

134 FERC ¶ 61,208
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
John R. Norris, and Cheryl A. LaFleur.

Devon Power LLC

Docket No. ER03-563-066

ORDER ON REMAND

(Issued March 17, 2011)

1. In response to a petition for review of the Commission's orders issued earlier in this proceeding,¹ the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit), on November 5, 2010, issued an order remanding the matter in part to the Commission for further proceedings.² At issue is whether the auction results and transition payments arising from a contested settlement approved by the Commission earlier in this proceeding constitute "contract rates" where challenges can only be reviewed by the Commission under a more rigorous application of the statutory "just and reasonable" standard of review; that more rigorous application is often characterized as the *Mobile-Sierra* "public interest" standard.³ Also at issue is, if the auction results and transition payments are not "contract rates," whether the Commission may act within its discretion in nevertheless approving a settlement provision imposing the *Mobile-Sierra*

¹ *Devon Power LLC*, 115 FERC ¶ 61,340 (*Settlement Order*), *order on reh'g*, 117 FERC ¶ 61,133 (2006) (*Rehearing Order*), *remanded in part sub nom. Me. Pub. Utils. Comm'n v. FERC*, 520 F.3d 464 (D.C. Cir. 2008), *order on remand*, 26 FERC ¶ 61,027 (2009).

² *Me. Pub. Utils. Comm'n v. FERC*, 625 F.3d 754 (D.C. Cir. Nov. 5, 2010).

³ *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) (*Mobile*); *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956) (*Sierra*). As the Supreme Court has found, the Federal Power Act's (FPA) just and reasonable standard is the only statutory standard of review. *Morgan Stanley Capital Group, Inc. v. Pub. Util. Dist. No. 1 of Snohomish County, Washington*, 554 U.S. 527, 545 (2008) (*Morgan Stanley*); *see also* 16 U.S.C. §§ 824d, 824e (2006).

“public interest” standard on certain future challenges to the auction results and transition payments.

2. We find that the settlement rates at issue are not “contract rates” where future challenges would necessarily be subject to a *Mobile-Sierra* “public interest” presumption. Nevertheless, we also find that the Commission has discretion to consider and decide whether future challenges to rates should be evaluated under a more rigorous application of the statutory “just and reasonable” standard of review. We find that, under the circumstances of this case, the Commission may properly exercise that discretion and apply that more rigorous application of the statutory “just and reasonable” standard of review here, making future challenges to the settlement rates subject to that more rigorous application of the just and reasonable standard, as described below.

I. Background

3. In 2006, the Commission approved a contested settlement agreement redesigning the New England market for installed electric generation capacity (Settlement).⁴ The Settlement established a forward capacity market, which would use annual auctions to set the price of capacity. In these auctions, capacity is procured three years in advance of its use, with the first auction procuring capacity for the one-year period beginning June 1, 2010. To address the period between the effective date of the Settlement and June 1, 2010, the Settlement included a transition mechanism, which provided fixed payments to capacity assignments.

4. Of the 115 parties to the Settlement proceedings, eight opposed the Settlement. Notwithstanding the opposition, the Commission approved the Settlement because, as a package, it presented a just and reasonable outcome for this proceeding consistent with the public interest.⁵ The Commission found that the Settlement provided a necessary solution to serious deficiencies in the New England market that were impairing critical infrastructure development and threatening reliability.⁶ Of particular interest here, section 4.C of the Settlement imposed the *Mobile-Sierra* “public interest” presumption on certain future challenges to the auction results and transition payments. The Commission found that this provision balanced the need for rate stability with the statutory requirement that rates be just and reasonable.⁷

⁴ *Settlement Order*, 115 FERC ¶ 61,340 at P 2.

⁵ *Id.*

⁶ *Id.* P 62-65.

⁷ *Id.* P 182-186.

5. On appeal, the D.C. Circuit rejected most of the petitioners' challenges to the Commission's orders. However, the court agreed with petitioners that applying the *Mobile-Sierra* "public interest" standard to challenges by non-settling parties "unlawfully deprived non-settling parties of their rights under the [Federal Power Act]."⁸

6. The Supreme Court reversed that determination, finding that "the public interest standard is not, as the D.C. Circuit presented it, a standard independent of, and sometimes at odds with, the 'just and reasonable standard' ...; rather, the public interest standard defines 'what it means for a rate to satisfy the just and reasonable standard in the contract context.'"⁹ The Supreme Court reasoned that *Mobile-Sierra* "is not limited to challenges to contract rates brought by contracting parties. It applies, as well, to challenges initiated by third parties."¹⁰ Thus, the Commission must presume "that contract rates freely negotiated between sophisticated parties meet the just and reasonable standard."¹¹

