as between the parties, the negotiated rate is “just and reasonable.” *See Morgan Stanley*

Capital Group, Inc. v. Pub. Util. Dist. No. 1, 128 S.Ct. 2733, 2737 (2008); *see also* 16 U.S.C. §§ 824d, 824e. In wholesale markets, the buyer and seller are often “sophisticated businesses enjoying presumptively equal bargaining power, who could be expected to negotiate a ‘just and reasonable’ rate as between the two of them.” *Verizon Communications v. FCC*, 535 U.S. 467, 479 (2002).

The Commission and the Courts of Appeals have referred to the much more restrictive mode of review applicable under the *Mobile-Sierra* doctrine to rate challenges by contracting parties as the “public interest standard,” as opposed to the statutory “just and reasonable standard.” *Morgan Stanley*, 128 S.Ct. at 2740 (citing *Southern Co. Servs., Inc., et al.*, 39 FERC ¶ 63,026 at 65,134, 65,141 (1987); *Kansas Cities v. FERC*, 723 F.2d 82, 87-88 (D.C. Cir. 1983); *Northeast Utils. Serv. Co. v. FERC*, 993 F.2d 937, 961 (1st Cir. 1993)). As this Court has observed, however, this “nomenclature” refers to the differing application of the just and reasonable standard to contract rates. *Id.* (citing *Philadelphia Elec. Co.*, 58 F.P.C. 88, 90 (1977)).

Courts of Appeals have characterized the *Mobile-Sierra* public interest standard as being “much more restrictive than the FPA’s ‘just and reasonable’ standard, even describing the burden of the public interest standard as ‘practically insurmountable’ and ‘almost insurmountable.’” *Potomac Elec. Power Co. v. FERC*, 210 F.3d 403, 407-408 (D.C. Cir. 2000) (citations omitted).

Although the public interest showing is the default mode of review of contract modifications sought by a contracting party, this Court has held that parties to a contract can agree that the *Mobile-Sierra* presumption shall not apply. See *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103, 110-113 (1958) (“*Memphis*”). “[I]n the absence of any contractual relationship rates determined ex parte by the seller may be filed under § 4(d) [of the Natural Gas Act]. . . . We perceive no tenable basis of distinction between the filing of such a rate in the absence of contract and a similar filing under an agreement which explicitly permits it.” *Id.* at 112-113 (internal citations omitted). Thus, contracting parties can agree that they may challenge the contract rate if it results in an unfair rate of return, not just if it violates the public interest. See *Morgan Stanley*, 128 S.Ct. at 2739 (citing *Papago Tribal Util. Auth. v. FERC*, 723 F.2d 950, 953, 955 (D.C. Cir. 1983); *Louisiana Power & Light Co. v. FERC*, 587 F.2d 671, 675-676 (5th Cir. 1979)). Such provisions are commonly referred to as “*Memphis* clauses.”

II. THE CONTESTED SETTLEMENT

This case arose from a highly contested FERC proceeding in which ISO New England, Inc. (“ISO New England”), the independent system operator that manages the reliability of the bulk power system in New England, filed changes to its market rules tariff to address deficiencies in the mechanism for

procuring generation capacity. Pet. App. 105a. After two years of litigation, 107 parties reached a settlement, while eight parties, including the Respondents here, opposed the settlement. *Id.* at 110a. Thus, there was no agreement between the settling parties and the Respondents. That settlement was subject to approval by the Commission.

The proposed settlement created a forward capacity market (“FCM”), in which an annual auction mechanism would determine the single rate paid to electric capacity resources three years in advance of when that capacity would be needed. *Id.* The auctions would procure the generating capacity required to satisfy the installed capacity requirement, which is the minimum level of capacity that ISO New England determines is necessary to maintain the reliability of the grid. *Id.* at 112a. ISO New England would then directly allocate the cost of such capacity to each utility serving end-use customers based on its proportional share of peak load. *Id.* The FCM would include an auction-based mechanism for setting a tariff-based regional clearing price that would apply to all New England market participants. *Id.* at 118a.

Because there would be a three-year gap between the first auction and the year that the capacity procured through the auction would be provided, the settling parties agreed that all qualifying capacity resources would receive payments according to a schedule of rates during a transition period between December 1, 2006 and ending on June 1, 2010, whether or not they were needed for reliability. *Id.* at

116a. The cost of these payments similarly would be allocated to utilities based on their proportionate share of peak load. *Id.* at 117a.

The settlement agreement contains a provision (§ 4.C) purporting to impose the *Mobile-Sierra* presumption against all challenges to the capacity clearing prices derived from the annual forward capacity auctions (“FCA”) and challenges to the transition period payments, regardless of whether the challenge is made “by a Settling Party, a non-Settling Party, or the FERC acting *sua sponte*.” *Id.* at 193a-194a (quoting § 4.C of the settlement agreement). The settlement agreement also contains a *Memphis* clause exempting all other terms of the settlement agreement from the operation of the *Mobile-Sierra* presumption. *Id.* at 194a.

FERC approved the *Mobile-Sierra* provision, noting that it has permitted the use of similar provisions in the past, citing a string of cases dating back to 2003. *Id.* at 200a-201a. Finding that it retained authority to protect non-settling parties under the public interest standard of review, FERC found the provision “reasonable.” It also based its finding of reasonableness on a provision in the settlement agreement that permits parties to challenge ISO New England’s “informational filings” on the auction results under the just and reasonable mode of review when ISO New England files them under Section 205. *Id.* at 78a, 201a-202a. Finally, FERC concluded that it was appropriate to apply the

Mobile-Sierra presumption to non-settling parties in order to achieve “contractual stability.” *Id.* at 202a.

Because the fixed-rate transition payments and auction based mechanism produce tariff based rates of general applicability to all New England market participants, the contested settlement directly binds the Respondents to accept the rates and conditions of service resulting from transition payments and the auction in precisely the same manner as the contested settlement agreement binds all of the market participants that agreed to the settlement. As noted above, NSTAR is directly responsible for 25 percent of New England’s load. NSTAR therefore is subject to the transition rates and the rates that result from the auction although it objected to the settlement.

