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FIXED RATE CONTRACTS UNDER THE FEDERAL POWER AND NATURAL GAS ACTS

DAVID C. HJELMFELT

Under the Federal Power Act¹ and the Natural Gas Act,² the Federal Energy Regulatory Commission, like its predecessor the Federal Power Commission,³ is empowered to review the lawfulness of rates set in the first instance by private parties. If the rates are found to be unjust, they may be set at a lawful level by the commission.⁴ Both acts prescribe procedures for changes in rates, but neither abrogates the power of private parties to set rates contractually. A problem that has arisen with surprising frequency is the interpretation of the language of private contracts to determine whether a party to the contract, typically the seller, may unilaterally initiate a rate change.

In general terms, both Acts require entities subject to the Commission's jurisdiction to file their rates with the Commission⁵ and charge only the filed rates.⁶ When an initial rate is filed with the Commission, it becomes effective upon thirty days notice⁷ subject to the power of the Commission to hold

1. 16 U.S.C. § 824 (1976).

2. 15 U.S.C. § 717 (1976).

3. In 1977 the Federal Power Commission ceased to exist pursuant to the provisions of the Department of Energy Organization Act, Pub. L. No. 95-91, § 301(b), 91 Stat. 565 (1977) and Exec. Order No. 12,009, 42 Fed. Reg. 46,267 (1977) and its functions were transferred, in pertinent part, to the Federal Energy Regulatory Commission.

4. *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332, 341 (1956).

5. The Federal Power Act provides:

Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

16 U.S.C. § 824d(c) (1976). The Natural Gas Act provides:

Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from June 21, 1938) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

15 U.S.C. § 717c(c) (1976).

6. *Montana-Dakota Utils. Co. v. North-Western Pub. Serv. Co.*, 341 U.S. 246 (1951).

7. The Federal Power Act provides in pertinent part: "Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public." 16 U.S.C. § 824d(d) (1976). This provision applies to initial rates as well as changes in existing rates. *American Pub. Gas Ass'n v. FPC*, 546 F.2d 983 (D.C. Cir. 1976).

The Natural Gas Act provides in pertinent part: "Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or

a hearing to determine whether the rate is just and reasonable and not unduly discriminatory and therefore lawful. If the initial rate is found to be unlawful, the Commission may prescribe rates to be in effect from the date of its order.⁸ When a change in existing rates is filed, the Commission may either allow the changed rate to become effective immediately and hold a hearing to determine whether the rate is lawful or suspend the rate for up to five months while holding a hearing to determine whether the rate is lawful. In the former situation, any rate change ordered after hearing is prospective only, while in the latter situation, any reduction in the new rate ordered by the Commission relates back to the effective date of the new rate filing; in addition the Commission may order any excessive rates received by the Company to be refunded.⁹

service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public." 15 U.S.C. § 717c(d) (1976).

8. The Federal Power Act provides:

Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.

16 U.S.C. § 824e(a) (1976).

The Natural Gas Act provides:

Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

15 U.S.C. § 717d(a) (1976).

9. The Federal Power Act provides:

Suspension of new rates; hearings; five month period.

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint or upon its own initiative without complaint, at once, and, if it so orders, without answer or formal pleading by the public utility, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of such five months, the proposed change of rate, charge, classification, or service shall go into effect at the end of such period, but in case of a proposed increased rate or charge, the Commission may by order require the interested public utility or public utilities to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and

Suppose that a natural gas pipeline has contracted with a natural gas distributor to sell gas to the distributor for a set rate for an agreed upon number of years. Do the rate provisions of the Natural Gas Act permit the pipeline company to unilaterally file a rate schedule imposing higher rates during the term of the contract? The Federal Power Commission thought so, and held that section 4(d) of the Natural Gas Act,¹⁰ requiring thirty days notice of filing of new rates, authorized such a unilateral contract change. The Supreme Court reversed in *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*¹¹ stating that section 4(d) only provides the method by which rate changes can be made and says nothing at all about when rate changes can be made. According to the Court, the Natural Gas Act is a single statutory scheme under which all rates are established initially by the natural gas companies, by contract or otherwise, and reviewed by the Commission. The Act proposes neither to define nor grant the initial rate setting powers of natural gas companies.

