UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Maine Public Utilities Commission, Richard Blumenthal, Attorney General for the State of Connecticut, and Martha Coakley, Attorney General for Massachusetts, Petitioners

Nos. 06-1403 *et al.*

v.

Federal Energy Regulatory Commission, Respondents

(August 4, 2008)

KELLY and WELLINGHOFF, Commissioners, *dissenting*:

We dissent from the Commission's decision to seek rehearing of the portion of the decision in *Maine Public Utilities Commission v. FERC*, 520 F.3d 464 (D.C. Cir. 2008) (*Maine PUC*) that concerns the applicability of the *Mobile-Sierra* doctrine to the rights of parties who do not agree to settlement in a Commission adjudication. Rehearing is not appropriate because (1) *Maine PUC* does not conflict with the U.S. Supreme Court decision in *Morgan Stanley Capital Group, Inc. v. Public Utility District No. 1 of Snohomish County*, Nos. 06-1457, *et al.* (U.S. Supreme Court June 26, 2008) (*Morgan Stanley*); (2) The *Maine PUC* court did not misapprehend the law, and its decision therefore is consistent with *Morgan Stanley*; and (3) *Maine PUC* does not damage the Commission's ability to approve settlements in contested proceedings before the Commission.

I. *Maine PUC* does not conflict with *Morgan Stanley*

Maine PUC does not conflict with *Morgan Stanley* because neither *Morgan Stanley*'s holding nor the reasoning supporting it applies to the type of agreement at issue in *Maine PUC*. Further, there is no basis in law or policy to expand the holding in *Morgan Stanley* to settlement agreements in contested adjudications before the Commission.

A. Neither *Morgan Stanley*'s holding nor the reasoning supporting it applies to the type of agreement at issue in *Maine PUC*

Morgan Stanley holds that whenever the Commission reviews a particular type of contract, the Federal Power Act (FPA) requires it to apply the presumption

that the contract meets the "just and reasonable" requirement imposed by the act. This presumption (called the *Mobile-Sierra* presumption) may be overcome only if the Commission concludes "that the contract seriously harms the public interest." Slip op. at 1 (citing *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956) (*Mobile*); *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (*Sierra*)). The contracts that are accorded this special application of the "just and reasonable" standard are those "freely negotiated, wholesale-energy [sales] contracts" that were given a special role in the FPA. *Id.* at 1, 2.

The Court explained how this type of contract plays a special role in the FPA: The FPA provides that regulated utilities may file rate schedules or "tariffs" with the Commission to provide service to electricity purchasers on the terms and prices set forth in those tariffs. Utilities must notify the Commission 60 days before the changes are to go into effect, and the Commission will approve the changes if the Commission finds them to be just and reasonable, usually through an adjudicatory process. However, the FPA also permits utilities to set rates with sophisticated, commercial electricity purchasers through bilateral contracts. These contracts are negotiated privately, in the marketplace, outside the Commission's auspices, and some are later filed with the Commission.[1] It is these wholesale-energy sales contracts between sophisticated commercial buyers and sellers "'that depart[] from the scheme of purely tariff-based regulation and . . . [can] be used in ratesetting,'" that must be accorded the *Mobile-Sierra* application of the just and reasonable standard. *Id.* at 2 (quoting *Verizon Communications Inc.* v. *FCC*, 535 U.S. 467, 479 (2002) (*Verizon*)). The FPA allows this type of contract to "unilaterally set rates." *Id.* at 17 n.3.

