

# FERC'S REVIEW OF A PROPOSED RATEMAKING METHODOLOGY—*UNION ELECTRIC v. FERC*

## I. INTRODUCTION

The Federal Energy Regulatory Commission (FERC or the Commission)<sup>1</sup> governs all public electrical energy utilities' interstate activities.<sup>2</sup> The *Mobile-Sierra* doctrine<sup>3</sup> and the Administrative Procedure Act (APA)<sup>4</sup> limit the treatment of private uncontested settlement contracts between a utility and the utility's customers. The FERC uses its remedial authority under section 5<sup>5</sup> of the Natural Gas Act<sup>6</sup> and under section 206<sup>7</sup> of the Federal Power Act<sup>8</sup> to conduct hearings to determine whether the rates filed by the utility are unjust, unreasonable, unduly discriminatory or preferential.<sup>9</sup> If such is discovered, the FERC may modify the contract rate and, more importantly, may do so using data accumulated after the record is closed<sup>10</sup> because the Commission has the authority to "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."<sup>11</sup> Nevertheless, the utility company enjoys a procedural right to a hearing to dispute the appropriateness of using any data generated after the record is closed.<sup>12</sup>

Two facets, the congressionally created APA, and the judicially created

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1. Federal Power Act, 16 U.S.C. §§ 791-824(e) (1982). The Federal Power Commission was terminated and its functions with regard to the establishment, review and enforcement of rates and charges for the transmission or sale of electric energy was transferred to the Federal Energy Regulatory Commission by The Public Health & Welfare Act, Title 42 §§ 717(a)(1)(B) & 7293.

2. FPA § 201, 16 U.S.C. § 824(b) (1982), provides that "[t]he provisions of this subchapter shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce," and that "[t]he Commission shall have jurisdiction over all facilities for such transmission or sale. . . ." See also *Pennsylvania Water & Power Co. v. FPC*, 89 U.S. 235, *aff'd* 343 U.S. 414 (1951).

3. *Union Elec. v. FERC*, 890 F.2d 1193, 1194 (D.C. Cir. 1989). The *Mobile-Sierra* doctrine is based on the companion cases of *United Pipeline Gas Co. v. Mobile Gas Corp.*, 350 U.S. 332 (1956), and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956).

4. Administrative Procedure Act § 7(b), 5 U.S.C. § 556(e) (1988).

5. Natural Gas Act § 5, 15 U.S.C. § 717(d) (1982).

6. Natural Gas Act, 15 U.S.C. §§ 717-717(w) (1982).

7. FPA, 16 U.S.C. § 824(e) (1988).

8. 16 U.S.C. § 824 (1982).

9. 15 U.S.C. § 717(d) (1982).

10. *Union Electric*, 890 F.2d at 1201.

11. 16 U.S.C. § 824(e)(a) (1982). This section provides that:

[w]henver the Commission, after a hearing . . . , 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.

*Id.*

12. 5 U.S.C. § 556(e) (1988).

*Mobile-Sierra* doctrine, constrain the FERC's power to fashion ratemaking methodology. First, before initiating a rate change, the utility must file its proposal, which incorporates the private settlement contract if there is one, with the FERC.<sup>13</sup> Under the *Mobile-Sierra* doctrine, the regulatory commission in its determination of the appropriate rate or rate-making methodology<sup>14</sup> must afford the private contract substantial weight. Secondly, if the FERC rejects the private settlement proposal and instead uses data the FERC believes to be comparable to an industry's fair rate of return that was accumulated after the record was closed, the APA may grant the parties a hearing on the appropriateness of using that data.

The United States Court of Appeals for the District of Columbia considered these standards of review, the *Mobile-Sierra* doctrine and the APA, in *Union Electric Co. v. FERC*<sup>15</sup> (*Union Electric*). The FERC violated both these standards. Giving the parties' private settlement agreement too little weight was contrary to the *Mobile-Sierra* doctrine. Forbidding the parties a hearing on the use of data generated after the record was closed violated the APA's regulations.

