Syllabus

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Timber & Lumber Co.,* 200 U. S. 321, 337.

# SUPREME COURT OF THE UNITED STATES

Syllabus

## MORGAN STANLEY CAPITAL GROUP INC. *v.* PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY ET AL.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 06–1457. Argued February 19, 2008—Decided June 26, 2008*

Under the *Mobile-Sierra* doctrine, the Federal Energy Regulatory Commission (FERC) must presume that the electricity rate set in a freely negotiated wholesale-energy contract meets the "just and reasonable" requirement of the Federal Power Act (FPA), see 16 U. S. C. §824d(a), and the presumption may be overcome only if FERC concludes that the contract seriously harms the public interest. See *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U. S. 332; *FPC* v. *Sierra Pacific Power Co.*, 350 U. S. 348. Under FERC's current regulatory regime, a wholesale electricity seller may file a "market-based" tariff, which simply states that the utility will enter into freely negotiated contracts with purchasers. Those contracts are not filed with FERC before they go into effect. In 2000 and 2001, there was a dramatic increase in the price of electricity in the western United States. As a result, respondents entered into long-term contracts with petitioners that locked in rates that were very high by historical standards. Respondents subsequently asked FERC to modify the contracts, contending that the rates should not be presumed just and reasonable under *Mobile-Sierra.* The Administrative Law Judge concluded that the presumption applied and that the contracts did not seriously harm the public interest. FERC affirmed, but the Ninth Circuit remanded. The court held that contract rates are pre-

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*Together with No. 06–1462, *American Electric Power Service Corp. et al.* v. *Public Utility District No. 1 of Snohomish County et al.,* also on certiorari to the same court.

sumptively reasonable only where FERC has had an initial opportunity to review the contracts without applying the *Mobile-Sierra* presumption and therefore that the presumption should not apply to contracts entered into under "market-based" tariffs. The court alternatively held that there is a different standard for overcoming the *Mobile-Sierra* presumption when a *purchaser* challenges a contract: whether the contract exceeds a "zone of reasonableness."

*Held:*

1. The Commission was required to apply the *Mobile-Sierra* presumption in evaluating the contracts here. *Sierra* held that a rate set out in a contract must be presumed to be just and reasonable absent serious harm to the public interest, regardless of when the contract is challenged. *FPC* v. *Texaco Inc.*, 417 U. S. 380, distinguished. Also, the Ninth Circuit's rule requiring FERC to ask whether a contract was formed in an environment of market "dysfunction" is not supported by this Court's cases and plainly undermines the role of contracts in the FPA's statutory scheme. Pp. 15–19.

2. The Ninth Circuit's "zone of reasonableness" test fails to accord an adequate level of protection to contracts. The standard for a buyer's rate-increase challenge must be the same, generally, as the standard for a seller's challenge: The contract rate must seriously harm the public interest. The Ninth Circuit misread *Sierra* in holding that the standard for evaluating a high-rate challenge and setting aside a contract rate is whether consumers' electricity bills were higher than they would have been had the contract rates equaled "marginal cost." Under the *Mobile-Sierra* presumption, setting aside a contract rate requires a finding of "unequivocal public necessity," *Permian Basin Area Rate Cases*, 390 U. S. 747, 822, or "extraordinary circumstances," *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U. S. 571, 582. Pp. 19–23.

3. The judgment below is nonetheless affirmed on alternative grounds, based on two defects in FERC's analysis. First, the analysis was flawed or incomplete to the extent FERC looked simply to whether consumers' rates increased immediately upon conclusion of the relevant contracts, rather than determining whether the contracts imposed an excessive burden "down the line," relative to the rates consumers could have obtained (but for the contracts) after elimination of the dysfunctional market. *Sierra*'s "excessive burden" on customers was the current burden, not just the burden imposed at the contract's outset. See 350 U. S., at 355. Second, it is unclear from FERC's orders whether it found respondents' evidence inadequate to support their claim that petitioners engaged in unlawful market manipulation that altered the playing field for contract negotiations. In such a case, the Commission should not presume that a

contract is just and reasonable. Like fraud and duress, unlawful market activity directly affecting contract negotiations eliminates the premise on which the *Mobile-Sierra* presumption rests: that the contract rates are the product of fair, arms-length negotiations. On remand, FERC should amplify or clarify its findings on these two points. Pp. 23–26.

471 F. 3d 1053, affirmed and remanded.

SCALIA, J., delivered the opinion of the Court, in which KENNEDY, THOMAS, and ALITO, JJ., joined, and in which GINSBURG, J., joined as to Part III. GINSBURG, J., filed an opinion concurring in part and concurring in the judgment. STEVENS, J., filed a dissenting opinion, in which SOUTER, J., joined. ROBERTS, C. J., and BREYER, J., took no part in the consideration or decision of the cases.