The Court made clear that the *Mobile-Sierra* presumption must be applied by the Commission *whenever* such a contract is reviewed. The Court specifically rejected the Ninth Circuit's finding to the contrary. *Id.* at 16. The Ninth Circuit had concluded that "so long as the Commission concludes . . . that a contract rate is just and reasonable when initially filed, the rate will be presumed just and reasonable in future proceedings." *Id.* at 16-17. The Supreme Court disagreed and held that the presumption applies *whenever* the Commission reviews it, including in its initial review. ("[O]nly when the mutually agreed-upon contract rate seriously harms the consuming public may the Commission declare it not to be just and reasonable." *Id.* at 16. This "is the 'sole concern' in a contract case." *Id.* at 17 n. 3.) This is different from the Commission's previous understanding of the law, which it believed required the Commission initially to review a contract

[1] Contracts executed by sellers with Commission-granted market-based-rate authority with non-affiliated buyers are not filed with the Commission.

under the "ordinary" just and reasonable standard, *i.e.*, without a *Mobile-Sierra* presumption. *Id.* at 15.

Throughout its opinion, the Court reiterates that its holding is based on the important role the FPA has given to these types of contracts: The FPA "permits rates to be set by [a wholesale-energy sales] contract and not just by tariff." *Id.* at 22. These are "contracts that the FPA [has] embraced as an alternative to 'purely tariff-based regulation,'" *id.* at 19 (quoting *Verizon*, 535 U. S. at 479); "utilities may set rates with individual electric purchasers through bilateral contracts." *Id.* at 2. The FPA "'departed from the scheme of purely tariff-based regulation and acknowledged that contracts between commercial buyers and sellers could be used in ratesetting.'" *Id.* (quoting *Verizon*, 535 U.S. at 479).

The *Morgan Stanley* Court further explained that its holding here, like that in *Sierra*, 350 U.S. 348, is "grounded in the commonsense notion that 'in wholesale markets, the party charging the rate and the party charged [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.'" *Id.* at 17 (quoting *Verizon*, 535 U. S. at 479). Building on that "commonsense notion", the Court expressed concern that "enabling sophisticated parties who weathered market turmoil by entering long-term contracts to renounce those contracts once the storm has passed … would reduce the incentive to conclude such contracts in the future." *Id*. at 18. The Court found that this premise and concerns about buyer's or seller's remorse support a requirement that the Commission must apply a presumption of justness and reasonableness whenever it is called upon to approve such a bilateral contract. The Court also stated that, should such a contract rate later be challenged by a party to it, the contract can only be abrogated in a case of "'unequivocal public necessity'" or "'extraordinary circumstances'". *Id*. at 22 (citations omitted).

The agreement at issue in *Maine PUC* is not at all like the contract before the Court in *Morgan Stanley*. To the contrary, it differs in every fundamental respect from a privately negotiated, voluntary contract for wholesale energy that unilaterally sets a rate between two sophisticated, commercial entities seeking to sell and buy electricity between them and that may be filed, fully and finally drafted and signed, with the Commission. The agreement at issue in *Maine PUC* is a contested settlement agreement addressing a utility's voluminous, complex proposal to revise its tariff substantially to enable it to establish and operate a locational installed electricity capacity market for the general public. While a voluntary, bilateral, buy-sell contract for wholesale-energy is essentially a private contract that is negotiated in the marketplace, outside the ambit of the regulator, the agreement at issue in *Maine PUC* emanated from a highly contested adjudicatory proceeding before the Commission and involves a broad, public

matter. Further, the agreement is not between two sophisticated actors playing on a level field. No "commonsense notion" would hold that the 115 parties to the adjudication of this matter enjoy presumptively equal bargaining power. It follows that the agreement at issue has no special status under the FPA. It is not an alternative to the Commission's tariff-based regulation of a regional transmission operator; it is an example of the Commission's tariff-based regulatory process, which, as the *Morgan Stanley* Court explained, is governed by the "ordinary" just and reasonable standard.

The holding of *Morgan Stanley* and the reasoning that supports it does not apply to the agreement at issue in *Maine PUC*.

B. There is no basis in law or policy to expand the holding in *Morgan Stanley* to apply to settlement agreements in contested adjudications before the Commission.