III. THE DECISION BELOW

In the decision below, the Court of Appeals held that, in approving the settlement agreement, the Commission unlawfully deprived non-settling parties—including the Respondents—“of their statutory right” under the Federal Power Act “to challenge rates under the ‘just and reasonable’ standard.” *Id.* at 19a. The court found that “[t]his case is clearly outside the scope of the *Mobile-Sierra* doctrine.” *Id.* at 22a. The court stated that *Mobile-Sierra* is invoked when “one party to a rate contract on file with FERC attempts to effect a unilateral rate change by asking FERC to relieve its

obligations under a contract whose terms are no longer favorable to that party.” *Id.* (quoting *Maine PUC v. FERC*, 454 F.3d 278, 284 (D.C. Cir. 2006)). The court found that “the settling parties are attempting to thrust the ‘public interest’ standard of review upon non-settling third parties who have vociferously objected to the terms of the settlement agreement.” *Id.* The court noted that “[i]t goes without saying that a contract cannot bind a nonparty.” *Id.* (quoting *EEOC v. Waffle House, Inc.*, 534 U.S. 279 (2002)). The court stated that the purpose of the *Mobile-Sierra* doctrine is to “preserve the terms of the bargain as between the contracting parties.” *Id.* (citing *Atlantic City Elec. Co. v. FERC*, 295 F.3d 1, 14 (D.C. Cir. 2002)). Accordingly “when a rate challenge is brought by a non-contracting third party, the *Mobile-Sierra* doctrine simply does not apply; the proper standard of review remains the ‘just and reasonable’ standard in section 206 of the Federal Power Act.” *Id.*

The court rejected FERC’s justifications for approving the *Mobile-Sierra* provision—that the public interest showing will only apply to future challenges to a narrow category of rates or that non-settling parties are adequately safeguarded under the Commission’s retained authority under *Mobile-Sierra*—holding that approval of the agreement still deprives non-settling parties of their statutory right to have rate challenges adjudicated under the ordinary “just and reasonable” showing. *Id.* at 22a-23a. The court also rejected FERC’s argument

that the Commission has routinely approved contracts that apply the public interest review to non-contracting parties, noting that the Commission has only done so since 2002 and that none of the decisions to which FERC cited has been subject to judicial review on the *Mobile-Sierra* issue. *Id.* at 23a.

Finally, with respect to the need for contract stability, the court explained that “the *Mobile-Sierra* doctrine is designed to ensure contract stability *as between the contracting parties*—*i.e.*, to make it more difficult for either party to shirk its contractual obligations.” *Id.* at 24a (citing *Atlantic City*, 295 F.3d at 14) (emphasis in original). The court observed that “[i]t makes no sense to say that the values of ‘stability’ and ‘certainty’ are furthered by applying the deferential standard of review to the eight parties that *refused* to agree to the terms of the settlement.” *Id.* (emphasis in original).



SUMMARY OF ARGUMENT

The *Mobile-Sierra* doctrine provides that freely negotiated contracts by sophisticated buyers and sellers are presumed “‘just and reasonable’ as between the two of them.” *Morgan Stanley*, 128 S.Ct. at 2746 (citations omitted). When a party to such a contract challenges it, FERC may only provide relief if the party shows that the public interest, strictly defined, will be injured by the contract. The Petitioners seek to impose that “public interest”

standard upon the Respondents, thereby drastically limiting the Respondents' ability to challenge rates imposed under a settlement that the Petitioners adopted, but to which the Respondents objected. Applying the *Mobile-Sierra* doctrine in that manner would unmoor it from its foundations, converting it to a sword by which contracting parties can bind third parties to rates to which they never agreed.

I. As an initial matter, the rates produced by the settlement are not “contract rates” to which the *Mobile-Sierra* presumption could apply in the first place. The rates at issue in this proceeding are fundamentally different from the typical bilateral contracts that were at issue in *Mobile*, *Sierra*, and *Morgan Stanley*. The transition payments and the FCA auction results are tariff rates of general applicability throughout New England. The *Mobile-Sierra* public interest standard applies only to rates arising from freely negotiated private contracts, and not to tariff rates or to rates established as a result of a regulatory process. FERC agrees that “neither of the two types of rates to which Section 4.C of the settlement applies . . . is subject to the statutory *Mobile-Sierra* presumption, and the Commission was not *required* to apply the public interest standard to its review of those rates.” FERC Br. 30. FERC’s concession is a sound one that this Court should accept.

II. Even assuming the *Mobile-Sierra* doctrine could apply to general tariffs, its presumption of reasonableness does not apply to challenges brought

by entities that objected to the settlement that produced the rates. The premise of the doctrine is that the sophisticated parties that enter wholesale energy contracts should be bound by their bargain, for they can “be expected to negotiate a ‘just and reasonable’ rate as between the two of them.” The doctrine therefore restricts the ability of a contracting party to obtain regulatory relief from the obligations it voluntarily incurred. But the doctrine has no application to efforts by contracting parties to bind third parties to the contractual terms. The FPA properly holds a contracting party to an “improvident bargain”; but the statute cannot reasonably be construed as binding a non-settling party to an “improvident bargain” to which it objected, but which was thrust upon it. The non-settling party is entitled to have FERC review the rates under the ordinary just and reasonable standard.

The Petitioners counter that allowing non-parties to challenge contractual rates under the ordinary standard would eviscerate the *Mobile-Sierra* doctrine because “hordes” of consumers indirectly affected by the rates would be able to file challenges. But the Respondents are not “indirectly affected” parties. To the contrary, the settlement created a tariff mechanism that sets the terms and conditions of service for all market participants in New England, including the Respondents. The *Mobile-Sierra* doctrine does not permit settling parties to contractually bind non-settling third parties to limit their challenges to a tariff derived from the

settlement rate mechanism simply because the parties have agreed among themselves that such challenges should be limited. As the Court of Appeals observed, the Petitioners' position conflicts with the fundamental principle of contract law that a contract cannot bind a non-party.

The Petitioners' various other attacks on the Court of Appeals' decision are unfounded. Although the Court of Appeals used the common nomenclature for the *Mobile-Sierra* doctrine that this Court clarified in *Morgan Stanley*, its reasoning did not depend on its use of that nomenclature. And the Court of Appeals' ruling does not conflict with any lower court precedent or with prior FERC practice. Indeed, it is the Petitioners' position that conflicts with this Court's longstanding recognition that the FPA does not presume that market-based rates are inherently just and reasonable.

III. Because the *Mobile-Sierra* doctrine does not apply to challenges by the Respondents to rates produced by the settlement, the Court of Appeals' judgment should be affirmed. FERC argues, however, that it has the authority to impose a *Mobile-Sierra* public interest presumption in the absence of any contract from which such presumption might arise. As an initial matter, FERC did not expressly raise this argument below and did not assert it in its brief in opposition. The Court should therefore affirm the Court of Appeals' judgment without reaching this argument. FERC is also wrong on the merits. FERC contends that it has the discretion to apply a public

interest standard to challenges by the Respondents under its broad authority to approve contested settlement agreements that it believes will produce just and reasonable rates. FERC Br. 32. But neither the FPA nor any court precedent supports the proposition that FERC may simply rewrite the terms of the FPA based upon what FERC believes may produce just and reasonable rates. While FERC has the authority to establish or approve a mechanism to set capacity costs, it does not have the discretion to abrogate the Respondents' statutory rights under Section 206. FERC is not permitted to use its discretion to determine that the public interest standard may be applied outside a contract context.