The same day that the Court decided the *Mobile* case under the Natural Gas Act, it decided the companion case *Federal Power Commission v. Sierra Pacific Power Co.*¹² under the Federal Power Act. Sierra purchased power from

upon completion of the hearing and decision may by further order require such public utility or public utilities to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

16 U.S.C. § 824d(e) (1976). The Natural Gas Act provides:

Whenever any such new schedule is filed the Commission shall have authority either upon complaint of any State, municipality, State commission, or gas distributing company, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

15 U.S.C. § 717c(e) (1976).

10. 15 U.S.C. § 717c(d) (1976).

11. 350 U.S. 332 (1956).

12. 350 U.S. 348 (1956).

Pacific Gas and Electric Company (PG&E) for resale to consumers. In 1947, Sierra began to negotiate for an alternate and less expensive source of power from the Bureau of Reclamation's generator at Shasta Dam. To forestall such competition, PG&E offered Sierra a special low rate for a fifteen year term. Sierra accepted PG&E's offer in 1948. In 1953 when power from Shasta Dam was no longer available, PG&E filed unilaterally with the Commission a twenty-eight percent rate increase pursuant to section 205(d) of the Federal Power Act. The Commission accepted the rates for filing, suspended them, and commenced a proceeding to review the rates under section 205(e) of the Act.¹³ Sierra appealed, arguing that the parties' contract precluded a unilateral rate filing.

On appeal, the Supreme Court reversed the Commission on the grounds that the Federal Power Act, like the Natural Gas Act, does not abrogate fixed rate contracts. Accordingly, it was error for the Commission to have accepted the rate for filing and proceeded under section 205(e).¹⁴

PG&E and the Commission also argued that in finally approving the new rates, the Commission had found by implication that the contract rate was unjust and unreasonable and therefore the new rates should be allowed prospectively under section 206 of the Act.¹⁵ The Court rejected this argument also, noting that as a condition precedent to changing a rate prospectively under section 206, the Commission must first find that the existing rate is unjust, unreasonable, unduly discriminatory or preferential. However, the purpose of section 206 is the protection of the public interest. Therefore the Court held that a contract rate may not be said to be unjust or unreasonable simply because it is unprofitable to the public utility.

[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. [citation omitted] In such circumstances the sole concern of the Commission would seem to be whether the rate is so low as to adversely affect the public interest—as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory.¹⁶

In one of the first tests of the scope of the *Mobile-Sierra* doctrine, the Memphis Light, Gas and Water Division argued that its contract with United Gas Pipe Line Company for a wholesale supply of gas at a designated rate "or any effective superceding rate schedules" on file with the Commission was a fixed rate contract.¹⁷ Memphis argued that the *Mobile-Sierra* doctrine precluded the acceptance for filing of a rate change under section 4(e) of the Natural Gas Act¹⁸ unless the parties mutually agreed to

13. 16 U.S.C. § 824d(d) (1976).

14. 16 U.S.C. § 824d(e) (1976).

15. 16 U.S.C. § 824e(a) (1976).

16. 350 U.S. at 355 (emphasis in the original).

17. *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103 (1958).

18. 15 U.S.C. § 717c(e) (1976).

the rate change. All other rate changes had to be processed under section 5(a) of the Act¹⁹ with only prospective application. The Commission held that the contract was for sales at United's "going rate" and that unilateral filings under section 4(e) were permissible.

The court of appeals reversed, citing *Memphis*. The Supreme Court reversed the court of appeals and held that United had reserved the right to make unilateral rate changes and that section 4(e) of the Act did not preclude a contractual reservation of the right by either party to make unilateral rate changes.²⁰

The holding of the *Sierra*, *Mobile* and *Memphis* cases has been characterized as "refreshingly simple. The contract between the parties governs the legality of the filing. Rate filings consistent with contractual obligations are valid; rate filings inconsistent with contractual obligations are invalid."²¹ Refreshingly simple or not, since its inception in 1956 the *Mobile-Sierra* doctrine has been the subject of considerable litigation and has given rise to some intriguing questions concerning rate discrimination.

RATES SUBJECT TO THE *MOBILE-SIERRA* DOCTRINE

It is clear that changes in rates filed with the Commission are subject to the *Mobile-Sierra* doctrine, but what of rates not filed or erroneously accepted for filing?