## II. UNION ELECTRIC—BACKGROUND

### A. Private Settlement Agreement and FERC's Decisions

*Union Electric* is a traditional cost of service ratemaking case reviewing FERC's efforts to set a utility's proposed rates aside and to implement its own rate plan. Union Electric Company (Utility Co.) entered into an agreement with its customers, the cities of Malden and Jackson, Missouri (Cities), about a phased-in rate increase<sup>16</sup> specifically designed to reduce the rate shock<sup>17</sup> that the Utility Co.'s new Callaway nuclear power plant would produce. Including this new nuclear power plant in the rate base would increase the Utility Co.'s wholesale rates by 75%.<sup>18</sup>

The agreement included three relevant provisions in which the Utility Co. agreed to give consideration to the Cities. That consideration, in effect, was to accelerate and compress certain offsetting benefits, thus ameliorating the initial impact of the higher costs; in return, the Cities agreed to drop a previous rate challenge against the Utility Co.<sup>19</sup> First, the Utility Co. agreed to amortize fuel credits due from Westinghouse Corporation over a two year period instead of the traditional ratemaking procedure of over a twenty year period.<sup>20</sup> In the second provision, the Utility Co. agreed to amortize certain Callaway deferred income taxes over three years<sup>21</sup> instead of the 10½ years the standard

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13. Federal Power Act § 203, 16 U.S.C. § 824(d) (1982).

14. *Union Electric*, 890 F.2d at 1194.

15. *Union Electric*, 890 F.2d 1195 (D.C. Cir. 1989).

16. *Id.* at 1,197.

17. *Id.* at 1,194.

18. *Id.*

19. *Id.*

20. *Union Electric Co.*, 28 F.E.R.C. ¶ 61,101 (1984).

21. *Union Electric Co.*, 35 F.E.R.C. ¶ 63,076, at 65,258 (1986).

ratemaking procedures would prescribe.<sup>22</sup> The third provision of the agreement delayed the effective date of the wholesale rate increase until the effective date of the retail rate increase.<sup>23</sup> In return, the Cities agreed that the Utility Co. could continue, even after plant operations began, building up its cost of capital needed for the construction of the plant, known as the "allowance for funds used during construction" (AFUDC). The Cities agreed to accept the slightly higher rates resulting from adding this AFUDC into the rate base.

The FERC rejected each of these provisions without giving the parties' agreement the proper amount of weight.<sup>24</sup> The FERC justified rejecting the first two proposals by citing an interest in avoiding any deviations from the traditional ratemaking practices.<sup>25</sup> FERC further argued that because the Utility Co. had promised the Cities simply that it would propose some solutions to FERC, that FERC could dismiss the proposals without any consideration.<sup>26</sup> FERC rejected the third provision of the agreement, in which the wholesale rate increase was delayed, because the standard ratemaking practice was not being followed; i.e., the AFUDC cannot be accumulated after a plant is placed in commercial operation.<sup>27</sup>

FERC then modified the rejected contract ratemaking agreement. To establish a reasonable rate of return, the FERC used data on the yield from U.S. Treasury Bonds covering a two year period after the Administrative Law Judge (ALJ) had formed the tribunal's record.<sup>28</sup> The FERC allowed the Utility Co. to present no arguments as to why using this data was inappropriate, even though section 556(e)<sup>29</sup> of the APA specifically allows parties to show why the agency in question should not use certain data "not appearing in the evidence in the record."<sup>30</sup>

### B. *Main Issues: Mobile-Sierra Doctrine and Administrative Procedure Act*

Two issues in *Union Electric* are reviewed here. First, whether the *Mobile-Sierra* doctrine imposes standards concerning individual contracts made between public utility companies and their customers. Second, whether the FERC may ascertain the reasonable rates the utility companies may charge by using information occurring after the ALJ record was closed with-

22. *Union Electric*, 890 F.2d at 1,195.

23. *Id.* at 1,197.

24. *Id.* at 1,194.

25. *Id.* at 1,196.

26. *Union Elec. Co.*, 40 F.E.R.C. ¶ 61,046, at 61,135 (1987); *Union Elec. Co.*, 35 F.E.R.C. ¶ 63,076, at 65,258 (1986).

27. *Union Electric*, 890 F.2d at 1,197.

28. *Id.* at 1,201.

29. "The transcript of testimony and exhibits, together with all papers and requests filed in the proceeding, constitutes the exclusive record for decision in accordance with section 557 of this title and, on payment of lawfully prescribed costs, shall be made available to the parties. When an agency decision rests on official notice of a material fact not appearing in the evidence in the record, a party is entitled, on timely request, to an opportunity to show the contrary."

5 U.S.C. § 556(e).

30. *Id.*

out the utilities being afforded a hearing on the appropriateness of the data being used.