IV. Finally, the Petitioners are wrong in asserting that affirmance would threaten industry stability. The narrow issue before the Court is whether an entity that objected to a settlement can challenge rates produced by the settlement and imposed on them under the ordinary just and reasonable standard. A positive answer to the question will not undermine the *Mobile-Sierra* doctrine and the stability the doctrine advances. Settling parties reasonably expect challenges by objectors. More generally, parties that enter contracts understand that they generally cannot bind third parties to the contractual terms. FERC has applied the *Mobile-Sierra* public interest standard to non-parties only since 2002, yet there is no evidence that industry stability was threatened before then. Proving that rates are unjust and unreasonable is a

challenge even absent the *Mobile-Sierra* presumption; its application to situations like the present one poses no threat to the industry.

◆

ARGUMENT

I. NEITHER THE SETTLEMENT AGREEMENT NOR THE RATES GENERATED UNDER THE AGREEMENT FALL WITHIN THE *MOBILE-SIERRA* DOCTRINE

The FPA provides for two rate setting mechanisms. Rates may be set bilaterally by contract or unilaterally by tariff. *Mobile*, 350 U.S. at 343 (parties may establish a tariff rate “*ex parte*, and change at will, the rates offered to prospective customers; or to fix by contract, and change only by mutual agreement, the rate agreed upon with a particular customer . . .”).

The *Mobile-Sierra* public interest standard applies only to rates arising from freely negotiated private contracts. FERC agrees that the auction results, “although possessing certain characteristics of contracts, do not constitute contracts between buyers and sellers,” FERC Br. 30, that would “require the Commission to apply the public interest standard.” FERC Br. 31. Similarly, with respect to the non-settling parties, “the transition payments do not resemble contractually negotiated rates at all.” *Id.* In short, FERC itself does not attempt to justify its imposition of the *Mobile-Sierra* presumption on any

Mobile-Sierra or contract theory. FERC is correct that the *Mobile-Sierra* doctrine does not apply to the settlement terms at issue because they do not constitute freely negotiated contracts.¹

A. The Forward Capacity Auction Results Are Not Contract Rates Subject To The *Mobile-Sierra* Doctrine

The contested settlement agreement is a negotiated contract between the settling parties. However, the tariffs that set the transition payments

¹ Although the Court of Appeals did not rule on this issue, the Respondents have preserved it (*see* Resp. BIO 10-12) and its resolution is “essential to the analysis of the decisions below or to the correct disposition of the other issues,” and therefore is “fairly comprised by the question presented.” *City of Sherrill v. Oneida Indian Nation of N.Y.*, 544 U.S. 197, 214 n.8 (2005) (quoting R. Stern, E. Gressman, S. Shapiro, & K. Geller, *Supreme Court Practice* 414 (8th ed. 2002)); *see also Ballard v. Commissioner*, 544 U.S. 40, 46-47 & n.2 (2005) (addressing “a question anterior” to the “questions the parties raised”). This case is an appeal of FERC’s approval of Section 4.C of the proposed settlement, which provides that any future challenge to auction results or transition payments would be reviewed under the public-interest standard. Yet FERC now disclaims having approved that provision based on the *Mobile-Sierra* doctrine, and asserts that the doctrine does not apply to this case. FERC Br. 22-23. To ignore that concession, assume that this case involves a contract to which *Mobile-Sierra* applies, and then resolve whether the doctrine applies to challenges by directly affected third parties would be tantamount to issuing an advisory opinion. The Court should either dismiss the petition as improvidently granted or address the threshold question whether the *Mobile-Sierra* doctrine applies to this case.

and the rules for conducting auctions are by definition not contract rates. Those tariff provisions provide a mechanism—auctions—for setting rates that will become the terms of service to both contracting and non-contracting parties. Those rates are clearly distinct from the rates established by contract and applicable only to the contracting parties. The FCA auction differs fundamentally from bilateral contracts. The settlement provisions for transition period payments and for payments under the forward capacity market were to be implemented through then yet-to-be-developed tariff revisions. *Order Accepting Proposed Settlement Agreement*, Pet. App. 118a. These tariff revisions are rules of general applicability.

The settlement agreement that the Petitioners seek to impose upon non-contracting third parties is fundamentally different from the privately negotiated bilateral energy contracts that were at issue in *Morgan Stanley*. Instead, the settlement agreement “emanated from a highly contested adjudicatory proceeding before the Commission and involves a broad, public matter.” Pet. App. 228a (quoting FERC commissioners Kelly and Wellinghoff); *cf. Morgan Stanley*, 128 S.Ct. at 2746. Whereas the *Mobile-Sierra* doctrine assumes that “sophisticated businesses enjoying presumptively equal bargaining power . . . could be expected to negotiate a ‘just and reasonable’ rate as between the two of them,” *Verizon*, 535 U.S. at 479, “no ‘commonsense notion’ would hold that the

115 *parties* to the adjudication of this matter enjoy presumptively equal bargaining power.” *Id.*²

The Petitioners and amici repeatedly mischaracterize the results from the FCM auction as “contracts” rather than “tariffs.” Pet. Br. 35, 46-52; EPSA Br. 22-23. They argue that auction rates become contract rates because the auction result constitutes an “offer” that the buyer may “accept.” Pet. Br. 47; EPSA Br. 23. The Court should reject their novel attempt to transform tariff rates into contract rates. A generally applicable rate is a tariff rate regardless of whether the consumer chooses to accept service under the tariff rate. The Petitioners’ claim that a tariff rate becomes a contract rate once a load serving entity agrees to take service under the tariff rate would subsume all tariff rates under the *Mobile-Sierra* doctrine. Such a construction would eviscerate the distinction between tariff rates and contract rates and would be directly contrary to this Court’s lengthy analysis in *Morgan Stanley*, 128 S.Ct. at 2740, 2746 n.3, 2749 n.6.

FERC acknowledges that the auction results and the rates thereby generated are not contract rates but are tariff rates. FERC states that the auction results “although possessing certain characteristics of contracts, do not constitute contracts between buyers and sellers,” FERC Br. 30, which would “require the

² This is why settlements are not presumed to be just and reasonable. *Mobil Oil Corp. v. PFC*, 417 U.S. 283, 314 (1974).