Unlike the type of contracts at issue in *Morgan Stanley*, the agreement at issue in *Maine PUC* is not of a type of agreement that can or should enjoy a statutory presumption that it is just and reasonable, either upon initial review by the Commission or in any subsequent challenge.[2]

The Court in *Morgan Stanley* explained that its holding is a special "*application* of the just-and-reasonable standard to contract rates . . . ([which application can be] referr[ed] to . . . as the "public interest standard.") *Id.* at 6. (citation omitted). As explained above, the Court found the legality of this special application of the just and reasonable standard lies in the special rate-setting role that the FPA gives to freely negotiated, bilateral, wholesale-energy sales contracts.

The FPA gives no role, let alone a special one, to settlement agreements reached by parties to contested adjudications before the Commission. Thus, there is no basis in law to expand the holding in *Morgan Stanley* to permit the Commission to apply a special version of the just and reasonable standard of the

[2] Although there is no legal basis for providing this type of agreement with a statutory presumption that affects the Commission's authority and responsibility under the just and reasonable standard, there is nothing in law or policy that prevents the parties to the agreement from binding themselves, pursuant to private contract law, to challenges of the agreement based only on a showing of "unequivocal public necessity". In effect, there is no legal prohibition on the parties' compromising their individual rights to the "ordinary" just and reasonable review pursuant to FPA sections 205 or 206, 16 U.S.C. § 824d, 824e (2006).

FPA (e.g., a *Mobile-Sierra* "public interest" standard) to an initial or subsequent review of a settlement agreement from a contested adjudication.

There is also no good policy reason to justify allowing the Commission to hold a settlement agreement to any standard other than the "ordinary" just and reasonable standard. Indeed, such a holding would result in imbuing private parties with regulatory authority heretofore reserved to the Commission; would cause untold uncertainty in future adjudications before the Commission; would be unduly discriminatory to applicants for tariff changes who do not obtain settlement agreements; and would result in a regulatory morass of utility tariff provisions with differing status.

1. Imbuing private parties with regulatory authority heretofore reserved to the Commission

Currently, when a utility applies for a tariff change under section 205 of the FPA, the Commission reviews the application, through an administrative adjudication to determine whether it is just and reasonable. If, during the course of the adjudication, one or more other parties enter into a settlement agreement, and the holding of *Morgan Stanley* is extended to this type of "contract," then the settlement agreement must be presumed by the Commission to be just and reasonable. Moreover, the presumption could only be overcome if the Commission were to conclude that the settlement agreement seriously harmed the public interest. This would result in significant decision-making authority being transferred from the Commission to the utility and other private parties entering into the settlement agreement. Such transfer of decision-making authority to private parties is justified when the agreement being reviewed is a voluntary, bilateral, wholesale-energy sales agreement, which is a private contract that affects no one except the contracting parties. However, this is unjustifiable in situations such as that at issue in *Maine PUC*, where the agreement establishes a locational installed electricity capacity market, essentially a public enterprise.

Further, if the Commission or any non-party to the settlement agreement becomes concerned about changed circumstances, and the *Morgan Stanley* holding has been extended to this type of "contract," the Commission would be unable to require a tariff change to reflect those circumstances absent a finding of "unequivocal public necessity" or "extraordinary circumstances." While this higher standard may be justified where sophisticated, private contracting parties are concerned, it imposes too high a standard in all other circumstances. The *Morgan Stanley* Court carefully described and proscribed the arena in which *Mobile-Sierra* should apply to the Commission's statutory just and reasonable review. That arena should not be expanded.