7. The Supreme Court remanded to the D.C. Circuit for further consideration, however, the question of whether the auction results and transition payments subject to the *Mobile-Sierra* clause in the Settlement are "contract rates" to which the Commission is required to apply the *Mobile-Sierra* "public interest" presumption.¹² If not, the D.C. Circuit was to consider whether the Commission has discretion, under the circumstances, to approve the Settlement provision imposing the *Mobile-Sierra* "public interest" presumption on future challenges to those results and payments.¹³

8. On remand, the D.C. Circuit stated that it was unable to determine whether the Commission's position is reasonable because the Commission had not articulated a rationale "for its discretion to approve a *Mobile-Sierra* clause outside the contract context, or an explanation for exercising that discretion here."¹⁴ Accordingly, the court

⁸ *Me. Pub. Utils. Comm'n v. FERC*, 520 F.3d at 467.

⁹ *NRG Power Mktg v. Me. Pub. Utils. Comm'n*, 130 S. Ct. 693, 700 (2010) (*NRG*) (quoting *Morgan Stanley*, 554 U.S. at 546).

¹⁰ *Id.*

¹¹ *Id.* at 699.

¹² *Id.* at 701.

¹³ *Id.*

¹⁴ *Me. Pub. Utils. Comm'n v. FERC*, 625 F.3d at 759.

asked the Commission to explain “why, if the auction rates are not contract rates, they are entitled to *Mobile-Sierra* treatment.” The court also asked the Commission to answer “[j]ust how do the auction rates reflect market conditions similar to freely-negotiated contract rates? Or does the Commission base its asserted discretion on some other ground?”¹⁵

II. Discussion

9. On remand, the Commission finds that the settlement rates at issue here are not “contract rates” that, under *Mobile-Sierra*, require a presumption that the rates are statutorily just and reasonable. The Commission also concludes, however, that it has the discretion to consider and decide whether future challenges to rates must overcome a more rigorous application of the statutory “just and reasonable” standard of review.¹⁶ We find that, based on the circumstances of this proceeding, it is appropriate for the Commission to exercise that discretion here.

10. Under *Mobile-Sierra*, as interpreted by the Supreme Court in *Morgan Stanley*, the Commission must presume that rates set by power sales contracts that are freely negotiated at arm’s-length between willing buyers and sellers meet the statutory “just and reasonable” standard of review.¹⁷ This presumption may be overcome only if the Commission concludes that the underlying rate “adversely affect[s] the public interest.”¹⁸ Thus, this “public interest” presumption demands a more stringent application of the statutory “just and reasonable” standard of review when the Commission reviews rates, terms and conditions of freely negotiated power sales contracts, both on initial review and if and when those rates, terms and conditions are later challenged. Nevertheless, the “public interest” presumption is not a different standard; rather, “the term ... refers to the differing *application* of [the statutory] just-and-reasonable standard,” which is the only statutory standard of review under the Federal Power Act (FPA).¹⁹ Thus, rather than

¹⁵ *Id.*

¹⁶ *See supra* P 2.

¹⁷ *Morgan Stanley*, 554 U.S. at 530.

¹⁸ *Sierra*, 350 U.S. at 355; *see also Morgan Stanley*, 554 U.S. at 530.

¹⁹ *Morgan Stanley*, 554 U.S. at 535. The Supreme Court found that it was “less confusing” to “refe[r] to the two different applications of the just-and-reasonable standard as the ‘ordinary’ ‘just and reasonable standard’ and the ‘public interest standard.’” *Id.* at 534.

being an extra-statutory test, separate and apart from the “just and reasonable” standard, the “public interest” presumption represents one of a set of points on a broad continuum of approaches employed to meet the statute’s requirement that rates, terms and conditions be just and reasonable.

11. The Supreme Court has found that this “public interest” presumption is based on “the commonsense notion that ‘[i]n 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.’”²⁰ The Supreme Court went on to find that “only when the mutually agreed-upon contract rate seriously harms the consuming public may the Commission declare it not to be just and reasonable.”²¹ The Supreme Court also found that allowing sophisticated parties to abrogate contract rates “would reduce the incentive to conclude such contracts in the future” and “undermine the role of contracts in the FPA’s statutory scheme.”²² By contrast, the “public interest” presumption does not apply, of its own force, when the parties have not agreed to set rates by contract.²³

12. As to the Settlement now before us, at the outset, we note that, although the capacity auction results and transition payments addressed in section 4.C of the Settlement possess certain characteristics of contracts, the results and payments apply to all suppliers and purchasers of capacity within the ISO New England (ISO-NE) market, not just to the settling parties. A non-settling party wishing to participate in the New England capacity market is as bound by the auction as a settling party, and, thus, a non-settling party’s obligation to make a payment cannot be said to be based on a contract executed by that party.