Commission to apply the public interest standard.” FERC Br. 31. Because the FCM auction results are plainly tariff rates, no *Mobile-Sierra* presumption can apply.

B. The Transition Payments Are Not Contract Rates Subject To The *Mobile-Sierra* Doctrine

The transition payments are similarly not a product of a contract freely negotiated outside of the regulatory process and subject to *Mobile-Sierra*. As FERC states, “[a]lthough the settlement represented an agreement among the signators, it was not a private contract of the sort at issue in *Mobile, Sierra*, and *Morgan Stanley*. It was, rather, the resolution of a disputed proceeding before the Commission. . . .” FERC Br. 31. In addition, “[t]he transition payments apply to all suppliers and purchasers of capacity—including the contesting parties and all future entrants into the market—not just to the settling parties. As to these other participants, the transition payments do not resemble contractually negotiated rates at all.” *Id.* This conclusion and the logic underlying it are unassailable.

II. THE *MOBILE-SIERRA* DOCTRINE DOES NOT APPLY TO CHALLENGES BY NON-SIGNATORIES TO A SETTLEMENT AGREEMENT

Even assuming the *Mobile-Sierra* presumption applies to the tariff rates at issue here, the

presumption would not apply to challenges asserted by the Respondents, who are non-contracting third parties directly subjected to the settlement rates. The Petitioners devote most of their energies to explaining the problems with excepting from *Mobile-Sierra* public interest review those challenges brought by members of the general public who are indirectly affected by wholesale energy contracts. That situation, however, is not before the Court. The settlement purports to bind the Respondents—including NSTAR, which purchases 25 percent of New England's capacity obligations—to pay certain rates for that capacity. While the *Mobile-Sierra* doctrine sensibly presumes that contractual rates are just and reasonable as between the contracting parties, there is no basis upon which to presume that contractual rates are just and reasonable when imposed upon non-parties. The Respondents should be entitled to challenge rates established under the settlement under the ordinary just and reasonable standard.

A. A Prerequisite To The Application Of The *Mobile-Sierra* Doctrine Is A Willing Buyer And A Willing Seller

In *Mobile* and *Sierra*, the Court recognized that buyers and sellers that have agreed to fix rates by contract do not have the right to seek to modify those rates by regulatory interdiction simply because it is in their private interest to do so. In *Mobile*, the Court held that a supplier under a contract does not have the right to change its rate contracts unilaterally by

filing a new tariff schedule and that such a filing is a “nullity.” 350 U.S. at 336. In *Sierra*, the Court held that a selling party asking a regulatory authority to modify a contract rate must demonstrate that the existing rate is “so low as to adversely affect the public interest—as where 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.” 350 U.S. at 355.

The Court explained that:

[W]hile it may be that the Commission 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 or that, if it does so, it is entitled to be relieved of its improvident bargain.

Id. The Court further concluded that “it is clear that a contract may not be said to be either ‘unjust’ or ‘unreasonable’ simply because it is unprofitable to the public utility.” *Id.*

In *Verizon Communications Inc. v. FCC*, 535 U.S. 467 (2002), this Court emphasized that the fundamental principle underlining the application of the *Mobile-Sierra* doctrine was to hold contracting parties to their contract obligations. The Court stated:

[i]n wholesale markets, the party charging the rate and the party charged were

often sophisticated businesses enjoying presumptively equal bargaining power, who could be expected to negotiate a “just and reasonable” rate *as between the two of them*. . . . When commercial parties did avail themselves of rate agreements, *the principal regulatory responsibility was not to relieve a contracting party of an unreasonable rate*, *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 355 (1956).

Id. at 479 (emphasis added).

Thus, the *Mobile-Sierra* doctrine restricts the ability of a contracting party to seek regulatory relief from the obligations to which it agreed in the contract. In this sense, the *Mobile-Sierra* doctrine “subordinate[s] the statutory filing mechanism [of the FPA] to the broad and familiar dictates of contract law.” *Borough of Lansdale v. FPC*, 494 F.2d 1104, 1113 (D.C. Cir. 1974).

B. Section 4(C) Of The Settlement Agreement Impermissibly Requires Non-Parties To A Settlement Agreement To Give Up A Statutory Right They Did Not Agree To Relinquish

Mobile-Sierra addresses the relationship between parties to a contract, and only then acts to limit those contracting parties’ ability to modify unilaterally the terms of their contracts by establishing a presumption that the rates to which a willing buyer and willing seller agree are just and reasonable “as

between the two of them.” *Verizon*, 535 U.S. at 479. Here, as the Court of Appeals properly held, the Respondents did not *agree* to give up a right to challenge the transition payments or the rate resulting from the auction process and that, therefore, settling parties could not require non-settling parties to relinquish rights granted under the FPA. While the Petitioners insist that the Court’s decision in *Morgan Stanley* expands the *Mobile-Sierra* presumption to apply to non-settling parties, the facts and holding of *Morgan Stanley* do not support this claim.

In *Morgan Stanley*, the buyers that sought to modify contract rates after “buyer’s remorse set in” were parties to the contract that they wished to alter. As the Court noted, “the contract rates between the parties included rates that were very high by historical standards,” but were “substantially lower” than the rates the buyers would have paid on the spot market when they entered into the contract. In holding that the presumption of reasonableness applies to *both buying and selling parties to a contract*, the Court confirmed that the underpinning of the *Mobile-Sierra* doctrine is that “under the FPA “[w]hen commercial parties . . . avail themselves of rate agreements, the principal regulatory responsibility [is] not to relieve a contracting party of an unreasonable rate.” *Morgan Stanley* (quoting *Verizon*, 535 U.S. at 479).

Thus, if a party to the settlement agreement at issue in the present case challenged the transition

payments as unjust and unreasonable due to changed circumstances, *Morgan Stanley* would require FERC to apply a presumption that the rate was reasonable *as to the party that agreed to it*. *Morgan Stanley* does not, however, require or even permit FERC to apply the *Mobile-Sierra* presumption to a non-party because the prerequisite of a willing buyer and willing seller simply does not exist. To do so would hold a non-settling party to an “improvident bargain” that the non-settling party objected to in the first place.

Thus, it is no way anomalous for FERC to assess the settlement-produced rates by the public-interest standard when they are challenged by the parties to the settlement, and by the ordinary just and reasonable standard when they are challenged by the Respondents. The Petitioners assert that, “[a]s a matter of logic, the presumption of reasonableness” cannot depend on the party who is challenging the contract. Pet. Br. 35. Not so. The parties to the agreement are entitled to decide—as between themselves—what is a reasonable rate. There is every reason for FERC to presume the rate is just and reasonable as between the parties who negotiated it, but no reason for such a presumption when the rate is imposed upon a third party that did not sign the contract.