2. Causing uncertainty in future adjudications before the Commission

Were the *Morgan Stanley* holding to be extended to the agreement at issue in *Maine PUC*, it would cause great uncertainty in future adjudications before the Commission. The agreement in *Maine PUC* is a settlement of an adjudication that 107 of the 115 parties to the proceeding signed. If the *Mobile-Sierra* standard is applied to this settlement, what does it mean for future settlements? Would it apply to any settlement arrived at by the utility with any of the intervening parties? What if the utility achieved the agreement of one party out of 115? How about 50 parties out of 115? How about two parties out of seven? What if the two settling parties were affiliates of the utility? Would a percentage, rather than numerical, requirement for *Mobile-Sierra* status be acceptable? How about a requirement that 90 percent of the parties have to sign the agreement to get *Mobile-Sierra* "protection"? If 90 percent is the requirement, then can the individual members of an organization intervene in their individual capacities in order to reach the 90 percent number? The gaming scenarios this could spawn are countless. The uncertainty would be boundless.

3. Undue discrimination concerns

Under current law, when a utility applies under section 205 of the FPA for a tariff change, the Commission reviews the filing through an administrative adjudication to determine whether it is just and reasonable. If the *Morgan Stanley* holding is extended to provide for a "public interest" standard of review of any settlement agreement in an adjudicated proceeding, this presents undue discrimination concerns. For example, what if no party intervenes in the proceeding? In such a case, the utility is "prevented" from getting a settlement agreement and, presumably, its requested tariff change is evaluated under the "ordinary" just and reasonable standard. Isn't it unduly discriminatory to hold a utility that has received no opposition to its proposal to a higher burden than a utility whose proposal was opposed but who resolved the opposition through a settlement agreement? If it is undue discrimination to do so, then should the utility that had no intervenor be presumed, in the absence of any objection, to have a settlement agreement? If so, then when does a utility's proposal ever receive the scrutiny of the "ordinary" just and reasonable standard that Congress contemplated? If not, then will the utility manufacture specious opposition solely to secure a settlement agreement?

4. Resulting regulatory morass of utility tariff provisions with differing status

Many adjudicatory proceedings before the Commission, like the one giving rise to *Maine PUC*, concern utility proposals under section 205 of the FPA to amend their tariffs. If this court were to permit settlement agreements in these cases to carry with them just and reasonable presumptions that can only be overcome if the Commission concludes that a provision in the agreement seriously harms the public interest, this will lead to a regulatory morass in future proceedings insofar as changes to tariff provisions are involved.

Currently, if the Commission or any person other than the utility with the tariff provision wishes to change a tariff provision, it must prove that the provision at issue is unjust, unreasonable, unduly discriminatory or preferential. 16 U.S.C. § 824e(a) (2006). If tariff provisions that have been established through settlement agreements have a special status different from the status of tariff provisions that have not been so established, any process undertaken to reform these tariff provisions will be an exercise in combing through haystacks to determine which of the tariff provisions get special treatment and which do not. And that will be only the beginning of the exercise.

In an actual proceeding to reform tariff provisions, those enjoying special status will only be able to be changed in a case of "unequivocal public necessity" or "extraordinary circumstances," slip op. at 22 (citations omitted), while the others could be changed if they are merely "unjust" or "unreasonable." Multiple tariff provisions frequently coalesce to establish a policy or program--for example, a locational installed capacity market. If, after several years of experience with the market's operation, a case were to arise to consider reform, it may be that some of the tariff provisions at issue will have special status and others will not. In that case, the reality is that the higher standard will rule the case and no change will be made unless it is in the "unequivocal public necessity." It seems particularly unwise in times of electricity industry and market evolution to make it *more difficult* to make changes to accommodate changing market circumstances.

II. The *Maine PUC* court did not misapprehend the law, and, therefore, its decision is consistent with *Morgan Stanley*

The majority believes that the *Maine PUC* court misapprehended the law. We disagree. *Maine PUC* is consistent with *Morgan Stanley*.