13. Moreover, the rates set by the forward capacity auctions represent tariff, not contract, rates. Prior to each forward capacity auction, ISO-NE estimates the amount of installed capacity that the system will require for reliability purposes three years in the future. ISO-NE then sets the capacity auction starting price, which is initially twice the estimated cost of new entry, and capacity providers state how much capacity they would offer at that price. If more capacity is offered than is required to meet the installed capacity requirement, ISO-NE lowers the offer price until the quantity of capacity offered

²⁰ *Id.* at 545 (quoting *Verizon Commc’ns, Inc. v. FCC*, 535 U.S. 467, 479 (2002)).

²¹ *Id.*

²² *Id.* at 546.

²³ *See id.* at 553.

equals the installed capacity requirement; the resulting price is known as the market clearing price. ISO-NE then assesses each utility a capacity charge equal to that utility's share of the installed capacity requirement multiplied by the market clearing price. Since this rate methodology applies even to parties who did not agree contractually to its adoption, the rates set through the forward capacity auction more closely resemble a tariff rate than a contract rate. Furthermore, utilities buying capacity in the forward capacity market do not participate in the auction (the auction, as explained above, involves ISO-NE first setting and then lowering the prices at which it will buy capacity until it is procuring just enough capacity; buyers do not bid into or otherwise participate in the auction) and, thus, cannot be said to be contracting with the capacity sellers. And, as noted above, non-settling parties have the same obligation to make transition payments as settling parties because the Commission has approved the Settlement prescribing those payments, which therefore are more properly viewed as tariff rates.²⁴

14. For these reasons, the auction results and transition payments do not constitute "contract rates." Nonetheless, the Commission finds that it has discretion to apply a more rigorous application of the "just and reasonable" standard of review to future challenges to rates and that it was appropriate to exercise that discretion here.²⁵

15. As the Supreme Court has found and as discussed above, the "just and reasonable" standard is the only statutory standard of review under the FPA for assessing wholesale electricity rates, whether set by contract or tariff.²⁶ But neither section 205 nor section 206 speaks directly to the application of this statutory standard when the Commission must apply it to future complaints about rates, including, as relevant here, auction results or transition payments -- other than providing that rates be just, reasonable, and not unduly discriminatory or preferential.²⁷ Under the statutory "just and reasonable" standard, the Commission is not "bound to any one ratemaking formula;"²⁸ rather, the Commission must interpret, and necessarily has the discretion to interpret, how that

²⁴ *NRG*, 130 S. Ct. at 698 (the FPA differentiates between rates set "unilaterally by tariff" and rates set "by contract" between seller and buyer).

²⁵ *See Me. Pub. Utils. Comm'n v. FERC*, 625 F.3d at 759.

²⁶ *Morgan Stanley*, 554 U.S. at 545.

²⁷ 16 U.S.C. §§ 824d, 824e (2006).

²⁸ *Morgan Stanley*, 554 U.S. at 532.

statutory standard is to be implemented.²⁹ Indeed, because “[t]he statutory requirement that rates be ‘just and reasonable’ is obviously incapable of precise judicial definition,” courts have long “afforded great deference to the Commission in its rate decisions.”³⁰ That is, the FPA requires only that rates be just and reasonable; it does not specify the manner in which that general formulation must be implemented in any particular context.

16. Given the flexibility inherent in the statutory “just and reasonable” standard, the Commission may require varying types and degrees of justification for challenges to particular rates or practices, depending on the circumstances. When power sales rates are set by contracts resulting from fair, arm’s-length negotiations between willing sellers and buyers, *Sierra* and the more recent *Morgan Stanley* require application of the more rigorous “public interest” presumption when the Commission is faced with a challenge to such contractually agreed-to rates.³¹ Nothing in the FPA or in the court opinions related to this proceeding, however, precludes the Commission from applying a similar more rigorous standard when faced with challenges to other rates as a matter of discretion, if considerations relevant to what is “just and reasonable” make that approach appropriate.

17. The Commission approved the Settlement at issue in this proceeding, including allowing application of the “public interest” standard in limited circumstances, because, as a package, it presented a just and reasonable outcome for this proceeding.³² The Commission explained that it had discretion in how it could address contested settlements.³³ With respect to section 4.C of the Settlement, the Commission stated that the application of the “public interest” standard to the specified types of future challenges

²⁹ *Chevron U.S.A. Inc. v. NRDC*, 467 U.S. 837, 842 (1984).

³⁰ *Morgan Stanley*, 554 U.S. at 532.

³¹ We need not address here the application of the statutory standard in the context of allegations of fraud or duress. See *Morgan Stanley*, 554 U.S. at 547; accord *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968); *Montana-Dakota Utils. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251 (1951); *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944).

³² *Settlement Order*, 115 FERC ¶ 61,340 at P 62, 69-71.