### III. DEVELOPMENT OF THE *MOBILE-SIERRA* DOCTRINE AND THE ADMINISTRATIVE PROCEDURE ACT

#### A. *Mobile-Sierra Doctrine*

The *Mobile-Sierra* doctrine enforces the public utility's rate scheduling contract as the legal limit that the utility must follow when filing rates with the FERC,<sup>31</sup> and also maintains pressure on the Commission to accept the proposed rate change. Under the Natural Gas Act (NGA),<sup>32</sup> those natural gas companies operating interstate must file with the FERC all rates and contracts; the FERC may only modify or reject these if they are found to be "unjust, unreasonable, unduly discriminatory, or preferential."<sup>33</sup> As the Court noted in *United Pipeline Gas Co. v. Mobile Gas Co.*<sup>34</sup> (*Mobile*), the NGA "expressly recognizes that rates to particular customers may be set by individual contracts."<sup>35</sup> The natural gas companies, therefore, may not change their rate contracts by unilateral action by filing a different rate schedule. However, the FERC's supervision of these individual contracts<sup>36</sup> effectively regulates and guards against high rates.

In *Federal Power Commission v. Sierra Pacific Power Co.*<sup>37</sup> (*Sierra*), the Court applied its holding in *Mobile* to rate-making cases under the Federal Power Act (FPA).<sup>38</sup> The FPA requires that all public utilities file their contract rates with the FERC and that a modification of these proposed rates must, therefore, follow the same guidelines as set out in the NGA.<sup>39</sup> The Court found in *Sierra* that all public utilities may negotiate fixed-price contracts with their customers as long as the public interest is protected.<sup>40</sup>

*Sierra* and *Mobile* taken together places the Commission under a heavy burden once the utility has proven the proposed rate change to be just and reasonable. Additionally, the court in *ANR Pipeline Co. v. FERC*<sup>41</sup> broadened the scope of the *Mobile-Sierra* doctrine by allowing privately made contracts to deal with cost-allocation and ratemaking methodology.<sup>42</sup> Therefore, the *Mobile-Sierra* doctrine applies in the instant case.

The burden of proof falls upon the utility company that seeks a rate

31. *Ohio Power Co. v. FERC*, 744 F.2d 162 (D.C. Cir. 1984) ("Indeed, we have recently noted that it 'would be foolish not to accord great weight to the judgment of the expert agency that deals with agreements of this sort on a daily basis.'" *Id.* at 166. (quoting *Kansas Cities v. FERC*, 723 F.2d 82, 87 (D.C. Cir. 1983))).

32. 15 U.S.C. § 717(d) (1982).

33. *Id.*

34. 350 U.S. 332 (1956).

35. *Id.* at 338.

36. *Id.* at 339.

37. 350 U.S. 348 (1956).

38. FPA, *supra* note 1.

39. *Sierra*, 350 U.S. at 355.

40. *Id.*

41. *ANR Pipeline Co. v. FERC*, 771 F.2d 507 (D.C. Cir. 1985).

42. *Id.* at 514.

increase<sup>43</sup> to show the proposed rate change is “just and reasonable” under either section 4 of the NGA<sup>44</sup> or section 206 of the FPA.<sup>45</sup> However, if the FERC imposes a rate change outside of the utility company’s proposal, section 5(a) of the NGA places the burden of proof on the FERC to show that the utility’s proposed change is “unjust, unreasonable, unduly discriminatory, or preferential,” and FERC’s decision must be supported by substantial evidence.<sup>46</sup>

The courts will defer to the FERC’s interpretation of a contract filed with it if the interpretation is “amply supported both factually and legally.”<sup>47</sup> These settlement agreements between the parties are not binding on the FERC, but great weight must be afforded to them.<sup>48</sup>

#### B. *Administrative Procedure Act—Due Process Challenge to Official Notice*

Under the FPA, the FERC’s enactment statute, the public utility has the right to a hearing on any material fact in dispute.<sup>49</sup> The APA provides the procedure to be followed in its hearing.<sup>50</sup> The Commission must address all the relevant facts and issues to the extent that no disputable facts remain; at this time a reviewing court will hold that a hearing will be unnecessary in order for the Commission to reach its conclusion.<sup>51</sup> For a party to be entitled to a hearing, a material fact or its use must be in dispute, and the party must be able to disprove that fact or prove the Commission’s use of it inappropriate.<sup>52</sup> The APA specifically addresses official notice: “When an agency decision rests on official notice of a material fact not appearing in the evidence in the record, a party is entitled, on timely request, to an opportunity to show the contrary.”<sup>53</sup>

An agency may take official notice of “technical or scientific facts that are

43. *Id.* at 513.