The *Maine PUC* court was faced with a contested settlement agreement concerning a regional transmission operator's request to the Commission to revise its tariff to allow it to establish a locational installed electricity capacity market. As the court noted, the Commission had "approved the settlement agreement, finding that 'as a package, it presents a just and reasonable outcome for this proceeding consistent with the public interest.'" *Maine PUC*, 520 F.3d at 469

(citation omitted). The provisions of the settlement agreement were then incorporated into the regional transmission operator's tariff. Several of the non-settling parties to the adjudication appealed various provisions of the settlement agreement, including one that provided that the Commission was required to apply "the 'public interest' standard, rather than the 'just and reasonable' standard" to "all future challenges to the transition payments and final auction prices 'whether the change is proposed by a Settling Party, a non-Settling Party, or the FERC acting *sua sponte*.'" *Id.* at 476. The non-settling parties argued that this provision "will deprive them of their statutory right to challenge rates under the 'just and reasonable' standard." *Id.* at 477. The court agreed.

The *Maine PUC* court's reasoning is remarkably consistent with the later-issued opinion in *Morgan Stanley*. The court began by explaining that the special treatment provided for under the *Mobile-Sierra* doctrine is reserved to "'freely negotiated private contracts that set firm rates or establish a specific methodology for setting the rates for service.'" *Id.* at 477 (quoting Atl. City Elec. Co. v. FERC, 295 F.3d 1, 14 (2002) (*Atl. City*)). Such contracts can only be modified by the Commission "if required by the public interest." *Id.* Compare this with the *Morgan Stanley* holding, as delivered in its first two sentences:

> Under the *Mobile-Sierra* doctrine, the [Commission] must presume that the rate set out in a freely negotiated wholesale-energy [sales] 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. Slip op. at 1.

The *Maine PUC* court continued that the "purpose of the *Mobile-Sierra* doctrine is 'to preserve the benefits of the parties' bargain as reflected in the contract, assuming that there was no reason to question what transpired at the contract formation stage.'" *Maine PUC*, 520 F.3d at 477 (quoting Atl.City, 295 F.3d at 14). Compare this with the *Morgan Stanley* Court's explanation that "the principal regulatory responsibility is not to relieve a contracting party of an unreasonable rate", but rather that "FERC has ample authority to set aside a contract where there is unfair dealing at the contract formation stage." Slip op. at 6, 19.

The *Maine PUC* court explained that the *Mobile-Sierra* doctrine "applies a more deferential standard of review to preserve the terms of the bargain as between the contracting parties," and the *Mobile-Sierra* protection afforded such contracts "departs from the usual 'just and reasonable' standard and makes it harder" for a party to the contract subsequently to "successfully challenge the rate in cases of changed circumstances." *Maine PUC*, 520 F.3d at 478. Compare this with the *Morgan Stanley* Court's explanation that

> the term 'public interest standard' refers to the differing *application* of the just-and-reasonable standard to contract rates. (It would be less confusing to adopt the Solicitor General's terminology, referring to the two differing applications of the just-and-reasonable standard as the "ordinary" "just and reasonable standard" and the "public interest standard.") Slip op. at 6 (citation omitted).

Thus, the *Maine PUC* interpretation of the *Mobile-Sierra* doctrine is completely consistent with *Morgan Stanley*.

The *Maine PUC* court, faced with a contested settlement agreement concerning tariff provisions proposed to establish a locational electricity capacity market, rather than a voluntarily negotiated, bilateral wholesale-energy sales agreement between two sophisticated commercial parties, went on to make the unsurprising finding that the "contract" before it was not of the type that qualifies for the special treatment afforded by *Mobile-Sierra*:

> This case is clearly outside the scope of the *Mobile-Sierra* doctrine. As we explained, *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." *Maine PUC*, 520 F.3d at 477-78 (quoting *Maine PUC*, 454 F.3d 278, 284 (2006)).

This holding is entirely consistent with the holding in *Morgan Stanley*, which, as explained above, limits the special *Mobile-Sierra* type contract review treatment to voluntarily and privately negotiated, bilateral wholesale-energy buy/sell agreements between sophisticated parties that unilaterally set a rate between them alone.