Prior to 1954, the rates charged by natural gas producers were not considered to be subject to the jurisdiction of the Commission.²² Producer rates were arrived at contractually but were not filed with the Commission. In *Natural Gas Pipeline Co. of America v. Harrington*,²³ the court was called upon to decide whether, after Commission jurisdiction was established, a producer might increase its rates when its contract did not permit unilateral rate changes. The court concluded that there was nothing in the Natural Gas Act or in the orders of the Federal Power Commission to indicate that in such circumstances there was no effective or lawful rate prior to filing of the rate. Accordingly, under the *Mobile-Sierra* doctrine the contract rate even though unfiled became and remained the only lawful rate until changed by the order of the Commission.

In another case involving Natural Gas Pipeline Company, the Third Circuit held that the fact that the *Mobile* case dealt with an attempt to supersede an already filed rate and that the instant case dealt with the filing of an initial rate was an immaterial difference. Thus the unilateral filing of an initial rate over the protest of the other contracting party could not annul

19. 15 U.S.C. § 717d(a) (1976).

20. *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103 (1958). The court of appeals decision created a chaotic condition in the bond market because of the restriction it placed on rate increases. See YOUNG, FORTY YEARS OF PUBLIC UTILITY FINANCE (1965).

21. *Richmond Power & Light v. FPC*, 481 F.2d 490, 493 (D.C. Cir.), cert. denied, 414 U.S. 1068 (1973).

22. *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

23. 246 F.2d 915 (5th Cir. 1957).

the rate established by the unfiled contract.²⁴ This is true even if the higher rate had actually been used for billing purposes.²⁵

Despite the two *Natural Gas Pipeline* cases which made clear that *Mobile-Sierra* applied to unfiled as well as filed rates, the Commission has tried to evade the rule in dealing with electric rates. In *Borough of Lansdale v. Federal Power Commission*,²⁶ the parties had executed a fixed rate contract which was duly offered for filing with the Commission. The Commission refused to accept the contract for filing on the grounds that fixed rate contracts were presumptively invalid. Subsequently, the company filed a new rate schedule at higher rates and Lansdale protested, arguing that the new rates were barred by the *Mobile-Sierra* doctrine. The Commission rejected the *Mobile-Sierra* argument, stating that the doctrine applied only to contracts previously accepted as lawful by the Commission. On appeal, the D.C. Circuit reversed, holding that the doctrine applied whether the company had properly filed the contract or not and that it applied to contracts not previously approved by the Commission.

In *City of Cleveland v. Federal Power Commission*,²⁷ the Commission refused to consider the city's *Mobile-Sierra* contentions. The city had negotiated a rate for load-transfer service from the Cleveland Electric Illuminating Company and the city council had enacted an ordinance authorizing the city to enter into a contract for the service at those rates. The company prepared a letter agreement containing a higher schedule of rates, which the city signed. The company then filed the letter agreement with the Commission. Subsequently, the city protested, claiming that the filed rate was not the agreed upon rate. The Commission refused to consider the city's argument claiming that a party could not go behind the filed rate.²⁸ On appeal the court reversed and remanded holding that "the proposition that a filed rate variant from an agreed rate is nonetheless the legal rate wages war with basic premises of the Federal Power Act,"²⁹ "that a contracted rate cannot be changed by the unilateral act of either party to the contract,"³⁰ and "that a utility is no more at liberty to alter an agreed rate as yet unfiled than it is to depart from one that has been filed."³¹

In *Sam Rayburn Dam Electric Cooperative v. Federal Power Commission*,³² the parties had a fixed rate contract for a stated amount of power. The contract was on file with the Commission. Over the years, the parties had in fact bought and sold power under the contract rate in amounts greatly in excess

24. *Natural Gas Pipeline Co. of America v. FPC*, 253 F.2d 3 (3d Cir.), *cert. denied*, 357 U.S. 927 (1958); *Public Serv. Comm'n v. FPC*, 543 F.2d 757 (D.C. Cir. 1974) (*Mobile-Sierra* doctrine applies to certificate proceedings under § 7 of the Natural Gas Act).

25. *Phillips Petroleum Co. v. FPC*, 258 F.2d 906 (10th Cir. 1958); *Natural Gas Pipeline Co. of America v. FPC*, 253 F.2d 3 (3d Cir.), *cert. denied*, 357 U.S. 927 (1958).

26. 494 F.2d 1104 (D.C. Cir. 1974).

27. 525 F.2d 845 (D.C. Cir. 1976).