44. NGA § 4, 15 U.S.C. § 717(c)(e) (1982).

45. 16 U.S.C. § 824(e)(a) (1988).

46. *ANR*, 771 F.2d at 513.

47. *Ohio Power*, 744 F.2d at 166.

48. *Tennessee Gas Pipeline Co. v. FERC*, 824 F.2d 78 (D.C. Cir. 1987).

49. 16 U.S.C. § 824(d)(e) (1982).

50. APA § 7(b), 5 U.S.C. § 556(b) (1988). *See also* *Sisselman v. New Jersey Turnpike Auth.*, 432 F.2d 750 (3rd Cir. 1970) (“[I]n its adjudicatory provisions the Administrative Procedures Act has no application unless some other statute directs an agency hearing.” *Id.* at 754.); *American Pub. Gas Ass’n v. FPC*, 498 F.2d 718 (D.C. Cir. 1972) (When an enacting statute does provide for a hearing, a written evidentiary showing may be sufficient. *Id.* at 723.).

51. *Cerro Wire & Cable Co. v. FERC*, 677 F.2d 124 (D.C. Cir. 1982); *Pacific Gas & Elec. Co. v. FERC*, 746 F.2d 1383 (9th Cir. 1984); *Public Serv. Co. v. FERC*, 600 F.2d 944, *cert. denied* 444 U.S. 990 (1979) (FERC may reach decisions without an evidentiary hearing only when there are no material facts in dispute. *Id.* at 998.).

52. *Market St. Ry. Co. v. Railroad Comm’n*, 324 U.S. 548, *reh’g denied* 324 U.S. 890 (1945). The Court held that the use of operating revenues collected during a period outside the record was not prejudicial to the company because the record without these figures supported the reasonableness of the Commission’s decision. *Id.* at 561. The Company made no showing that a hearing would be beneficial. *Id.* Only those objections bearing on a substantial matter affect the due process rights of the parties. *Id.* at 562. Trivial formalities such as the objection to incidental references to a party’s own reports in the absence of prejudice does not constitute a want of due process. *Id.*

53. 5 U.S.C. § 556(b) (1988).

within the agency's area of expertise."<sup>54</sup> In the past, the courts have approved of the agency's taking official notice of the change in interest rates in the public market.<sup>55</sup> In *Mississippi Industries*,<sup>56</sup> the court held that the Commission, on a routine basis, adjusts the rate of return upward following change in the financial markets. The courts allow the use of this information, even though post-record, because it is not the type of material fact that is the subject of disputes. Additionally, when the facts of which an agency takes notice have already been fairly tested by rule making procedures, a litigant may not respond as to the accuracy of those facts.<sup>57</sup> This deference does not mean, however, that a public utility cannot challenge an official notice by providing evidence to show the contrary.<sup>58</sup>

The litigant may also challenge the official use of the data occurring after the record is closed, just as the Utility Co. wishes to do. As seen in *Boston Edison*,<sup>59</sup> the utility company argued that the commission's use of treasury bonds to adjust the rate of return was unreasonable because "utility investors do not react in precisely the same way as treasury bond holders."<sup>60</sup> The court, however, found nothing unreasonable about this adjustment.<sup>61</sup>

#### IV. THE DECISION IN *UNION ELECTRIC*

The court in *Union Electric* applied the *Mobile-Sierra* doctrine to FERC's lack of deference to the parties' settlement agreement, and held that FERC improperly gave too little weight to it, and that "[t]he Commission should not ignore the fact that all parties to the [agreement] . . . agreed on the [questioned] point."<sup>62</sup> On the APA due process issue, the court held that the parties were entitled to an opportunity to dispute the FERC's use of the U.S. Treasury Bond data in its determination of the Utility Co.'s cost of acquiring equity capital.<sup>63</sup> The court ordered the case remanded<sup>64</sup> to the Commission for further proceedings.

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54. *McLeod v. INS*, 802 F.2d 89, 93 n.4 (3rd Cir. 1986).

55. *Mississippi Indus. v. FERC*, 808 F.2d 1525 (D.C. Cir. 1987); *Boston Edison Co. v. FERC*, 885 F.2d 962 (1st Cir. 1989).

56. *Id.*, *Mississippi Indus.*

57. *Heckler v. Campbell*, 461 U.S. 458 (1983).