The ability of parties to contract out of the default *Mobile-Sierra* presumption through a *Memphis* clause further undermines the Petitioners’ claim that FERC cannot have multiple thresholds

for reviewing a challenged rate depending upon the entity challenging the rate. Parties to a contract may agree, via a *Memphis* clause, that one party to the contract may opt out of the application of the *Mobile-Sierra* presumption—meaning the presumption would apply depending on the party that brings the challenge. Moreover, it would be absurd to construe the FPA as allowing the contracting parties to agree amongst themselves to opt out of the application of *Mobile-Sierra* via a *Memphis* clause, yet allow them to bind non-settling parties to *Mobile-Sierra* public interest review of the rates.

C. The Respondents Are Not “Indirectly Affected” Third Parties Already Protected Under The *Mobile-Sierra* Public Interest Standard

The Petitioners argue that the Court of Appeals’ approach in this case creates legions of “indirectly affected” parties, such as end use consumers, who may now challenge rates. Pet. Br. 41. This would make the *Mobile-Sierra* doctrine “an exercise in futility,” Pet. Br. 18, and for no good reason—the public-interest standard “exists for the precise purpose of protecting the ‘public.’” Pet. Br. 27. That argument might have some force if this case involved a rate challenge brought by one of the “hordes,” Pet. Br. 18, of consumers who is indirectly affected by the settlement rates. The argument has no force, however, with respect to the challenge actually before this Court.

The Respondents are not indirectly affected by the rates in question. They were parties to the underlying litigation that resulted in the settling parties' auction process and transition payments, pricing mechanisms that would apply generally to all capacity in New England. The Respondents vigorously opposed the settlement agreement between the Petitioners and the other parties. Nonetheless, in the wake of FERC's approval of the settlement, the auction process and transition payment schedule will result in tariff rates that are applicable throughout New England. The Petitioners and the settling parties have therefore created a rate scheme that directly affects not only themselves, but also sets the default tariff rate for every market participant in New England, including the non-settling Respondents.

The rates at issue, therefore, are not "inputs" that "affect" rates charged to the Respondents—they *are* the rates charged to the Respondents for wholesale service. The public interest standard does *not* "exist[] for the precise purpose of protecting" entities in the Respondents' position. And there are not "hordes" of third parties in the Respondents' position, such that affirming the D.C. Circuit would create a vast loophole to the *Mobile-Sierra* doctrine.

For this reason, the Court of Appeals correctly concluded that principles of contract law militate against application of the *Mobile-Sierra* doctrine to the Respondents. As the court observed, "[i]t goes without saying that a contract cannot bind a

nonparty.” Pet. App. 22a (quoting *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 294 (2002)). Yet applying the *Mobile-Sierra* presumption of reasonableness to a rate challenge by the Respondents would effectively bind them to a contract to which they were a non-party.

The Petitioners counter that a contract “does not ‘bind’ a non-party merely because its existence somehow *affects* that nonparty.” Pet. Br. 41. That is correct, but no one contends otherwise. The contract here does not “merely affect” the Respondents—it purports to revoke a standard of review guaranteed to them by statute and impose on them a much more rigorous standard. Moreover, as explained above, the Respondents are not merely members of the general public who are indirectly affected by a wholesale contract rate. They are significant participants in the relevant wholesale power market and parties that objected to the settlement agreement. For this reason, *Local No. 93 Int’l Ass’n of Firefighters v. City of Cleveland*, 478 U.S. 501 (1986), upon which the Petitioners rely (Pet. Br. 42), is inapposite. The Court held in *Firefighters* that a nonsettling party’s agreement was not required before a district court could approve the consent decree because the consent decree *would not affect the nonsettling party’s rights*. 478 U.S. at 529-30. That is not the case here.

D. The Court Of Appeals' Approach Is Fully Consistent With Precedent

Both the Petitioners and FERC mistakenly argue that the Court of Appeals' ruling conflicts with this Court's decision in *Morgan Stanley* because the court rejected the application of *Mobile-Sierra* to non-party challenges on the basis that it would "deprive non-settling parties of their statutory right to have rate challenges adjudicated under the 'just and reasonable' standard." Pet. Br. 25. *See also* FERC Br. 14. The Petitioners state that this Court's decision in *Morgan Stanley* rejected the claim that the public interest standard was "a standard different from the statutory just and reasonable standard," but instead was a "differing application of that statutory just and reasonable standard." Pet. Br. 26 (citing *Morgan Stanley*, 128 S.Ct. at 2740). These arguments elevate form over substance as these concepts played no role in the Court of Appeals' legal conclusions.

In *Morgan Stanley*, this Court observed that the Commission and the Courts of Appeals have used a longstanding nomenclature to refer to the two modes of review under the single, statutory "just and reasonable" standard, language that this Court explicitly recognized did not "stand for the obviously indefensible proposition" the Petitioners now claim the Court of Appeals construed it to mean. *Morgan Stanley*, 128 S.Ct. at 2740. There is nothing in the Court of Appeals' decision below to suggest that the court misunderstood or intended to modify the standard of review. Moreover, the Court of Appeals

did not base its decision on whether the *Mobile-Sierra* presumption was either an extra-statutory standard or an application of the “just and reasonable standard in the contract context.” Instead, the court based its decision on the analytically distinct question presented here: whether the *Mobile-Sierra* public interest application of the just and reasonable standard governs rate challenges initiated by non-contracting third parties who are directly affected by the settlement.

Moreover, contrary to the Petitioners’ claims, the Court of Appeals’ decision below does not upset decades of well-settled precedent. In fact, no court has previously addressed the question of whether the *Mobile-Sierra* doctrine should apply to a challenge to a contract rate brought by an entity that was not a party to the contract. As the Court of Appeals explicitly stated in the decision below: “[i]n the instant case, we are presented with a question of first impression: may the Commission approve a settlement agreement that applies the highly-deferential public interest standard to rate challenges brought by non-contracting third parties?” Pet. App. 20a.