28. More recently the Commission has held that *Mobile-Sierra* allegations are so fundamental to the power to accept rates for filing that the issue can be raised at any time. *Columbus & S. Ohio Elec. Co.*, Docket No. EN 77-529, FERC Order modifying Prior Order (Feb. 2, 1978).

29. *City of Cleveland v. FPC*, 525 F.2d at 854-55.

30. *Id.* at 855.

31. *Id.* at 856.

32. 515 F.2d 998 (D.C. Cir. 1975), *cert. denied*, 426 U.S. 907 (1976).

of the contract amount. The seller then filed a rate increase to apply to all amounts sold in excess of the contract amount. Mid-South Electric-Cooperative argued that the course of conduct had transformed the contract into an all-requirements contract at a fixed rate. The Commission rejected Mid-South's argument on the grounds that a contract on file could not be altered by a course of conduct. On appeal the court reversed, holding that *Mobile-Sierra* applied to the actual contract whether or not it was on file with the Commission. It cannot now be argued that the *Mobile-Sierra* doctrine is applicable only to contracts already filed with the Commission.

CONTRACTS CONSTRUED

The first step when a *Mobile-Sierra* issue is raised is to determine whether the contract provides for sales at a fixed rate as in *Mobile* and *Sierra* or at the "going rate" as in *Memphis*.

Interpreting contract language dealing with the right to make rate changes "involves matters peculiarly within the area of the Commission's special competence."³³ Nevertheless the Court of Appeals for the District of Columbia has pointed out that "[t]he FPC's distaste for the *Mobile-Sierra* doctrine is well known, and it has been in the past necessary for this court to remind the FPC that it is not free to ignore the doctrine."³⁴ In practice, the court has given lip service to approaching the Commission's determination with deference while making its own determination.³⁵ The Seventh Circuit has said that it is "at least as capable of interpreting the effect of [the] contract as the Commission."³⁶

The normal rules of contract interpretation are applicable and resort to extrinsic evidence is permitted only in cases of ambiguity.³⁷ However, the Federal Power Commission's construction of contract language, colored by its "distaste" for the *Mobile-Sierra* doctrine, has led to several stinging reversals.³⁸ With this background, a review of the interpretation of various contracts should assist contract draftsmen to avoid undesired results in future cases.

In *Nevada Natural Gas Pipe Line Co. v. Federal Power Commission*, the court held that the following contract language permitted the filing of a unilateral rate increase: "The rates contained in aforesaid rate schedule on file with said Commission and in effect at the time of commencement of service hereunder shall be the rates to be paid by Buyer to Seller under this agreement

33. *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. at 114.

34. *Sam Rayburn Dam Elec. Coop. v. FPC*, 515 F.2d 998, 1005 (D.C. Cir. 1975), *cert. denied*, 426 U.S. 907 (1976).

35. *City of Kaukauna v. FPC*, 581 F.2d 993 (D.C. Cir. 1978); *Sam Rayburn Dam Elec. Coop. v. FPC*, 515 F.2d 998 (D.C. Cir. 1975), *cert. denied*, 426 U.S. 907 (1976).

36. *Public Serv. Co. v. FERC*, 575 F.2d 1204, 1210 n.6 (7th Cir. 1978).

37. *Public Serv. Co. v. FERC*, 575 F.2d 1204 (7th Cir. 1978); *Appalachian Power Co. v. FPC*, 529 F.2d 342 (D.C. Cir.), *cert. denied*, 429 U.S. 816 (1976); *Sam Rayburn Dam Elec. Coop. v. FPC*, 515 F.2d 998 (D.C. Cir. 1975), *cert. denied*, 426 U.S. 907 (1976).

38. *Borough of Lansdale v. FPC*, 494 F.2d 1104 (D.C. Cir. 1974); *Richmond Power & Light v. FPC*, 481 F.2d 490 (D.C. Cir.), *cert. denied*, 414 U.S. 1068 (1973); *Sam Rayburn Dam Elec. Coop. v. FPC*, 515 F.2d 998 (D.C. Cir. 1975), *cert. denied*, 426 U.S. 907 (1976).

until the same are changed in accordance with lawful requirements.”³⁹

The court said the contract was typical of “tariff-and-service arrangements,” which, like the “going rate” contract in *Memphis*, did not preclude a unilateral rate filing.