58. *Ohio Bell Tel. Co. v. Public Util. Comm'n*, 301 U.S. 292 (1937).

59. *Boston Edison*, 885 F.2d 962 (1st Cir. 1989).

60. *Id.* at 967.

61. The interest rate in Treasury Bonds had dropped 25%, but the Commission adjusted its rate of return downward by less than 5%. *Id.*

62. *Union Electric*, 890 F.2d at 1,197.

63. See *City of Cleveland v. FPC*, 174 U.S. 1 (1975) (A reviewing court will ordinarily remand to enable the agency to enter a new order after remedying the defects that vitiated the original action, as where the agency action must be set aside as invalid but the agency is still legally free to pursue a valid course of action. *Id.* at 11.)

64. *Union Electric*, 890 F.2d at 1,202.

## V. ANALYSIS OF COURT REVIEW OF FERC'S DECISION

A. *The Mobile-Sierra Standard Issue Concerning FERC's Lack of Proper Weight to Private Contracts*

The court reviewed the FERC's treatment of settlement agreement between the Utility Co. and the Cities filed with the Commission. The court incorporated the *Mobile-Sierra* doctrine in ascertaining whether or not the FERC gave proper deference to this private settlement contract.

The FERC argued that it interpreted the settlement agreement as binding the Utility Co. to make the agreed upon proposal to the Commission, but that the provisions themselves were not to be afforded any weight,<sup>65</sup> suggesting this interpretation was an industry practice. As to the Commission's argument that it was an industry practice to ignore any contract or settlement agreement the parties may have, the court held that "the record contains no reference to such a practice."<sup>66</sup> The court suggested that, had the record contained evidence of this practice, it would be proper for the Commission to follow it.<sup>67</sup> The court was, in effect, holding the Commission to a standard whereby an administrative agency may not act arbitrarily or capriciously.<sup>68</sup> To rule otherwise would plunge the industry into chaos, giving a commission almost unlimited power to veto and set new rate schedules. Agreements between utilities and their customers would cease to exist because of uncertainty and lack of uniformity of the Commission's decisions.

The court further held in *Union Electric* that these components of the ratemaking methodology in the agreement were designed to take effect as written.<sup>69</sup> The court relied on the holding in *Ohio Power*<sup>70</sup> that extrinsic evidence may be considered to interpret a contract if the language of the contract is ambiguous. Following this holding would mean the Commission must go outside the written agreement for evidence about the meaning each party has given the language in question, but not simply disregard the entire agreement. Because the parties have come to an agreement on only some aspects of the proposed rate increase, and each expects to have a significant amount of input to the final methodology chosen,<sup>71</sup> allowing the Commission to disregard the provisions in their entirety would "completely destroy the provision being interpreted."<sup>72</sup>

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65. 40 F.E.R.C. ¶ 61,046, at 61,135 (1987); 35 F.E.R.C. ¶ 63,076, at 65,258.

66. *Union Electric*, 890 F.2d at 196.

67. *Id.*

68. See also *International Union v. NLRB*, 459 F.2d 1,329 (D.C. Cir. 1972) ("Administrative agencies are required to obey the minimal requirements of rationality." *Id.* at 1,339.) (An agency must either conform to its own precedents or explain its departure from them. *Id.*); *Garrett v. Mathews*, 474 F. Supp. 594, *aff'd* 625 F.2d 658, *reh'g denied*, 629 F.2d 1,349 (1980) (An administrative agency may properly change its procedures, even without notice, if the parties' substantive rights are not affected. *Garrett*, 474 F. Supp. at 603.)

69. *Mobile*, 350 U.S. at 344; *Sierra*, 350 U.S. at 348.

70. *Ohio Power*, 744 F.2d at 166.

71. *Tennessee Gas Pipeline*, 504 F.2d at 202.

72. Several issues were not in the agreement, such as whether the nuclear power plant should be included in the rate base at all. Both parties, however, advocated the noted provisions in the agreement before the ALJ and the Commission. *Union Electric*, 890 F.2d at 1,196.