³³ *Id.* P 58.

balanced the need for rate stability with the requirement that rates be just and reasonable.³⁴

18. In approving section 4.C of the Settlement, the Commission specified the standard of review applicable to future complaints about the auction results and transition payments.³⁵ Because such complaints would invoke the Commission's authority under section 206 of the FPA to set aside rates that are "unjust, unreasonable, unduly discriminatory or preferential,"³⁶ as well as its authority under section 205 of the FPA to ensure that "[a]ll rates and charges...shall be just and reasonable,"³⁷ the Commission's approval of section 4.C represents an interpretation and application of sections 205 and 206, and as we explain below, a reasonable interpretation and application.

19. The Commission reasonably acted within its discretion to approve section 4.C of the Settlement and to make it more difficult to challenge the auction results brought after an initial 45-day review period.³⁸ In response to the D.C. Circuit, although these auctions will not result in contracts between buyers and sellers, we find that they nevertheless share with freely-negotiated contracts certain market-based features that tend to assure just and reasonable rates.³⁹ The auctions provide a market-based mechanism to appropriately value capacity resources based on their location, satisfying cost-causation

³⁴ *Id.* P 183.

³⁵ *Id.* P 172.

³⁶ 16 U.S.C. § 824e(a) (2006).

³⁷ *Id.* § 824d(a).

³⁸ Under the Settlement, ISO-NE is required to make a section 205 filing with the auction results and parties have 45 days to object under the ordinary "just and reasonable" standard. *Settlement Order*, 115 FERC ¶ 61,340 at P 179, 185.

³⁹ *See Me. Pub. Utils. Comm'n v. FERC*, No. 06-1403 at 11. The D.C. Circuit directed the Commission on remand to explain why the auction rates, if not contract rates, are deserving of special protection from future challenges. As we explain above, the auction rates, while not contract rates imposing a public interest presumption on the Commission, nevertheless reflect market forces and market conditions.

principles.⁴⁰ The forward-looking nature of the Forward Capacity Market provides appropriate signals to investors when infrastructure resources are necessary with sufficient lead time to allow that infrastructure to be put into place before reliability is sacrificed.⁴¹ And the locational component of the Forward Capacity Market ensures that the addition of new infrastructure is targeted to where reliability problems are most imminent.⁴² Thus, the Commission reviewed the design of the proposed auctions and found that they would produce just and reasonable rates, and the D.C. Circuit has recognized that rates disciplined by a market are consistent with the FPA's requirements.⁴³ Accordingly, the Commission reasonably could presume, and did conclude, that the forward capacity auctions would result in just and reasonable rates.⁴⁴

20. In addition, the Commission determined that use of a more rigorous application of the statutory "just and reasonable" standard to auction results, making them more difficult to challenge in the future, would promote rate stability, which the Supreme Court has recognized as an important goal under the FPA.⁴⁵ Specifically, the Commission found that rate stability was particularly important in this case, which was initiated in part because of the unstable nature of capacity revenues and the effect that that instability has on generating units, particularly those critical to maintaining

⁴⁰ See *Settlement Order*, 115 FERC ¶ 61,340 at P 65 (citing *PJM Interconnection, L.L.C.*, 107 FERC ¶ 61,112, at P 19-20 (2004); *PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079, at P 49-51 (2006)).

⁴¹ See *id.* (citing *PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079 at P 67-72).

⁴² See *id.* (citing *PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079 at P 49-51).

⁴³ See, e.g., *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870 (D.C. Cir. 1993) ("[W]hen there is a competitive market the FERC may rely upon market-based prices in lieu of cost-of-service regulation to assure a 'just and reasonable' result."); accord *Louisiana Energy & Power Auth. v. FERC*, 141 F.3d 364, 365 (D.C. Cir. 1998); *Cajun Elec. Power Coop., Inc. v. FERC*, 28 F.3d 173, 176, 179, 180 (D.C. Cir. 1994).

⁴⁴ See *Morgan Stanley*, 554 U.S. at 545-546 (finding that the Commission may declare a contract rate unjust and unreasonable only when it seriously harms the consuming public).

⁴⁵ See *id.* at 551 (stating that "[t]he FPA recognizes that contract stability ultimately benefits consumers").

reliability.⁴⁶ That finding, coupled with the design of the auction, which, as noted above, yields market-disciplined results consistent with the FPA, amply supports the Commission's decision to approve the Settlement with a provision that makes it more difficult to prevail on a challenge to the auction results that is raised after the initial 45-day period.⁴⁷

21. The Commission also reasonably approved a more rigorous application of the statutory "just and reasonable" standard to any future challenges to the transition payments. The Commission reviewed the transition payments in the challenged orders and found them just and reasonable,⁴⁸ a finding that the D.C. Circuit upheld.⁴⁹ The Commission reasonably determined that, given the interest in the stability provided by the Settlement and its provision for prompt transition to capacity auctions,⁵⁰ a party seeking to alter the transition payments should have to show that the transition payments were impairing the public interest.