Another example of contract language creating an unambiguous right to make a unilateral filing was quoted in *Public Service Company of Indiana v. Federal Energy Regulatory Commission (PSCI)* as follows:

The terms and conditions of this Agreement, and the provisions of the rates attached hereto and made a part hereof, may be changed by the Company from time to time by filing such change(s) with the Federal Power Commission and upon receipt of such Commission’s acceptance for filing will supercede [*sic*] and cancel the present terms and conditions of this Agreement and such rate provisions.⁴⁰

Although it would seem to be a simple enough task to contractually reserve a right to make unilateral rate changes, that has not always been the case. For example, a contract which stated that rate changes could be made pursuant to section 205 of the Federal Power Act and that the purchasing city “agrees to accept such new or changed rates as are ultimately made effective through such proceedings and review” was held to fall under the *Mobile-Sierra* doctrine in *City of Kaukauna v. Federal Energy Regulatory Commission*.⁴¹ The court held that, pursuant to the parties’ contract, no rate increase could become effective until finally approved by the Commission. Section 205 does not dictate when a contractually-authorized rate increase can be made effective. Beyond minimum statutory constraints, parties are free to determine by contract when a rate change may become effective.

Contracts between Louisiana Power & Light Company and its wholesale customers, providing that the rates were subject to change “as a result of and in accordance with” an order of a regulatory agency, were construed by the Commission to permit unilateral rate changes but only prospectively pursuant to section 206 of the Federal Power Act.⁴²

Frequently wholesale customers have attempted to tie their rate to the wholesale supplier’s retail industrial rate to maintain their competitive position and avoid a price squeeze. These attempts have created confusion regarding the right of the wholesale supplier to make unilateral rate filings. For example, a contract providing that when an increase in the supplier’s retail industrial rate was approved by the Wisconsin Public Service Commission the wholesale customers would “automatically receive and accept such rates” did not provide when the new rate would become effective. Rather,

39. 267 F.2d 405, 406 (5th Cir. 1959).

40. 575 F.2d 1204, 1210 (7th Cir. 1978).

41. 581 F.2d 993, 996 (D.C. Cir. 1978).

42. Louisiana Power & Light Co., FPC Docket No. ER-77-533, Order Rejecting Section 205 Filing, Amending Prior Order, Establishing Section 206(A) Proceedings, Granting Intervention and Establishing Price Squeeze Procedures (Sept. 30, 1977). *Accord*, Kansas Power & Light Co., FERC Docket No. ER 78-1, Order Accepting For Filing and Suspending Proposed Increased Rates, Denying Motion to Reject, Granting Intervention and Establishing Procedures Issued (Dec. 1, 1977) (contract provided for billing at rates “as may from time to time be authorized by . . . any . . . regulatory body having jurisdiction”).

approval by the state commission was merely a triggering event permitting the filing of new rates, which would become effective only after Commission approval under section 205.⁴³

The City of Richmond, Indiana, had a contract with Indiana and Michigan Electric Company (I&M) which provided for sales to Richmond at I&M's industrial rate on file with the Indiana Commission. It was conceded that when I&M filed for a ten percent increase in its industrial rate, it could have sought a similar increase in its rate for sales to Richmond. Instead, I&M filed a new rate for sales to Richmond, increasing the rate by forty-five percent. The Federal Power Commission permitted the filing, reasoning that since the contract concededly permitted a unilateral rate filing, there was no *Mobile-Sierra* problem. On appeal, the D.C. Circuit reversed, holding that the parties had by contract limited the rate filing.⁴⁴ Moreover, the court found no impermissible attempt to limit the Commission's jurisdiction by a private contract.

In the *Sam Dam*⁴⁵ case, the parties agreed that the "draftsmanship evidenced by the contract leaves much to be desired." The contract included several rate provisions, each of which included a provision for renegotiation of the rate. Following each renegotiation provision was a clause, 4(c), providing that if a rate change should be made applicable by final order or acceptance for filing such changed rate would be the contract rate. The Commission held that clause 4(c) provided for unilateral rate changes. Once again the commission was reversed on appeal. The appellate court ruled that clause 4(c) merely described the method of effectuating a rate resulting from renegotiation.