Here, the interpretation was that the provisions were not to be afforded any weight in its determination. In reviewing agency decisions, the court traditionally defers to the Commission's interpretation of a contract only if "amply supported both factually and legally."<sup>73</sup> The court in *Union Electric* emphasized that private settlement agreements must be encouraged, and that uniformity on the part of the Commission is a necessity. Once the Commission decides that the contract is ambiguous regarding certain provisions, it must consider extrinsic evidence to maintain the integrity of the agreement. In the agreement, the Cities abandoned their claim against the Utility Co. in a prior rate dispute in return for accelerating the Westinghouse credits and the deferred tax benefits being accelerated. Each side expects to be afforded the opportunity for further input on those issues on which they are not in complete agreement. Therefore, the FERC must not disregard the private contract.

In emphasizing the position that the private contract must be afforded great weight, the court relies on the two part *Mobile-Sierra* doctrine: Only those rate filings consistent with a public utility's contract are lawful, and the Commission must give substantial weight to private agreements.<sup>74</sup> The Supreme Court held in the *Mobile-Sierra* cases that the preservation of private rate setting contracts between utilities and their customers promotes economic stability. Therefore, whenever possible the Commission should interpret the statutory provisions governing public utilities' rates to mesh with the private rate agreements.<sup>75</sup> In fact, the Commission may override agreements setting a proposed rate increase only if it could prove the rate increase to be unjust or unreasonable.<sup>76</sup> Here, the parties agreed to a rate methodology to be used in the rate determinations; therefore, the Commission would have to prove the methodology unjust or unreasonable.<sup>77</sup>

The Commission did not meet this standard. The Commission merely disregarded the agreement in order to minimize departures from traditional ratemaking and accounting procedures.<sup>78</sup> The Commission stressed the need for a consistent and predictable framework for dealing with phased-in rate

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73. *Union Electric*, 890 F.2d at 1,194. See *Cities of Bethany v. FERC*, 727 F.2d 1,131 (D.C. Cir. 1984); *cert. denied*, 489 U.S. 917 (1984) (Settlement agreements may differ from fixed rate contracts, but like fixed rate contracts, they "promote market stability and reduce litigation over rate filings." *Bethany*, 747 F.2d at 1,138.); see also *United Mun. Distrib. Group v. FERC*, 732 F.2d 202 (D.C. Cir. 1984); *Cities of Campbell v. FERC*, 770 F.2d 1,180 (D.C. Cir. 1985); *Cities of Newark v. FERC*, 763 F.2d 533 (3rd Cir. 1985).

74. *Union Electric Co.*, 28 F.E.R.C. ¶ 61,101 (1984).

75. *Ohio Power*, 744 F.2d at 168. See also *Securities & Exch. Comm'n v. Chenery Corp.*, 332 U.S. 194 (1947) ("The administrative experience is of weight in judicial review . . . it is a persuasive reason for deference to the Commission in the exercise of discretionary powers under and within the law." *Id.* at 201.).

76. *Union Electric*, 890 F.2d at 1194. See also *Pennsylvania Water & Power Co. v. FPC*, 193 F.2d 230, *aff'd*, 343 U.S. 414 (1951) (The Commission is not bound to the use of any single formula or combination thereof in determining the rate methodology. The total effect, however, of the rate order must not be unjust or unreasonable. *Id.* at 241.).

77. 15 U.S.C. § 717(d) (1982); 16 U.S.C. § 824(e) (1982).

78. 40 F.E.R.C. ¶ 61,046, at 61,134 (1987).

increases.<sup>79</sup> The court responded that “[a]ny phase-in plan, including the one adopted by the Commission, will require deviations from traditional practices.”<sup>80</sup>

Innovative procedures should be encouraged, and if just, reasonable, and not against public policy,<sup>81</sup> must be followed by the agency. The industry might soon stagnate and wither away economically if too many constraints are imposed. Agreements made between the utility and their customers are necessarily tailor-made to fit individual needs. If the methodology for rate scheduling were boiler-plated and inflexible, there would be no incentive for these agreements at all.

#### B. *The APA Hearing Issue Concerning FERC's Use of Post-Hearing Data*

The court reviewed FERC's decision denying the litigants a hearing and an opportunity to offer evidence against FERC's use of data occurring after the record was closed. The court relied on the APA that provides such a hearing whenever a material fact is in dispute.

The Commission took official notice of the fluctuations of 10-year U.S. Treasury Bonds and assumed a linear relationship between them and the rate fluctuation on the Utility Co.'s cost of equity.<sup>82</sup> This practice is accepted where the technical facts are within the Commission's area of expertise.<sup>83</sup> The court held that the FERC may take official notice of the market fluctuations, even though part of this data occurred outside the record.<sup>84</sup> The APA<sup>85</sup> gives the Commission the authority “to take official notice of material not appearing in the evidence in the record.”<sup>86</sup> Market fluctuations should be used whenever appropriate to set uniform scheduling rates; this gives the Commission a financial focal point, and gives the utilities some guidelines as to what is just and reasonable when drafting their agreements.

