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# THE END OF CONTRACT SANCTITY? MOBILE-SIERRA UNDER ASSAULT AT FERC

June 16, 2016

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## SUMMARY

- The viability of the Mobile-Sierra presumption protecting the sanctity of negotiated market-based rate contracts is at serious risk.
- Topics:
  - What is the Mobile-Sierra presumption?
  - Recent initial decisions subverting Mobile-Sierra
  - Trade association action

## THE MOBILE-SIERRA DOCTRINE

- The Mobile-Sierra doctrine was first established in two 1954 Supreme Court cases.
- It holds that negotiated, fixed-rate contracts are to be presumed just and reasonable under the Federal Power Act and cannot be revised by FERC without a finding that the public interest requires contract modification.
- In other words, an extraordinary need to intervene in a contract exists such that there will be a harm to society unless the government acts.

# THE MOBILE-SIERRA DOCTRINE

- Ninth Circuit: Pub. Util. Dist. No 1 of Snohomish v. FERC (Dec. 19, 2006)
  - Held that Mobile-Sierra (just and reasonable) presumption applies only to contracts that FERC reviewed (at time of formation); found just and reasonable; and placed on file.
  - Even assuming Mobile-Sierra applied, when a purchaser challenges a contract, the standard for overcoming the presumption is a “zone of reasonableness” test.

# THE MOBILE-SIERRA DOCTRINE

- Supreme Court: Morgan Stanley (June 26, 2008)
  - Reversed the Ninth Circuit.
  - Upheld market-based rate application of Mobile-Sierra.
  - Generally found that the traditional Mobile-Sierra presumption applied.
  - Underscored the importance of contracts to the structure of the Federal Power Act.
  - Remanded the case for FERC to address two specified issues.

# THE MOBILE-SIERRA DOCTRINE

- Supreme Court : NRG Power Marketing v. Maine PUC (Jan. 13, 2010)
  - Reversed the DC Circuit.
  - Found that the Mobile-Sierra presumption applies even in the case of complaints brought by third parties.
  - Strongly reaffirmed the importance of contract certainty under the Federal Power Act.
  - Emphasized that abrogation of these agreements can occur only in circumstances of unequivocal public necessity.

## THE MOBILE-SIERRA DOCTRINE

- As interpreted by Morgan Stanley, Mobile-Sierra requires that contracts are presumed just and reasonable and cannot be reformed unless:
  - the negotiation of the contract has been directly affected by unlawful acts by a party, causing the contract to not be the product of fair, arms'-length negotiation; or
  - the contract causes such an excessive burden on consumer rates that there is an unequivocal public necessity that it be reformed.

## WHAT THE SUPREME COURT SAYS ABOUT MOBILE-SIERRA

- Contract challenges must exceed a high bar as “the regulatory system created by the [FPA] ... contemplates abrogation of these agreements only in circumstances of unequivocal public necessity.”
- “[E]nabling 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 .... Such a rule has no support in our case law and plainly undermines the role of contracts in the FPA’s statutory scheme.”
- “We emphasize that the mere fact of a party’s engaging in unlawful activity in the spot market does not deprive its forward contracts of the benefit of the Mobile-Sierra presumption.”

## WHAT THE SUPREME COURT SAYS (CON'T.)

- “Like fraud and duress, unlawful market activity that directly affects contract negotiations eliminates the premise on which the Mobile-Sierra presumption rests: that the contract rates are the product of fair, arms-length negotiations.”
- “The FPA recognizes that contract stability ultimately benefits consumers, even if short-term rates for a subset of the public might be high by historical standards—which is why it permits rates to be set by contract and not just by tariff. As the Commission has recently put it, its ‘first and foremost duty is to protect consumers from unjust and unreasonable rates; however, . . . uncertainties regarding rate stability and contract sanctity can have a chilling effect on investments and a seller’s willingness to enter into long-term contracts and this, in turn, can harm customers in the long run.’”