22. Moreover, the transition payments lasted only for a limited time, with the final payment made in May 2010. The short duration of the transition payment regime made it unlikely that the transition payments would, in that short time, become unjust or unreasonable.⁵¹ Finally, we add that the parties challenging the Settlement did not challenge the transition payments. Thus, the Commission reasonably approved section

⁴⁶ *Settlement Order*, 115 FERC ¶ 61,340 at P 186; *see also Rehearing Order*, 117 FERC ¶ 61,133 at P 95 ("[P]rice certainty is important to ensure the [forward capacity market] achieves its goals of attracting and retaining generators needed for reliability."); *cf. Morgan Stanley*, 554 U.S. at 551 (finding that the *Mobile-Sierra* "public interest" presumption is "a key source of stability").

⁴⁷ *See supra* note 38 (explaining that a different standard applied during that initial 45-day period).

⁴⁸ *Settlement Order*, 115 FERC ¶ 61,340 at P 75-108.

⁴⁹ *Me. Pub. Utils. Comm'n v. FERC*, 520 F.3d at 470-75.

⁵⁰ *Settlement Order*, 115 FERC ¶ 61,340 at P 186.

⁵¹ *See Me. Pub. Utils. Comm'n v. FERC*, 625 F.3d at 757 n.1 (noting that the transition payments no longer are being made and that objections to the payments are now moot).

4.C of the Settlement as part of a package, which the Commission found to be just and reasonable.

23. Finally, the Commission finds that the discretion discussed in this order to impose a more stringent standard of review to future challenges, outside the context of a power sales contract to which *Morgan Stanley* makes clear that the “public interest” presumption always applies, is grounded solidly in public policy, as well as law. Because we have that discretion, we were able to approve a Settlement that – even in the opinion of two concurring Commissioners who in other contexts dissented frequently to oppose the application of the “public interest” standard of review to future challenges⁵² – as an overall package advanced the interests of all market participants, even non-settling participants. The Settlement is the result of extensive negotiations among market participants and it might not have been reached without the inclusion of the “public interest” standard provided in section 4.C.⁵³

24. Importantly, if the Commission believes that, in other circumstances outside the context of the type of “contract rates” addressed in *Morgan Stanley*, it is unjust and unreasonable to lock in a more stringent application of the just and reasonable standard, then the Commission has the discretion not to impose that more stringent standard of review. A “public interest” clause of the type present here might motivate the Commission, in its discretion, to reject a filing that is not as manifestly just and reasonable as this Settlement. In other words, the Commission could find that a “public interest” standard of review that is tolerable in the context of the broader goals and purposes of the Settlement at issue here might be intolerable in the context of other circumstances. As in any just and reasonable inquiry, the focus will be on the particular circumstances presented.

25. In addition, even when, as in the particular circumstances presented, the Commission does decide to exercise its discretion and apply a more stringent standard of review to govern future challenges, that action does not mean that the Commission is unable to review the rate. The Commission’s hands are not tied. The “public interest” standard respects the settled expectations of parties, but still allows the Commission to

⁵² *Devon Power*, 115 FERC ¶ 61,340 (Kelly, Comm’r, concurring), *order on reh’g*, *Devon Power*, 117 FERC ¶ 61,133 (Kelly and Wellinghoff, Comm’rs, concurring).

⁵³ *See* ISO-NE April 5, 2006 Reply Comments at 8 (contending that “every detail” of the Settlement “was critical to one or more of the negotiating parties” and that “changing one aspect of the Settlement package will likely cause a chain reaction that could easily lead to the demise of the Settlement, leaving New England without a solution for what most if not all agree is a serious problem”).

respond as necessary to the threat of serious harm to the public interest.⁵⁴ The Commission has taken such action in the past,⁵⁵ and we retain the ability to do so in the future.

By the Commission. Commissioner Norris is dissenting in part with a separate statement attached.
Commissioner LaFleur is concurring with a separate statement attached.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

⁵⁴ *Morgan Stanley*, 128 S. Ct. at 2747-48 & n.4 (Commission may look at the “totality of the circumstances,” not just the three factors – continuing ability of utility to provide service, excessive burden on consumers, undue discrimination – identified in *Sierra*).

⁵⁵ *See Arizona Corporation Commission v. FERC*, 397 F.3d 952 (D.C. Cir. 2005) (modifying the terms of earlier settlements, despite presence of *Mobile-Sierra* public interest standard, not to protect one party from an “improvident bargain,” but rather to prevent “the imposition of an excessive burden” on third parties) (quoting *Northeast Utils. Serv. Co. v. FERC*, 55 F.3d 686, 691 (1st Cir. 1995)).