In *Gulf States Utilities Co. v. Federal Power Commission*,⁴⁶ the parties had a fixed rate contract with a capacity limitation of 8000 kw. Over the years, Gulf routinely delivered power in excess of the contract amount by a factor as great as eleven. In 1970, the parties amended the contract to remove the capacity ceiling. In 1973, Gulf filed a unilateral rate increase. The Commission and the reviewing court agreed that when the parties eliminated the capacity ceiling the fixed rate provision was applicable to all power sold. The same result should have been reached on the basis of a course of conduct change in the contract even without the formality of the 1970 contract amendment.⁴⁷

Even the effective period of a fixed rate contract can cause problems. In *Columbus & Southern Ohio Electric Co.*,⁴⁸ the fixed rate contract was executed on February 9, 1976 with the rates made effective as of January 1, 1976. The contract provided for successive one year fixed rate renewals absent prior

43. Wisconsin Elec. Power Co., FPC Docket No. ER 76-303 and Wisconsin Michigan Power Co., FPC Docket No. ER 76-394, Order Granting in Part and Denying In Part Application for Rehearing and Granting Stay (Sept. 26, 1977).

44. *Richmond Power & Light v. FPC*, 481 F.2d 490 (D.C. Cir.), *cert. denied*, 414 U.S. 1068 (1973).

45. *Sam Rayburn Dam Elec. Coop. v. FPC*, 515 F.2d 998 (D.C. Cir. 1975), *cert. denied*, 426 U.S. 907 (1976).

46. 518 F.2d 450 (D.C. Cir. 1975).

47. See text accompanying note 32, *supra*.

48. FERC Docket No. ER 77-529, Order (modifying prior order) (Feb. 2, 1978).

notice of termination or rate change. At issue was whether for *Mobile-Sierra* purposes the one year period began on January 1 or February 9. The Commission held that the starting date was February 9.

An interesting evasion of the *Mobile-Sierra* doctrine occurred in *Municipal Electric Utility Association of Alabama v. Federal Power Commission*.⁴⁹ On November 1, 1971 Alabama Power Company filed new rates to become effective upon the termination of some forty-six individual contracts which expired at varying times between January 3, 1972 and April 1976. The new rates were predicated upon a 1970 test year. The court said the filing did not violate *Mobile-Sierra* because the new rates only became effective when the fixed rate contracts expired. The problem of a stale test period,⁵⁰ was theoretically avoided by requiring the Commission to provide an opportunity for a modified section 205 hearing upon the expiration of each fixed rate contract. As a result certain customers were forced to participate in a rate proceeding to contest rates which, because of intervening rate proceedings, never did become effective as to them. This unwarranted burden is one of the matters sought to be avoided by fixed rate contracts. Nor did the Court consider the rate discrimination which resulted from the varying contract termination dates. That problem is discussed below.

CHANGING RATES IN A FIXED RATE CONTRACT

The rate established by a fixed rate contract may be changed prospectively after a section 206 hearing under the Federal Power Act or a section 5 hearing under the Natural Gas Act. In such a proceeding

the sole concern of the Commission would seem to be whether the rate is so low as to adversely affect the public interest—as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory.⁵¹

In practice, when the Commission has found a unilateral rate filing banned by the *Mobile-Sierra* doctrine, it has not hesitated to order a section 206 hearing.⁵²

The test set forth in *Sierra* is a difficult one. It is doubtful that the first leg of the test, that is, whether the rates are so low as to impair the financial ability of the public utility to continue its service, could ever be met.⁵³ The other two tests in *Sierra* are also difficult to satisfy.

One issue is whether *Sierra* imposed a test different from the test set out

49. 485 F.2d 967 (D.C. Cir. 1973).

50. *Tennessee Valley Mun. Gas Ass'n v. FPC*, 470 F.2d 446 (D.C. Cir. 1972).

51. *FPC v. Sierra Pac. Power Co.*, *supra* note 12.

52. *Public Serv. Co. of Ind. v. FERC*, 575 F.2d 1204 (7th Cir. 1978); *Louisiana Power & Light Co.*, FPC Docket No. ER 77-533 (Order issued Sept. 30, 1977); *Philadelphia Elec. Co.*, FPC Opinion No. 791 (issued Apr. 6, 1977).