None of the cases cited by the Petitioners conflicts with the proposition set forth by the Court of Appeals that the *Mobile-Sierra* doctrine is applied “to preserve the terms of the bargain *as between the contracting parties*. But when a rate challenge is brought by a non-contracting third party, the *Mobile-Sierra* doctrine simply does not apply; the

proper standard of review remains the ‘just and reasonable’ standard in section 206 of the FPA.” Pet. App. 22a. For example, in *Boston Edison Co. v. FERC*, 233 F.3d 60 (1st Cir. 2000), the application of *Mobile-Sierra* was to a contract rate agreed to between a utility and its two large wholesale customers. FERC’s determination that the rate was unjust and unreasonable *for the two customers that were parties to the contract* improperly failed to apply the public interest standard under the *Mobile-Sierra* doctrine.

The First Circuit reasoned that the parties could have “negat[ed] the protection afforded by *Mobile-Sierra* by providing that the contract rate initially fixed by the parties and filed with FERC could be overridden by FERC at any time under the just and reasonable standard.” *Id.* at 66. Since the parties did not agree to override the application of the public interest standard to the contract rate, the court ruled that FERC should not have applied the just and reasonable standard. *Boston Edison* thus does not address the situation at issue here, in which contesting parties could not have “opted out” of application of the *Mobile-Sierra* standard (except by agreeing to a settlement that they opposed).

The Petitioners cite *Northeast Utils. Serv. Co. v. FERC*, 993 F.2d 937 (1st Cir. 1993) (*Northeast I*) and *Northeast Utils. Serv. Co. v. FERC*, 55 F.3d 686, 692 (1st Cir. 1995) (*Northeast II*) for the proposition that “[l]ower courts have long applied *Mobile-Sierra* without regard to a challenger’s identity.” Pet. Br. 31.

However, the question of whether a non-settling party to a settlement agreement may bring a challenge to a rate derived from that settlement agreement was not addressed in *Northeast I* and *II*.

The Petitioners also cite *Wisconsin Public Power v. FERC*, 493 F.3d 239 (D.C. Cir. 2007), and *Town of Norwood v. FERC*, 587 F.2d 1306 (D.C. Cir. 1978), for the proposition that courts have applied *Mobile-Sierra* regularly to non-parties. Pet. Br. 31-32. These cases also do not stand for the proposition for which they are cited. As the Petitioners acknowledge, these cases involved claims of “undue discrimination” and the question of whether disparities between *Mobile-Sierra* contract rates and rates made available to other non-contracting customers constitute prohibited discrimination. Thus, the decisions in these cases addressed challenges to existing contracts, not on the grounds that the contracts would bind the third-party challengers, but instead upon the grounds that contractual counterparties received more favorable terms and conditions of service than those provided to other non-contracting third parties. *See, e.g., Wisconsin Public Power*, 493 F.3d at 269-275. Unlike here, the contracts in question in the cases upon which Petitioners rely did not purport to bind third parties to take service under their own privately negotiated terms and conditions. Nor did those contracts and the *Mobile-Sierra* protections afforded their parties purport to deprive any third party of its statutory right to challenge any

rate applicable to the third party under the ordinary just and reasonable review.

Finally, there is no consistent FERC practice regarding application of the *Mobile-Sierra* presumption. As FERC acknowledged to the Court of Appeals, FERC has applied the *Mobile-Sierra* presumption to third parties only as far back as 2002. Pet. App. 23a. Until 2002, FERC expressly and repeatedly refused to apply the *Mobile-Sierra* presumption to third parties.³ The Petitioners point to no evidence that, prior to 2002, FERC was besieged by “hordes” seeking to assert rate challenges. Nor do they make any effort to reconcile FERC’s pre-2002 *Mobile-Sierra* policy with their sweeping and erroneous declaration that the Court of Appeals’ decision conflicts with decades of practice.

Moreover, FERC’s application of the *Mobile-Sierra* presumption to non-contracting third parties since 2002 has been far from uniform. FERC has continued

³ For example, in *PJM Interconnection*, 96 FERC ¶ 61,206 at 61,878 (2001), FERC rejected an argument that parties to a contract may “bind not only one another, but also other entities who are not parties to that contract (and did not receive the contractual benefits in exchange for which the parties traded away their right to seek rate changes).” See also *Westar Generating, Inc.*, 100 FERC ¶ 61,255 (2002); *Niagara Mohawk Power Corp.*, 97 FERC ¶ 61,018 (2001); *Turlock Irrigation Dist. and Pacific Gas and Elec. Co.*, 88 FERC ¶ 61,322 (1999); *Montana Power Co.*, 88 FERC ¶ 61,019 (1999); *New England Power Co.*, 81 FERC ¶ 61,281 (1997); *Southern Co. Servs. Inc.*, 67 FERC ¶ 61,080 (1994).

to reject agreements that applied the *Mobile-Sierra* presumption to non-signatories in contested settlement agreements. *See, e.g., Milford Power Co., LLC*, 119 FERC ¶ 61,167, at 64,032 (2007); *Bridgeport Energy, LLC*, 118 FERC ¶ 61,243 at 62,193 (2007). Just as in the present case, FERC has observed that the purpose of certain types of agreements with generators to provide reliability service have a “wide applicability” to market participants that are much broader in number than the entities executing the agreements. *Id.* In such cases, FERC determined that it was inconsistent with its duty under the FPA to be bound to the restrictive “public interest” mode of review when reviewing such agreements. *Id.* FERC determined that “any challenges to the . . . agreement by non-parties under section 206 of the FPA shall be reviewed by the Commission under the just and reasonable standard.” *Milford Power*, 119 FERC ¶ 61,167, at 62,043; *see also Bridgeport Energy*, 118 FERC ¶ 61,243 at 62,194 (2007).

E. The Fpa Does Not Presume That Market-Based Rates Are Reasonable Except With Respect To Challenges By The Contracting Parties Themselves

The Petitioners assert that non-parties should be subject to the *Mobile-Sierra* presumption because market-based rates are presumptively reasonable “in the broader sense of economic efficiency.” Pet. Br. 35. That argument does not withstand scrutiny, even

assuming that rates derived from the contested settlement agreement are actual market-based rates (which is not at issue here). The cases that the Petitioners cite do not stand for the proposition that the *Mobile-Sierra* presumption invariably insulates market-based rates from challenge. To the contrary, this Court and Court of Appeals cases have consistently warned FERC against presuming that contracts putatively reflecting market-based transactions naturally yield just and reasonable rates. Neither the Commission nor the courts may presume that “market-based” rates are inherently just and reasonable. *See Tejas Power Corp. v. FERC*, 908 F.2d 998, 1003-05 (D.C. Cir. 1990). Such rates must remain subject to the ordinary just and reasonable standard of review.