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Devon Power LLC

Docket No. ER03-563-066

(Issued March 17, 2011)

NORRIS, Commissioner, *dissenting in part*:

I agree with the majority's conclusion in this order that the settlement rates at issue in this proceeding are not "contract rates" requiring application of the *Mobile-Sierra*¹ "public interest" presumption, as articulated by the Supreme Court in *Morgan Stanley*.² I disagree, however, with the majority's determination that the Commission can or should exercise its discretion to decide *in advance* that it will employ the more rigorous public interest application of the just and reasonable standard to future challenges to non-contract rates, terms and conditions. As I explain further below, I am concerned that today's order is inconsistent with the fundamental premise of the *Mobile-Sierra* public interest presumption, establishes a policy that will be challenging for the Commission to administer and less protective of consumers, and potentially avoids our responsibility under the Federal Power Act (FPA).

As today's order correctly explains, under the *Mobile-Sierra* doctrine (as recently interpreted by the Supreme Court in *Morgan Stanley* and *NRG*³), the Commission must presume that the rates, terms and conditions set forth in arms-length, freely-negotiated power sales contracts between willing buyers and sellers are just and reasonable. This just and reasonable presumption attaches at the time of contracting and the Commission must presume a *Mobile-Sierra* contract to be just and reasonable upon our initial review of that contract.⁴ To overcome this presumption and find that the rates, terms and conditions are unjust and unreasonable, the Commission must find that they "adversely affect the public interest."⁵ While this public interest application of the just and

¹ *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) (*Mobile*); *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956) (*Sierra*) (together, *Mobile-Sierra*).

² *Morgan Stanley Capital Group, Inc. v. Pub. Util. Dist. No. 1 of Snohomish County, Washington*, 554 U.S. 527, 545 (2008) (*Morgan Stanley*).

³ *NRG Power Mktg v. Me. Pub. Utils. Comm'n*, 130 S. Ct. 693, 700 (2010) (*NRG*).

⁴ *Morgan Stanley*, 554 U.S. at 546.

⁵ *Sierra*, 350 U.S. at 355; *see also Permian Basin Area Rate Cases*, 390 U.S. 747, (continued)

reasonable standard has never been precisely defined, it clearly imposes a much higher burden to successfully challenge those contract rates as unjust, unreasonable or unduly discriminatory. Prior court decisions have described this application of the just and reasonable standard as “practically insurmountable”⁶ and ““much more restrictive””⁷ than the ordinary application of the just and reasonable standard; more recently, the Supreme Court has declared that the *Mobile-Sierra* presumption can only be overcome if a contract rate “seriously harms the consuming public”;⁸ and today’s order repeatedly describes it as “more stringent” and “more rigorous”.⁹

In this order, the majority concludes that the Commission has discretion to extend the more rigorous public interest application of the just and reasonable standard to future challenges to non-contract rates, terms and conditions. The majority finds this discretion in the inherent flexibility of the FPA just and reasonable standard, which does not bind the Commission to “any one ratemaking formula”.¹⁰ While I agree that the just and reasonable standard affords the Commission flexibility in its application, I am concerned that the approach adopted in this order is inconsistent with the Commission's obligations under the FPA, in non-contract rate situations, to ensure that rates, terms and conditions of service are just and reasonable and not unduly discriminatory. I also believe today’s order establishes a policy that will be difficult to administer in practice and could hurt the Commission’s ability to adequately protect consumers over the long-term.

First, I am not convinced that the majority’s conclusion that the Commission has discretion to apply the more stringent public interest application of the just and reasonable standard in non-contract settings is consistent with the fundamental basis of *Mobile-Sierra*, as recently clarified by the Supreme Court in *Morgan Stanley* and *NRG*. As the Supreme Court has explained, the *Mobile-Sierra* public interest presumption is grounded squarely on the presence of a voluntary, freely-negotiated contract between a willing buyer and a willing seller. The *Morgan Stanley* decision makes clear that “*Sierra* . . . provide[s] a definition of what it means for a rate to satisfy the just-and-reasonable

822 (1968) (Commission may only abrogate contractual arrangements “in circumstances of unequivocal public necessity”).

⁶ *Papago Tribal Auth. v. FERC*, 723 F.2d 950, 954 (D.C. Cir. 1983).

⁷ *East Ky. Power Coop. v. FERC*, 489 F.3d 1299, 1309 (D.C. Cir. 2007) (quoting *Potomac Elec. Power Co. v. FERC*, 210 F.3d 403, 407 (D.C. Cir. 2000)).

⁸ *Morgan Stanley*, 554 U.S. at 545.