53. Wholesale sales typically represent less than 20% of an electric utility's business. The wholesale customers of Commonwealth Edison, for example, account for less than 1% of the company's revenues. *Commonwealth Edison Co.*, FERC Docket Nos. E-9002 and ER 76-122. When a single wholesale contract is involved the financial impact is likely to be *de minimis*. Sales to the Borough of Lansdale account for only .089% of the seller's total revenues. *Philadelphia Elec. Co.*, *supra* note 52.

in section 206. In *Philadelphia Electric Co.*,⁵⁴ the Commission rejected the argument that the *Sierra* case definitely established the only three elements bearing upon the public interest which would be sufficient to set aside rates under section 206. Rather the Commission held that the public interest "is a fluid concept, dynamic in nature, and necessarily discernible only within a particular context once a full appreciation of all relevant facts is achieved."⁵⁵ According to the Commission, the elements discussed in *Sierra* were illustrative only.⁵⁶

The Commission then rejected the finding of the administrative judge that a rate which recoups revenues insufficient to recover costs is necessarily contrary to the public interest.⁵⁷ Rather, the Commission said that a public utility may only be excused from its contractual obligations where it is demonstrated that the public, which it has a duty to serve, will as a whole be seriously disadvantaged if the commitment is allowed to run its full course. Moreover in assessing the impact of the fixed rate, it may be necessary in some cases to look at the impact on the company over the entire term of the contract. In the early years the rate may be more than compensatory, mitigating in some degree a later revenue deficiency under the rate.⁵⁸ As interpreted by the Commission, changing a fixed rate under section 206 is a very unlikely event.

Public Service Company of Indiana (PSCI), appealing a rate proceeding, argued that its fixed rate contracts should be changed as unduly discriminatory.⁵⁹ PSCI's contract permitted unilateral rate changes by its supplier, while its contract with four other cities did not permit rate changes during the term of the contract. PSCI argued in the section 206 proceeding that the fixed rate contracts were unduly discriminatory and should be increased. The court, applying the *Sierra* test, rejected PSCI's argument, noting that a rate may be excessively discriminatory under section 205 but not unduly discriminatory under section 206. The purpose of section 205 is protection of the consumer, while the purpose of section 206 is protection of the public interest.

The court then explained the difference in application of the two sections as follows:

In our view the anti-discrimination policy in section 205(b) is violated in a case such as this where one consumer has its rates raised significantly above what other similarly-situated consumers are paying. In such a case, the lone consumer would be placed in an unjustifiably non-competitive position, and thus should have recourse to the FPC under section 205(b). Section 206's ban on discrimination may be breached in a case where one consumer is afforded, without any factual justification, a contract rate that is

54. *Philadelphia Elec. Co.*, FPC Opinion No. 791 (Apr. 6, 1977).

55. *Id.* at 12.

56. It was assumed without analysis that the elements set forth in *Sierra* governed but were to be applied in the alternative, in *Public Serv. Co. v. FERC*, 575 F.2d 1204 (7th Cir. 1978).

57. A contract may not be said to be unjust or unreasonable under § 206 simply because it is unprofitable to the public utility. *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956).

58. *Philadelphia Elec. Co.*, FPC Opinion No. 791 (issued Apr. 6, 1977).

59. *Public Serv. Co. v. FERC*, 575 F.2d 1204 (7th Cir. 1978).

significantly lower than the pre-existing rates for all other members of the class. In that case the public interest in avoiding blatant favoritism by a regulated utility and in protecting the vast majority of the class of consumers may require the FPC to find a violation of section 206.⁶⁰

Given the difficulty of changing a fixed rate contract under section 206 of the Federal Power Act or section 5 of the Natural Gas Act, the problem arises as to what to do with rate differentials between customers which exist solely because some customers of a supplier have fixed rate contracts while others have going rate contracts. This problem is discussed in the following section.

RATE DISCRIMINATION

In the PSCI rate proceeding discussed above, PSCI served a group of five cities at wholesale rates. Four of the cities had fixed rate contracts and Frankfurt, the remaining city, had a going rate contract. Both the Commission and the reviewing court refused to increase the rates to the fixed rate cities after a section 206 hearing. This caused Frankfurt to pay significantly higher rates than the fixed rate cities. Frankfurt argued that the result was rate discrimination prohibited by section 205. The Commission rejected Frankfurt's contention, but the reviewing court reversed and remanded.⁶¹ Differences in rates are justified where they are predicated upon differences in facts.⁶² In this case the Commission determined that the existence of the contracts constituted such a factual difference. Since the rates were otherwise just and reasonable, it permitted the increased rates.

