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SUPREME COURT ALERT BULLETIN

June 26, 2008

MORGAN STANLEY v. SNOHOMISH **AEP v. SNOHOMISH** ***The “Mobile-Sierra Cases”¹***

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INTRODUCTION

Today, the Supreme Court of the United States (“Supreme Court”) issued its long-awaited decision in the related cases of *Morgan Stanley Capital Group Inc. v. Public Utility District No. 1 of Snohomish County, Washington* (“*Morgan Stanley*”) (No. 06-1457) and *American Electric Power Service Corp. v. Public Utility District No. 1 of Snohomish County, Washington* (“*AEP*”) (No. 06-1462).

Both cases represent appeals of a December 19, 2006 Ninth Circuit Court of Appeals (“Ninth Circuit”) decision which found that the Federal Energy Regulatory Commission (“FERC”) misapplied the *Mobile-Sierra* doctrine to long-term power sales contracts entered into by Morgan Stanley, Calpine, and others during the Western Energy Crisis of 2000-2001.²

In today’s decision, the Supreme Court disagreed with the Ninth Circuit’s reasoning, but affirmed its decision nonetheless. The opinion essentially reaffirmed the validity of the *Mobile-Sierra* doctrine, extending its applicability to both high and low rate challenges, and indicated that the doctrine would not apply where a party to the contract engaged in unlawful market manipulation that impacted the contract at issue.

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² *Public Utility Dist. No. 1. of Snohomish County, Washington, et al. v. FERC*, 471 F.3d 1053 (9th Cir. 2006).

On this basis, the Court remanded the case back to FERC to determine: (a) whether the contracts at issue imposed an excessive burden to consumers “down the line” rather than merely at the outset of the contracts; and (b) whether there was evidence that the respondent sellers engaged in unlawful market manipulation that altered the playing field for contract negotiations, thereby eliminating the presumption that such contracts were just and reasonable.

Justice Scalia delivered the opinion of the Court, in which Justices Kennedy, Thomas and Alito joined. Justice Ginsburg filed a concurring opinion. Justice Stevens filed a dissenting opinion in which Justice Souter joined. Chief Justice Roberts and Justice Breyer took no part in the decision or the consideration.

1. Background

Both *Morgan Stanley* and *AEP* stem from various buyers and sellers entering into long-term power purchases under the Western Systems Power Pool (“WSPP”) Agreement during and shortly after the Western Energy Crisis of 2000-2001. The buyers – Snohomish Public Utility District and Nevada Power – claimed that their contracts with Morgan Stanley, Calpine, and others contained “unjust and unreasonable” prices and should be reformed.

Following a trial by a FERC Administrative Law Judge (“ALJ”), FERC concluded that the “*Mobile-Sierra*” doctrine applied to the contracts and that the complainant buyers failed to satisfy their burden of the *Mobile-Sierra* “public interest” standard of review. FERC reasoned that the contracts were not contrary to the public interest simply because the contracts became uneconomic over time.

On appeal, the Ninth Circuit remanded the case back to FERC and criticized FERC’s application of the *Mobile-Sierra* standard. In short, the court found that while market-based rate authority can qualify as sufficient prior review to justify application of the *Mobile-Sierra* “public interest” standard of review, it can only do so when accompanied by effective FERC oversight permitting timely reconsideration of market-based authorization if market conditions change.

The Supreme Court granted certiorari on September 26, 2007, and heard oral argument on February 19, 2008.

2. The Decision

In today’s decision, the Supreme Court affirmed the Ninth Circuit’s remand to FERC, but on different grounds from those articulated by the Ninth Circuit. Importantly, the Supreme Court found that the Ninth Circuit incorrectly articulated the *Mobile-Sierra* doctrine and its scope, but that FERC misapplied the doctrine to the contracts at issue.

Key findings and holdings of the Court’s decision are set out below.

- There is only one statutory standard for assessing wholesale electricity rates – the just and reasonable standard.³ The term “public interest standard” simply refers to the different application of the just and reasonable standard to contract rates.⁴
- The Ninth Circuit misinterpreted *Sierra* as requiring FERC to apply the *Mobile-Sierra* doctrine differently depending on the time period under which a contract rate is challenged. *Sierra* should not be read as an “estoppel doctrine” under which FERC is precluded from modifying rates after its initial review absent future harm to the public interest.⁵
- The Ninth Circuit erred in finding that a “zone of reasonableness” test – rather than the *Mobile-Sierra* “public interest” test – should be used to evaluate a buyer’s challenge that a rate is too high. Instead, the standard for a buyer’s challenge (a “high rate challenge”) and the standard for a seller’s challenge (a “low rate challenge”) should be the same – a contract rate must seriously harm the public interest to be abrogated.⁶
- The Ninth Circuit erred in holding that FERC is required to determine whether a contract was formed in an environment of market “dysfunction” before the *Mobile-Sierra* doctrine may be applied.⁷ Such an undertaking would be speculative – “the mere fact that the market is imperfect, or even chaotic, is no reason to undermine the stabilizing force of contracts....”⁸ However, if the “dysfunctional” market conditions were caused by illegal action of one of the parties, FERC should not apply the *Mobile-Sierra* presumption.⁹
- Notwithstanding the Ninth Circuit’s errors, it was correct in finding that FERC erred. More specifically, FERC erred with regard to: (a) the time period analyzed to determine whether there is an “excessive burden” to consumers under the contract at issue and (b) the dismissal of evidence of market manipulation that could have shown the contract rates were not the result of fair negotiations.¹⁰ Both issues must be amplified and clarified by FERC on remand.
- As to the time period analyzed, the Court found that FERC must determine on remand whether the contracts imposed an excessive burden on consumers “down the line,” relative to the rates they could have obtained (but for the contracts) after the

³ Slip Op. at 16.

⁴ *Id.* at 6, 17.

⁵ *Id.* at 17.

⁶ *Id.* at 19-20.

⁷ *Id.* at 18.

⁸ *Id.* at 19.

⁹ Slip Op. at 19.

¹⁰ *Id.* at 24-25.

elimination of the dysfunctional market. “The ‘unequivocal public necessity’ that justifies overriding the *Mobile-Sierra* presumption does not disappear as a factor once the contract enters into force.”¹¹

- As to evidence, the Court indicated that where a party to a contract engaged in unlawful market manipulation, to the extent that contract negotiations were altered, FERC should not presume that contract to be just and reasonable. “Like fraud and duress, unlawful market activity that directly affects contract negotiations eliminated the premise on which the *Mobile-Sierra* presumption rests: that the contract rates are the product of fair, arms-length negotiations.”¹²
- The Court emphasized, however, that FERC should not be able to abrogate a contract simply because a party engaged in unlawful activity in the spot market. Rather, causality must be found between such unlawful activity and the contract at issue. As such, where there is causality, the *Mobile-Sierra* presumption should not apply.¹³
- The dissenting opinion written by Justice Stevens disagreed with the Court’s ruling that the public interest standard represents a different application of the just and reasonable standard.¹⁴ According to Justice Stevens, Section 206 of the Federal Power Act does not establish a different standard for challenges to rates established by contract – “If Congress had intended to impose such detailed constraints on the Commission’s authority to review contract rates, it would have done so itself in the FPA.”¹⁵

¹¹ *Id.* at 24.

¹² *Id.* at 25.

¹³ *Id.* at 26.

¹⁴ Dissenting Opinion at 4.

¹⁵ *Id.* at 3.