## WHAT FERC SAYS ABOUT MOBILE-SIERRA

- To avoid Mobile-Sierra, a party must identify specific transactions and show that a seller's unlawful behavior directly affected a contract rate.
- The "Commission has consistently rejected arguments that 'simply identifying high prices should be sufficient to overcome or avoid the Mobile-Sierra presumption.'"
- "[W]e find that Cal Parties' claims of uniformly higher prices amount to little more than a variation on claims of general market dysfunction, which have been previously rejected by the Supreme Court as a basis for overcoming Mobile-Sierra."
- "The Mobile-Sierra inquiry is not about whether market dysfunction exists that would provide opportunities for unlawful activity, but whether a specific seller actually did engage in unlawful activity that directly affected a contract rate."

## WHAT FERC SAYS (CON'T.)

- General allegations that dysfunction and/or manipulation in energy markets resulted in higher prices are not relevant to a case for overcoming Mobile-Sierra presumption.
- A showing of cumulative impact of the rates paid by a party is not sufficient to overcome Mobile-Sierra.
- To overcome Mobile-Sierra a party must make a “contract-specific” showing that a contract rate “seriously harms the public interest.”
- “Due to the contract-specific nature of the Mobile-Sierra analysis, the Commission has rejected the California Parties’ attempts to obtain refunds for...bilateral contracts using a theory of vicarious liability.”

## PACIFIC NORTHWEST CASE – INITIAL DECISION

- Case related to contracts in the Pacific Northwest during the CA Energy Crisis.
- ID Found Mobile-Sierra overcome w/o considering specific contracts or their negotiation.
  - Ignored facts regarding how contracts are formed under the WSSP agreement.
  - Relied on a “Power Markets Week + \$75 screen” test to identify sales of energy at prices that were “too high” and in “bad faith.”
  - Found a contract that exceeds screen during emergency condition per se loses Mobile-Sierra presumption.
- Found that “high prices”= bad faith (without other findings of unlawful activity).
- Made other conclusory, non-contract-specific findings to avoid the Mobile-Sierra presumption.

## LONG-TERM CONTRACT CASE – INITIAL DECISION

- Addressed CDWR long-term contracts executed during the CA Energy Crisis.
- Mobile-Sierra presumption was overcome based on:
  - Finding of “public outrage”
  - Finding that the Energy Crisis was “unprecedented”
  - Finding that a consumer rate impact of \$0.0-\$0.08 per month on an average \$75 bill is an excessive burden on consumers (citing Beethoven’s “Rage Over a Lost Penny”)
  - Sua sponte finding of “fraud in the execution” under CA law - despite no claim pled or evidence of any actionable fraud affecting contract negotiations
    - ALJ unilaterally created a cause of action and supporting “facts” (wrong on CA law and wrong on facts)

## LONG-TERM CONTRACT CASE ID – EXCERPTS

- “The Supreme Court made clear that avoiding or overcoming the Mobile-Sierra-Morgan Stanley Rule occurs only in ‘extraordinary circumstances’ involving ‘unequivocal public necessity’ where the contract ‘seriously harms’ the public interest or imposes ‘an excessive burden on consumers.’ Remarkably, it is an undisputed fact among all parties that ‘[t]he Crisis was unprecedented in the modern history of the U.S. electric industry in terms of its severity, duration, and consumer impacts.’ This finding of fact alone suffices to dispose of the Mobile-Sierra-Morgan Stanley presumption in its entirety in this case.”

## LONG-TERM CONTRACT CASE ID – EXCERPTS (CON'T.)

- “It is that public outrage, however, that the FPA empowers the Commission to embody in formulating a just remedy for the extraordinary circumstances presented here. The public outrage is precisely why the contracts at issue are not entitled to the Mobile-Sierra-Morgan Stanley presumption of justness and reasonableness. ....Neither the State nor the Respondents come to this forum with clean hands. They may have had a lot of sophisticated advice and counsel, but in the end they faced an emergency that they had never seen before and could not cope with. As a result, the public was clearly, palpably, seriously harmed. ‘[T]he Mobile-Sierra doctrine does not overlook’ the interests of consumers; indeed, ‘it is framed with a view to their protection.’ Hence, these contracts do not deserve a cloak of sanctity just because they are contracts.”