This was not the crux of their argument, however. The Utility Co. objected to the Commission's use of the Treasury Bond fluctuations, not to its taking official notice of it.<sup>87</sup> The court in *Union Electric* agreed. It held that the agency must first have appropriate facts from which to take official notice; and second, follow the APA guidelines and allow the parties an opportunity to

79. *Union Electric Co.*, 28 F.E.R.C. ¶ 61,399, at 61,742 (1984).

80. *Union Electric*, 890 F.2d at 1,196.

81. *See Metropolitan Edison Co. v. FERC*, 595 F.2d 851 (D.C. Cir. 1979) (The purpose of the power given the Commission under 16 U.S.C. § 824(e) is to protect the public interest. Once the contract rate is so low as to adversely affect the public interest, the Commission may exercise its power. The contract rates must not impair the financial ability of the public utility to continue its service, or impose an excessive burden on its consumers, or otherwise be unduly discriminatory. *Id.* at 859.).

82. *Union Electric*, 890 F.2d at 1,202. The Commission can take judicial notice of current rates of interest on normal borrowing when determining the capital-acquisition cost of an industry it regulates daily. *City of Cleveland*, 174 U.S. at 11.

83. *McLeod*, 802 F.2d at 93 n.4 (“Official notice, rather than judicial notice, is the proper method by which agency decision-makers may apply knowledge not included in the record.”).

84. *Union Electric*, 890 F.2d at 1,202.

85. 5 U.S.C. § 556(e) (1988).

86. *McLeod*, 802 F.2d at 93 n.4; *see also Doe v. I.N.S.*, U.S. Dept. of Justice, 867 F.2d 285 (6th Cir. 1989).

87. *Union Electric*, 890 F.2d at 1,202.

provide evidence as to the inappropriateness of using this information.<sup>88</sup> The court relied heavily on *Ohio Bell Telephone Co. v. Public Utilities*,<sup>89</sup> where the Supreme Court ruled that a party may, when official notice is taken of a material fact not in evidence, "[dispute] the matter by evidence if he believes it disputable."<sup>90</sup>

The Commission did not seriously consider the parties' objections to the use of the data. FERC instead dismissed the complaint because, according to precedent FERC had already set, the Utility Co. should have been aware that recent fluctuations in U.S. Treasury Bonds occurring outside the record might be used to determine just and reasonable rates.<sup>91</sup> Therefore, no hearing on this issue was required. The court, however, could find no generally accepted financial theory supporting FERC's assumption that the return on equity allowed the Utility Co. was to be based on the market rate fluctuations of U.S. Treasury Bonds occurring after the record was closed. Moreover, in a recent FERC decision, *South Carolina Generating Co.*, the Commission noted that "it has not been established that there is a one-for-one correlation between fluctuations in Treasury bond rates and fluctuations in the cost of equity capital."<sup>92</sup> The Commission admitted to this uncertainty in *Allegheny Generating Co.*, and had suggested to the parties that they try to work out a solution to the individual company rates of return based on reasonable current equity rate of return.<sup>93</sup> Furthermore, the only precedent the Commission has, in fact, established, is the use of market fluctuations within a certain range of reasonableness that was contained in the record.<sup>94</sup> Therefore, no precedent had been established by FERC for using information outside the record and, without affording the parties an opportunity to dispute this use of data, FERC had violated the APA's regulation.

APA provides that, at the very least, the litigants must be afforded a written hearing. Neither the FPA nor the APA specifically requires a trial-type hearing.<sup>95</sup> The Commission has the authority to deny an oral, trial-type hearing with an opportunity to cross-exam, but only so long as the material facts in dispute can adequately be addressed and resolved by written submission of

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88. A prerequisite to the requirement that an agency must follow the APA guidelines is that the agency's enactment statute must give the parties the right to a hearing on the record. The court will set aside agency action, findings and conclusions that are found to be unsupported by substantial evidence in a case subject to APA §§ 556 & 557.

89. *Ohio Bell*, 301 U.S. 292 (1937); see also *Ex parte Rosier*, 133 F.2d 316 (D.C. Cir. 1942).