⁹ See, e.g., *Devon Power LLC*, 134 FERC ¶ 61,208, at P 10, 16 (2011).

¹⁰ *Id.* P 16.

standard *in the contract context*.”¹¹ Further, the Commission is bound to presume that a freely-negotiated bilateral contract filed with it is just and reasonable because “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.”¹² Since this presumption is grounded on the presence of a freely negotiated contract and the expectation that the parties will negotiate a just reasonable rate as between them, the Commission can only reject (or “abrogate”) a contract rate that “seriously harms the consuming public.”¹³ This presumption that a contract is just and reasonable absent an adverse public interest finding recognizes that “[w]hen commercial parties . . . avail themselves of rate agreements, the principal regulatory responsibility [i]s not to relieve a contracting party of an unreasonable rate” that it has contractually committed to honor.¹⁴

It is difficult to reconcile the fact that the *Mobile-Sierra* presumption is grounded on the presence of a freely-negotiated contract with the Commission’s decision here to allow application of the more stringent public interest form of the just and reasonable standard required by that presumption to non-contract situations. In this instance, the Commission explicitly concludes that the auction results and transition payments at issue *are not* contract rates.¹⁵ As a result, the contractual factors forming the basis for the *Mobile-Sierra* presumption that rates set by contract are just and reasonable – particularly the expectation that sophisticated parties, negotiating a contract at arms-length, will negotiate a just and reasonable rate between them – cannot be presumed to be present. Because these contractual factors are not present, I do not agree that it is reasonable to nonetheless apply the more stringent public interest form of the just and reasonable standard dictated by the presumption to situations where a contract is not present.

Secondly, I am concerned that this order opens the door for entities to propose, in non-contract rate filings such as generally-applicable tariffs or settlements, that the more stringent public interest form of the just and reasonable standard be applied

¹¹ *Morgan Stanley*, 554 U.S. at 546 (emphasis added).

¹² *Morgan Stanley*, 554 U.S. at 545 (citation omitted).

¹³ *Id.*

¹⁴ *Id.* at 534-35, quoting *Verizon Communs., Inc. v. FCC*, 535 U.S. 467, 479 (2002); see also *Sierra*, 350 U.S. at 355 (“[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.”)

¹⁵ *Devon Power LLC*, 134 FERC ¶ 61,208 at P 12-14.

to *future* challenges to the rates, terms or conditions contained in the filing. I believe that opening this door is both inappropriate and could have serious repercussions.

In particular, I am concerned that opening this door puts the Commission in the untenable position of trying to decide, at the time a tariff or other non-contract rate is filed, which application of the just and reasonable standard a future Commission should use to address a challenge that may occur several years later. Binding a future Commission to the more stringent application of the just and reasonable standard demanded by the public interest presumption tends to ignore that circumstances may change significantly.¹⁶ While the majority suggests that “[t]he Commission’s hands are not tied,”¹⁷ the fact remains that the particularly stringent application of the just and reasonable standard required by the public interest presumption establishes a much higher burden to justify rate changes. As I note above, this burden has been described as “practically insurmountable,”¹⁸ and requires a showing of “serious[] harm[] [to] the consuming public” to be satisfied.¹⁹ In my view, this extraordinary burden should not be placed on a future Commission outside of the contractual context it was created to address.

Further, I note that the majority’s decision could encourage arguments in individual non-contract rate proceedings regarding which application of the just and reasonable standard the Commission should employ. This kind of precedent could turn into an administrative quagmire for the parties and the Commission, bogging down the consideration of important non-contract rate matters with debates about the applicable form of the just and reasonable standard.

Moreover, it is difficult to understand how the Commission will be able to meaningfully differentiate the circumstances when it will exercise its discretion to approve the future application of the more stringent public interest form of the just and reasonable standard from those circumstances when it will not. I appreciate the majority’s suggestion in today’s order that the Commission will “focus . . . on the

¹⁶ While the circumstances surrounding a freely-negotiated bilateral contract may of course also change, as I note above, the courts have determined that contractual considerations nonetheless require the more stringent public interest application of the just and reasonable standard.

¹⁷ *Devon Power LLC*, 134 FERC ¶ 61,208 at P 25.

¹⁸ *Papago*, 723 F.2d at 954.

¹⁹ *Morgan Stanley*, 554 U.S. at 545.

particular circumstances presented” in making this determination in individual cases.²⁰ While this statement is encouraging, it ignores the precedent that this and future orders exercising similar discretion will establish, and that the Commission will be bound to follow under the Administrative Procedure Act’s arbitrary and capricious standard.