## LONG-TERM CONTRACTS CASE – FERC TRIAL STAFF’S VIEW

- The ALJ cited the “sheer uniqueness” of the Crisis as sufficient justification for overcoming the...contracts, then all freely negotiated wholesale energy contracts entered into during the Crisis would no longer be protected by the Mobile-Sierra presumption. This aspect of the Initial Decision drastically warps Mobile-Sierra jurisprudence and risks rendering the doctrine ineffective.

## LONG-TERM CONTRACTS CASE – FERC TRIAL STAFF’S VIEW (CON’T.)

- The ALJ suggests that findings regarding extraordinary circumstances and overcoming the Mobile-Sierra presumption have a limited applicability to “unparalleled historical event[s].” ...The Great Recession, a historic economic downturn comparable only to the Great Depression, has gripped economies around the globe since 2007. ...[T]he Commission has given its imprimatur that the Great Recession was an unparalleled historical event.
- Therefore, under the Initial Decision’s radical holding, all freely negotiated wholesale energy contracts entered into since 2007 are at risk of forfeiting the Mobile-Sierra presumption because of the sheer uniqueness of the Great Recession. Contractual agreements would no longer serve as a source of stability during periods of economic turbulence like the Crisis or the Great Recession. In fact, “[i]t would be a perverse rule that rendered contracts less likely to be enforced when there is volatility in the market.” Surely, the Commission did not intend to disfigure the venerable Mobile-Sierra doctrine to that extent when it set this matter for hearing.

## INDUSTRY RESPONSE – EPSA/WPTF LETTER

- Filed with the Commission February 8, 2016 in response to January 2016 Pacific Northwest Initial Decision.
- “The Trade Associations have become concerned that the January 8 Revised Initial Decision does not apply the Mobile-Sierra presumption as set forth by the Supreme Court, including in the recent decisions Morgan Stanley and NRG Power Marketing. The Commission’s orders in this proceeding are consistent with these recent Supreme Court decisions, and affirmed the Mobile-Sierra presumption as a general matter and its application to the contracts at issue in this proceeding. The Revised Initial Decision, on the other hand, appears to find that the Mobile-Sierra presumption can be avoided based upon different and less stringent grounds than those articulated by the Court or the Commission...Trade Associations are making this unusual filing due to the critical role the Mobile-Sierra presumption plays in power contracting and its concern that the Revised Initial Decision appears to be an abject rejection of its legitimate application. Contracts that are subject to the Mobile-Sierra presumption should be honored absent a showing in line with the presumption that the Court and Commission have previously articulated.”

## IMPLICATIONS OF INITIAL DECISIONS IF AFFIRMED

- Mobile-Sierra challenges will not need to be based upon contract-specific facts.
- Mobile-Sierra will not exist if the market is retrospectively determined to be volatile or that prices were high.
- Contracts executed during times of high demand or supply shortages will be at particular risk.
- FERC's market-based rates program will not result in predictable contract sanctity.
- Contract parties (or their allies) will be emboldened to enter into contracts and subsequently seek their abrogation.

# EFFECT OF LOSS OF MOBILE-SIERRA PRESUMPTION

- Mobile-Sierra “presumes” rates are just & reasonable.
- If no such presumption exists, a just and reasonable showing is required.
  - FERC precedent indicates that just and reasonable rates would be assessed based upon costs.
- Thus, without Mobile-Sierra, it is unclear whether there can be market-based rates.
- If not, contracts would be replaced by FERC cost determinations.



# QUESTIONS?

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