90. *Id.* at 301. See also *Ohio Power*, 744 F.2d at 170, note 32, where the court held that "[a]lthough an evidentiary hearing generally is required for resolving issues of material fact, a hearing is not required to resolve issues of law. Questions of contract interpretation are issues of law if the interpretation need not derive either from the credibility of extrinsic evidence or from a choice among reasonable inferences drawn from extrinsic evidence."

91. *Union Electric*, 890 F.2d at 1,201.

92. *South Carolina Generating Co.*, 44 F.E.R.C. ¶ 61,008, at 61,039 (1988).

93. *Allegheny Generating Co.*, 44 F.E.R.C. ¶ 61,436, at 61,379 (1988).

94. In its request for rehearing Union submitted an affidavit asserting that there was "no generally-accepted financial theory which supports the Commission's assumption that a Company's cost of common equity capital varies linearly with the yield on ten-year U.S. Treasury bonds. Given the existence of variation among companies, . . . the point is scarcely disputable. . . ." *Union Electric*, 890 F.2d at 1203.

95. *Sierra Ass'n v. FERC*, 744 F.2d 611, 663 (9th Cir. 1984).

evidence.<sup>96</sup> The litigator bears the burden of proof to prove that only an evidentiary hearing with an opportunity to cross-exam will suffice.<sup>97</sup>

Not all industries and businesses are the same; each is distinguished by differing needs and capabilities. The point of financial comparison the Commission used was the "return on U.S. government fixed-income obligations"<sup>98</sup>—U.S. Treasury Bonds. Allowing the Commission to officially notice these off-the-record fluctuations serves to establish a rate of return on equity based on current capital costs. Allowing utilities to oppose the use of the information the Commission chooses follows the APA guidelines, acknowledges that each company is unique,<sup>99</sup> and provides for greater flexibility within the industry.

## VI. CONCLUSION

The Federal Energy Regulatory Commission, in its determination of a rate making methodology, must give substantial weight to the feasibility and effectiveness of proposed solutions in a private contract or a settlement agreement between a public utility and its customer. The terms of the agreement, if it is just and reasonable and does not go against public policy,<sup>100</sup> binds both the Commission and the public utility. The Administrative Procedures Act dictates the procedure to be followed whenever an administrative agency takes official notice of a material fact not in evidence on the record. In this case, the Utility Co. has a procedural right to an opportunity to provide evidence in a hearing before the Commission showing why the use of the fluctuations of U.S. Treasury Bonds would be inappropriate in this instance.

The *Mobile-Sierra* doctrine and the Administrative Procedure Act will referee all future disputes between the Commission and the utility companies. Too little guidance allows the Commission a dangerously large amount of authority, and nothing would prevent it from running rampant, unchecked, over any settlement agreement. Thus stripped of incentives, the utilities and their customers will no longer be able to negotiate effectively. The result would be a profusion of litigation before the administrative bodies and the reviewing courts.

A company must be able to challenge the acceptability of the particular focal point the Commission uses to figure out the reasonable rate of return, or risk going bankrupt with an inadequate return rate. All companies are unique

96. *Central Neb. Pub. Power*, 51 F.E.R.C. ¶ 61,257, at 61,741 (1990); *See also American Pub. Gas Ass'n v. FPC*, 188 U.S. 23, *cert. denied*, 435 U.S. 907 (1978); *Wisconsin Gas Co. v. FERC*, 248 U.S. 231 (1985).

97. *Amador Stage Lines, Inc. v. United States*, 685 F.2d 333 (9th Cir. 1982) (It is the petitioners duty to show that only an oral-type hearing would adequately address the material facts in dispute. *Id.* at 338.).

98. *Union Electric*, 890 F.2d at 1,204.

99. *Id.* *See also FPC v. Conway Corp.*, 427 U.S. 271 (1976) (In rate making, there is no single cost-recovering rate, but rather a zone of reasonableness. *Id.* at 276.).

100. *See Citizens for Allegan County, Inc. v. FPC*, 414 F.2d 1,125 (1969) (The Commission has a duty to guard public interest. *Id.* at 1,129. This may require consideration of alternative courses of action other than those suggested by the parties, but does not require that the Commission always undertake exhaustive inquiries searching for every possible alternative if no viable ones have been suggested by the parties or suggest themselves to the agency. *Id.*).

and not all follow the fluctuations of one particular indicator, such as the U.S. Treasury Bonds. Industry must continue to be competitive to encourage the most efficient use of a valuable, national resource.

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