This Court has stated that the Commission may not rely upon market-based regimes to produce just and reasonable rates, not because markets are necessarily inefficient, but because Congress and the FPA prohibit it. *See FPC v. Texaco*, 417 U.S. 380, 400 (1974) (“*Texaco*”). Specifically, the Court held that:

[i]n concluding that the Commission lacks the authority to place exclusive reliance on market prices, we bow to our perception of legislative intent. It may be, as some economists have persuasively argued, that the assumptions of the 1930’s about the competitive structure of the natural gas industry, if true then, are no longer true today. It may also be that control of prices in this industry, in a time of shortage, if such

there be, is counterproductive to the interests of the consumer in increasing the production of natural gas. It is not the Court's role, however, to overturn congressional assumptions embedded into the framework of regulation established by the Act. This is a proper task for the Legislature where the public interest may be considered from the multifaceted points of view of the representational process.

Id. While *Texaco* did not involve an application of the *Mobile-Sierra* doctrine, it is clear that FERC may not rely solely upon market forces to produce just and reasonable rates.

Similarly, in *Farmers Union Central Exchange v. FERC*, 734 F.2d 1486 (D.C. Cir. 1984), *cert. den. sub nom.*, *Williams Pipe Line Co. v. Farmers Union Cent. Exch. Inc.*, 469 U.S. 1034 (1984), the court considered the permissible context for the charging of market-based rates. In that case, FERC presumed that if it established ceiling prices, albeit at very high levels, "market forces could be relied upon to keep prices at reasonable levels throughout the oil pipeline industry." *Id.* at 1510. The court rejected this reasoning, stating that:

[w]ithout empirical proof that it would, this regulatory scheme, however, runs counter to the basic assumption of statutory regulation, that "Congress rejected the identity between the 'true' and the 'actual' market price." *FPC v. Texaco*, 417 U.S. at 399. In fact, FERC's "'regulation' by such novel 'standards' is

worse than an *exemption simpliciter*. Such an approach retains the false illusion that a government agency is keeping watch over rates, pursuant to the statute's mandate, when it is in fact doing no such thing." *Texaco v. FPC*, 474 F.2d at 422.

Id.; *Cal. ex rel. Lockyer v. FERC*, 383 F.3d 1006, 1012-13 (9th Cir. 2004).

As these cases make clear, applying a presumption that rates are reasonable simply because they are market-based would be incompatible with FERC's obligation under the FPA. In the end, if the Petitioners' market theory operated in practice, there would be no need for the FPA or the Natural Gas Act. Congress, however, determined that sellers and buyers in the utility industry may possess market power and hence required FERC review of such contracts to ensure that utility economic power was not used to exploit the public, which is the ultimate purchaser of utility goods and services but is not invited to the bargaining table. It is beyond the authority of the Commission and the courts to alter a statutory scheme of regulation and review simply because certain economists or contracting parties may believe they have a better approach.

III. FERC DOES NOT HAVE “DISCRETION” TO APPLY THE *MOBILE-SIERRA* PUBLIC INTEREST STANDARD AGAINST THIRD PARTIES OUTSIDE THE CONTRACT CONTEXT

Although FERC properly acknowledges that the transition payment rates and auction results are not contracts subject to the *Mobile-Sierra* presumption, FERC argues that it has the discretion to apply the presumption to future challenges to those rates under its broad authority to approve contested settlement agreements that the Commission believes will produce just and reasonable rates. FERC Br. 32. FERC further argues that the regulatory structure for non-parties remains unchanged because the public interest standard is “simply one application of the more general just and reasonable standard.” *Id.* This argument is not properly before the Court and fails on its merits.

As an initial matter, the Court should not accept FERC’s invitation to decide whether it has the power to impose the public interest standard as a matter of discretion. FERC did not present this theory in its brief in opposition to the petition for a writ of certiorari and did not expressly present this theory to the Court of Appeals. Whether FERC has the far-reaching power to decide unilaterally that ordinary just and reasonable review does not apply to a tariff rate challenge is a significant issue of first impression that should not be raised for the first time

in this Court to justify reversing a Court of Appeals judgment.⁴ *See also SEC v. Chenery Corp.*, 318 U.S. 80, 95 (1943) (“an administrative order cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained”).

FERC’s argument is also wrong on the merits. This Court stated in *Morgan Stanley* that the public interest standard operates in a contract context. *Morgan Stanley*, 128 S.Ct. 2746. Because the rate at issue is not a contract, *Mobile-Sierra* does not apply *ab initio*. Moreover, outside the context of a contract, the Commission has no authority to vitiate the Section 206 rights of non-contracting parties. If, as FERC acknowledges, there is no contract, any review must be under the ordinary and statutory just and reasonable standard.

FERC’s broad authority to approve settlement agreements is circumscribed by the statutory requirement that it must fix rates “upon complaint,” on a showing by the complainant that a rate is “unjust, unreasonable, unduly discriminatory, or preferential.” 16 U.S.C. § 824e. This mandate would be wholly undermined and circumvented if FERC had discretion to apply a contract-based standard of

⁴ By contrast, the Respondents pressed below and in their brief in opposition that auction results and transition payments are not contracts subject to the *Mobile-Sierra* presumption.

review in a non-contract case. Whereas in a contract context, a party could agree to an unfair rate that may nevertheless be consistent with the public interest, FERC may not impose such a rate absent an agreement. *See Sierra*, 350 U.S. at 354-355.

To permit FERC to apply *Mobile-Sierra* in a non-contract context would in effect ignore the plain language of Section 206 that permits a complainant to seek modification of rates “upon complaint” when the complainant demonstrates that the rates to which it did not agree are unjust. FERC should not be permitted to claim discretion to determine when it will ignore the private interests of complainants and consider only whether the rates pose a grave harm to the public.

Contrary to FERC’s claim, the public interest standard is not merely a general application of the just and reasonable standard that provides for the statutory review of claims raised by non-contracting parties. Rather, as noted above, the public interest standard is “the definition of what it means for a rate to satisfy the just-and-reasonable standard in the contract context,” *Morgan Stanley*, 128 S.Ct. 2746, a context FERC expressly admits is not present.

FERC does not have discretion to establish rebuttable presumptions that form a barrier to Section 206 relief. There is nothing in Section 206 that provides for any shifting of burdens or presumptions other than placing the burden of proof on the complainant to show that a rate is unjust or

unreasonable. FERC has not been delegated authority to raise the barrier to a Section 206 review any higher than that established by Congress. That is the role of Congress, and FERC may not overturn congressionally established provisions of the FPA. *See Texaco*, 417 U.S. at 400.