III. *Maine PUC* does not damage the Commission's ability to approve settlements of contested proceedings before the Commission

By holding that the contested settlement in *Maine PUC* is outside the scope of the *Mobile-Sierra* doctrine, the court essentially preserves Congressional intent as set out in section 205 of the FPA, to require the Commission to apply the "ordinary" just and reasonable standard when considering any settlement in a contested adjudication of a proposed tariff revision. This holding is consistent with the Commission's long-standing practice. However, if the court were to grant rehearing of *Maine PUC* and extend *Morgan Stanley* beyond the type of bilateral contracts discussed above, then the Commission would need to change

this practice and apply a presumption of justness and reasonableness to such settlement agreements.

The *Maine PUC* holding also preserves Congress' decision, as set out in section 206 of the FPA, to allow utility tariff provisions, whether arrived at through settlement agreements or not, to be challenged in the event of future changed circumstances by complainants or the Commission acting *sua sponte* under the "ordinary" just and reasonable standard.

We believe the *Maine PUC* holding is not only the correct legal outcome, but also the best policy outcome. The majority disagrees. It believes that unless the law allows parties to a contested settlement who have agreed among themselves to compromise their FPA section 206 rights[3] to impose this compromise on non-settling parties, as well as on the Commission acting *sua sponte*, the Commission's ability to approve settlements in the future will be "seriously damaged". The majority also expresses concern that this will "undermine" the Commission's ability to provide "a degree of future rate certainty." We do not share those concerns.

Starting with the second concern, we believe that the just and reasonable standard is rigorous, in and of itself, and not easily satisfied by challengers. In order to change a utility tariff provision that has been approved by the Commission under the just and reasonable standard, a challenger or the Commission acting *sua sponte* must prove that circumstances have changed so dramatically that the tariff provision has become unjust and unreasonable. This does not happen often.

Second, the fact that parties to a contested adjudication before the Commission have the legal right to compromise their FPA section 205 and 206 rights to limit their own future challenges to the tariff provisions gives them substantial control over the future certainty of the provisions. The greater number of parties to an adjudication who can be brought to the negotiation table to compromise their statutory challenge rights, the smaller the universe of persons who can mount a challenge under the "ordinary" just and reasonable standard. Further, this provides an incentive to negotiate a broad settlement—an incentive that is not provided if any settling party could bind all non-settling parties. The broader the settlement, the more likely it is to be just and reasonable to all involved and in the broader public interest.

[3] In the case of the utility, it would be its FPA section 205 right.

Finally, when parties to a settlement agreement choose to limit their challenge rights, it has an impact on the Commission as a decision-maker, providing potent evidence that they so strongly believe this is the best course for them that they are willing to sign away valuable rights. Such evidence matters as the Commission engages in its statutorily required deliberation whether the tariff is just and reasonable.

Regarding the majority's concern that the inability of settling parties to bind non-settling parties and the Commission acting *sua sponte* to a standard higher than the "ordinary" just and reasonable standard will somehow damage the Commission's ability to approve settlements, we simply fail to see why that would occur. What will otherwise settling parties do upon being apprised that they cannot legally bind non-settling parties to their agreement? It seems that they will do one of two things. To the extent they highly value almost-absolute-future-certainty, and to the extent they believe that having the non-settling parties compromise their FPA section 206 rights is necessary to achieve that high degree of certainty, they will compromise other aspects of the settlement to get non-settling parties to agree to it. To the extent they do not value absolute certainty more highly than other aspects of the settlement, they will not compromise the other aspects of the settlement. It does not seem at all likely, however, that this issue will result in no settlement at all. The objective is maximum certainty, and failing to reach a settlement provides none.

For these reasons, as well as for the policy reasons we discussed above, we do not believe that *Maine PUC* damages the ability of the Commission to approve settlements. In fact, we believe its holding will provide more, not fewer, incentives for parties to a contested adjudication to settle the issues among themselves.

For all of the reasons we have enumerated above, we respectfully dissent.

_____	_____
Suedeen G. Kelly	Jon Wellinghoff
Commissioner	Commissioner