The court held that the Commission was not responsive to the statutory test. Once Frankfurt demonstrated a substantial rate disparity, it was incumbent upon PSCI to show factual differences that justified the specific rate differential.⁶³ The Commission's failure to tie factual differences to the nature and amount of the rate differential in its opinion required a remand.⁶⁴ The court went on to state that matters that might justify a rate differential included the length of the contract term, since discounts can be justified on the basis of long-term commitments.⁶⁵

However, both the Commission in *Kansas Power & Light*⁶⁶ and the Court of Appeals for the District of Columbia in *Boroughs of Chambersburg v. Federal Energy Regulatory Commission*⁶⁷ have disagreed with the result reached in the PSCI case. Both have held that a rate differential which exists by virtue of the fact that one customer had a fixed rate contract while others had going rate contracts, where no other factual difference is demonstrated, is not discriminatory. In such cases, the contractual differences alone justify

60. *Id.* at 1213.

61. *Id.* at 1222.

62. *St. Michaels Util. Comm'n v. FPC*, 377 F.2d 912 (4th Cir. 1967).

63. 575 F.2d at 1212.

64. *Id.* at 1213.

65. *Id.* at 1212 n.12.

66. *See* note 42, *supra*.

67. 580 F.2d 573 (D.C. Cir. 1978).

the difference sufficiently for section 205. Further the court found that the necessary result of the *Mobile*, *Sierra* and *Memphis* cases is a potential for rate discrimination which can not be unreasonable if it exists solely as a result of contracts.

In *PSCI*, the court attempted to distinguish the *Chambersburg* case factually.⁶⁸ The court noted that in *PSCI* only one city had a going rate contract while in *Chambersburg* only one city had a fixed rate contract. Further, in *PSCI* the Commission had agreed that Frankfurt would be significantly injured by the rate differential while no such finding was made in *Chambersburg*. In a section 205 proceeding to protect the consumer, the number of consumers injured should make no difference. Accordingly the first factual distinction is irrelevant. The second distinction goes to the question of whether there is in fact an undue preference or an unreasonable difference in rates.

There exists then a fundamental divergence between the Seventh Circuit and the D.C. Circuit regarding the existence of undue rate discrimination resulting from the applicability of *Mobile-Sierra* to some but not all of a supplier's wholesale contracts. On the one hand, it is clear that a significant rate disparity not predicated on cost-of-service differences may result. On the other hand, it is argued that the company should not be deprived of the benefit of its bargained for going rate contract simply because some of its customers had fixed rate contracts. Both arguments are appealing.

The resolution of the dispute between the circuits lies in the development of a more exhaustive record regarding the inception of the contractual differences. The damage from the discrimination does not arise until one consumer has experience a rate increase. No relief is appropriate until that event occurs. However, the discriminatory event occurred when different contracts were executed. Accordingly, when no cost-of-service justification for the rate differential appears, it is necessary to consider the facts surrounding the execution of the contracts. In this regard, it would be appropriate to consider whether the going rate customers had the option of signing fixed rate contracts. Other differences in the contracts may also justify the distinction.

When it is recognized the wholesale suppliers frequently have a monopoly position in dealing with a wholesale customer the potential for discrimination at the inception of the contracts is apparent.⁶⁹ In such situations one of the customers of a wholesale supplier may be so fortuitously situated as to have an alternative supplier. To keep that customer, the supplier may offer a fixed rate contract which it will not offer to customers who are not geographically situated so as to have a choice among suppliers. It appears that such evidence would be considered by the D.C. Circuit.

When rate discrimination is demonstrated, the remedy in cases under section 205 has been to reduce the level of the higher rate to the level of the

68. 575 F.2d at 1212 n.12.

69. *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973); *Consumers Power Co.*, ALAB-452, 6 N.R.C. 892 (1972); *Toledo Edison Company*, ALAB-560, — N.R.C. — (Sept. 6, 1979), *appealed docketed*, *Duquesne Light Co.*, No. 80-1295 (3d Cir., Feb. 29, 1980).

lower rate.⁷⁰ This remedy would remove the damage resulting from discrimination at the inception of the contracts.

CONCLUSION

The law regarding the application of the *Mobile-Sierra* doctrine is sufficiently clear that most problems can be avoided by careful contract drafting. When the existence of both fixed rate and going rate contracts produces a significant rate differential not resulting from cost-of-service differences, a full record regarding the contract negotiations should be developed to permit a determination of whether section 205 discrimination exists.

70. *Otter Tail Power Co.*, 2 F.P.C. 134 (1940).