IV. THE DECISION BELOW DOES NOT VITIATE ANY REASONABLE EXPECTATION OF CONTRACT STABILITY OR THREATEN INDUSTRY STABILITY

The Petitioners' and amici's claim that the right of the non-settling parties to challenge rates that result from the settlement agreement under the ordinary just and reasonable standard will threaten industry stability is without merit and should be rejected. *See* Pet. Br. 37-41; Econ. Br. 18-26; EPSA Br. 19-21. The Petitioners' claim that the "vast field of potential complainants with powerful incentives to upset the agreements," will upset the agreements destroy stability, and reduce the role of *Mobile-Sierra* to a "historical footnote" is grossly exaggerated. *See* Pet. Br. 39-40.

The Petitioners' argument is premised on their concern that any and all non-parties to a contract—*e.g.*, indirectly affected consumers—can now challenge energy contracts under the ordinary standard. Pet. Br. 37. In their view, this effectively vitiates the *Mobile-Sierra* doctrine, which was created to advance stability. But that situation is not

presented here and the Respondents take no position on it. On the narrower issue of challenges by entities that objected to a settlement but are now bound by it, the Respondents' position poses no threat whatsoever to industry stability.

As an initial matter, the settling parties cannot have had a reasonable expectation that their settlement agreement, or the tariff rates resulting from the transition payments and FCM pricing mechanisms that they agreed upon amongst themselves over the objections of the Respondents, would be free from uncertainty. As the Court of Appeals explained, the *Mobile-Sierra* presumption of reasonableness ensures contract stability “*as between the contracting parties*” and “[i]t makes no sense to say that the values of ‘stability’ and ‘certainty’ are furthered by applying the deferential standard of review to the eight parties that *refused* to agree to the terms of the settlement.” Pet. App. 24a (emphasis in original). Entering into a settlement agreement with some, but not all, parties to a complex multiparty case entails the risk of further litigation.

Upholding the ruling below does not create uncertainty. If settling parties cannot unilaterally bind non-settling parties to their agreement, they still have recourse to compromise other aspects of the settlement with the non-settling parties in order to obtain their consent to limit their rights under Section 206. Alternatively, to the extent that the settling parties value those other aspects of the settlement more than absolute certainty, they may

choose to settle amongst themselves without the consent of all the parties.

The notion that upholding the right of the non-settling parties to challenge the FCM tariff rates under the ordinary just and reasonable standard would cause substantial increases in risk premiums to developers or force developers to abandon development necessary to meet the increasing demand for electricity, *cf.* Pet. Br. at 40, is belied by the fact that even with this supposed litigation uncertainty, for the first three annual capacity auctions, significant amounts of new capacity resources, well in excess of the installed capacity requirement for New England, have qualified to participate in the auctions. At the same time, the annual price determined by the auction mechanism has been moving downward, not upward, and is now below the unreasonably high rates paid to capacity resources during the transition period. To say that ratepayers will be harmed by their own right to challenge these rates is unfounded.

Moreover, the Petitioners' claim that allowing non-settling parties to challenge the settlement agreement under the ordinary just and reasonable standard threatens industry stability is profoundly overstated. As noted above, FERC's "policy" of applying the *Mobile-Sierra* public interest standard to non-parties dates back only as far as 2002, Pet. App. 23a, and since that time has not been applied consistently. The electric industry managed to maintain its stability and integrity for the five

decades of *Mobile-Sierra* jurisprudence before that 2002 policy shift, and since.

The Petitioners cite to forty-one cases before FERC, resolved subsequent to the ruling below, in which the parties included with their *Mobile-Sierra* provisions language that would apply the “most stringent standard permissible,” or similar language, to challenges raised by non-parties. Pet. Br. 39; Pet. Reply, App. 1a-10a. The Petitioners maintain, “[t]hat so many thought it desirable to include such provisions confirms that non-party challenges are a real threat.” *Id.* At most this tells us that contracting parties will try to bind non-contracting parties if given the opportunity. Parties, however, have continued to enter into agreements, even where *Mobile-Sierra* has not applied to non-parties. Although the new “most stringent standard permissible” language now incorporated into contracts under the ordinary just and reasonable standard is not nearly as restrictive as the “nearly insurmountable” public interest standard under *Mobile-Sierra*, the stability of contract afforded to contracting parties by FERC under the ordinary just and reasonable standard has been sufficient and has not caused uncertainty.

FERC always has an obligation to consider all of the public policy concerns articulated by the Petitioners, including the benefits of contract stability, industry stability, grid reliability and resource adequacy, in resolving any challenge to the settlement tariff rates. FERC also must be free to consider all the other policy concerns any challenger

to the rates might bring, including whether the rates are so high as to constitute a burden to consumers and the regional economy. After all, the “primary aim of this legislation was to protect consumers against exploitation.” *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944). Therefore, non-contracting ratepayers must always be permitted to show that unfair rates pose a specific harm to them and not be limited to making a showing of a grave public necessity requiring a modification to such rates.

Finally, recognizing that *Mobile-Sierra* does not apply to challenges raised by non-contracting parties does not leave contracts unprotected nor does it upset the reasonable expectations of contracting parties. Non-contracting parties challenging contract rates still have the burden to prove that the terms are unjust and unreasonable, and the Commission has shown restraint in abrogating private contracts unless this fairly high burden is met.

The Respondents would have the burden of showing that the auction rate or the transition payment was unjust and unreasonable. This is as Congress intended. Moreover, this is not an insignificant burden. For example, FERC recently denied a complaint by several regulatory agencies, consumer advocates and consumer interests against PJM Interconnection, LLC. The complainants in that matter asserted that the results of the PJM capacity auction were unjust and unreasonable. FERC denied the complaint finding that the auction elements complained of were part of the Reliability Pricing

Model (“RPM”) that was incorporated into the provisions of the PJM tariff and that there was no allegation that PJM had violated these tariff provisions. *Maryland Public Service Commission v. PJM Interconnection, LLC*, 124 FERC ¶ 61,276, 62,562 (2008). On rehearing, FERC affirmed its dismissal of the Complaint stating that “as we found in the September Order, while revisions to RPM may be appropriate for the future, RPM Buyers have not made a sufficient showing to justify upsetting already-conducted auctions.” *Id.* at 62,559.

Thus, simply filing a Complaint would not result in an overturning of the transition or auction rates established by tariff pursuant to the contested settlement agreement. Instead, under the applicable just and reasonable standard under Section 206 of the FPA, the Respondents or any other party would have to clear a high hurdle to show that the rates had become unjust and unreasonable. Parties operating in the public utility arena well know that unjust and unreasonable rates may be set aside and hence there is no violence to their contractual expectations to hold them to such a standard.



CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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