The precedent that this order will establish is a case in point. The majority bases its finding that it is appropriate for the Commission to exercise its discretion to approve a settlement provision applying the more stringent public interest form of the just and reasonable standard to future challenges to the Forward Capacity Market auction results and transition payments on two grounds. First, it relies on the “market-based features” of the Forward Capacity Market, which “tend to ensure just and reasonable rates”.²¹ Additionally, it notes the particular need for rate stability and certainty in New England’s capacity market.²² While these two grounds may have been applicable to the situation facing New England’s capacity markets at the time the Forward Capacity Market settlement was approved, as a general matter these grounds are not especially unique to this circumstance. Many (if not most) of the tariffs, settlements, and other legal instruments that the Commission considers today can be said to contain “market-based features,” and stability and certainty are always important in the industries we regulate. As a result, it may prove difficult to limit the exercise of discretion the majority uses today to only a few exceptional cases.

I am cognizant of the difficult circumstances that faced market participants in New England when they pursued the settlement at issue in these proceedings. I am also aware of the tremendous efforts of numerous parties that went into arriving at the settlement. I respect the need for certainty in regulatory decision-making, and appreciate the value of settlements in difficult and contentious proceedings. However, I believe the Commission can exercise its respect for rate certainty and stability and recognize the value of settlements without sacrificing a future Commission’s ability to conduct a fulsome review of rates that are no longer just and reasonable due to a change in circumstances. I believe that this order potentially sacrifices our statutorily-mandated responsibility by attempting to bind a future Commission to the more rigorous public interest application of the just and reasonable standard outside of the contractual context where it is required by *Mobile-Sierra*.

I agree with today’s order that the just and reasonable standard gives the Commission significant flexibility in its implementation. With that flexibility, the Commission can take many factors into account in individual proceedings, including

²⁰ *Devon Power LLC*, 134 FERC ¶ 61,208 at P 24.

²¹ *Id.* P 19.

²² *Id.* P 20.

proceedings involving future challenges to non-contract rates, terms and conditions. In an instance involving such a challenge, the Commission must carefully weigh the evidence presented and consider the totality of facts and circumstances. In doing so, the Commission can and should consider factors such as the need for rate certainty and stability in the particular circumstances, and whether the challenge implicates a hard-fought settlement agreement. I do not believe that this or any Commission will take its responsibility to ensure just and reasonable rates and to provide certainty and stability lightly. In fact, I believe that the Commission would be hard-pressed to overturn a widely-supported settlement that found agreement on extremely contentious issues and was recently approved by the Commission absent some very significant change in circumstances. I simply disagree that, as a matter of law or policy, the Commission can or should exercise discretion to decide in advance of those future cases to bind a future Commission to employing the more rigorous public interest application of the just and reasonable standard without knowing the significant change in circumstances with which the Commission may be presented. To do so would be an abdication of our FPA responsibility to ensure that rates are just and reasonable, and poor public policy.

For these reasons, I respectfully dissent in part.

John R. Norris, Commissioner

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Devon Power LLC

Docket No. ER03-563-066

(Issued March 17, 2011)

LaFLEUR, Commissioner, *concurring*:

In *NRG Power Marketing v. Maine Public Utilities Commission*, the Supreme Court remanded to the Court of Appeals for the District of Columbia Circuit two questions left unanswered in this proceeding: whether the auction rates arising from the Forward Capacity Market settlement are contract rates that the Commission must presume are just and reasonable unless they violate the public interest; and if not, whether the Commission has discretion to treat them “analogously.”¹ The Court of Appeals, in turn, remanded these questions to the Commission.² In today’s order, the Commission finds that the auction rates are not contract rates, but that the Commission has discretion under the statutory “just and reasonable” standard to approve a settlement provision that requires the Commission to apply the public interest standard of review to future challenges to the auction rates.

I agree with these judgments, and thus concur in today’s order. Specifically, I agree that the Commission has discretion, and should use that discretion, to approve a settlement agreement adopting a public interest standard of review on the facts of this case as set out in the order. However, I write separately to emphasize what I see as the narrow and fact-bound basis of today’s decision. In my view, the question of whether the Commission should apply its discretion to approve a public interest standard of review in other instances that do not strictly involve contract rates must be decided on the facts of each case. As we seek to apply our new understanding of the “Mobile-Sierra doctrine” in light of the Supreme Court’s decisions in *Morgan Stanley*³ and *NRG*, we will be exploring new ground and should do so in the first instance on a case-by-case basis.

Accordingly, I respectfully concur in the judgment.

Cheryl A. LaFleur
Commissioner

¹ 130 S. Ct. 693, 701 (2010) (*NRG*).

² *Me. Pub.Util. Comm’n v. FERC*, 625 F.3d 754, 759-60 (D.C. Cir. 2010).

³ *Morgan Stanley Capital Group, Inc. v. Pub. Util. Dist. No. 1 of Snohomish County, Washington*, 554 U.S. 527, 545 (2008).