103 FERC ¶ 61,353

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

Nevada Power Company and Sierra Pacific Power Company v. Enron Power Marketing, Inc. El Paso Merchant Energy American Electric Power Services, Corp.	Docket Nos. EL02-28-000 EL02-28-002 EL02-33-000 EL02-33-002 EL02-38-000 EL02-38-002
Nevada Power Company v. Morgan Stanley Capital Group Calpine Energy Services Mirant Americas Energy Marketing, L.P. Reliant Energy Services BP Energy Company Allegheny Energy Supply Company, L.L.C.	Docket Nos. EL02-29-000 EL02-29-002 EL02-30-000 EL02-30-002 EL02-31-000 EL02-31-002 EL02-32-000 EL02-32-002 EL02-34-000 EL02-34-002 EL02-39-000 EL02-39-002
Southern California Water Company v. Mirant Americas Energy Marketing, L.P.	Docket Nos. EL02-43-000 EL02-43-002

Public Utility District No. 1 Snohomish County, Washington Docket Nos. EL02-56-000 EL02-56-002

v.

Morgan Stanley Capital Group, Inc.

(Consolidated)

ORDER ON INITIAL DECISION,
REHEARING REQUESTS, AND MOTIONS

(Issued June 26, 2003)

1. This case is before the Commission on exceptions to an Initial Decision[1] issued in this proceeding. This proceeding addresses complaints filed by Nevada Power Company and Sierra Pacific Power Company (Nevada Power and Sierra Pacific or collectively, Nevada Companies), Southern California Water Company (SCWC), and Public Utility District No. 1 Snohomish County, Washington (Snohomish). The complaints allege that dysfunctions in the California electricity spot markets caused forward contracts negotiated in the bilateral markets in California, Washington and Nevada, and entered into pursuant to the Western Systems Power Pool (WSPP) Agreement during the period November 1, 2000 through June 20, 2001, to be unjust and unreasonable. The complaints seek a remedy of contract modification.

2. In the order issued on April 11, 2002,[2] the Commission set the instant complaints for hearing. After an evidentiary hearing, the Administrative Law Judge (ALJ) concluded that the applicable standard of review intended by the parties for the contracts

---

[1] Nevada Power Co. and Sierra Pacific Power Co. v. Enron Power Marketing, Inc., et al., 101 FERC ¶ 63,031 (2002) (Initial Decision).

[2] Nevada Power Co. and Sierra Pacific Power Co. v. Enron Power Marketing, Inc., et al., 99 FERC ¶ 61,047, order on reh'g, 100 FERC ¶ 61,273 (2002), reh'g pending. (April 11 Order).

at issue here is the "public interest" standard[3] and that the Complainants have failed to meet their burden under this standard of review.

3. In this order, we affirm the ALJ's decision denying the complaints for the reasons stated below. In denying the instant complaints, we took into consideration the evidentiary record developed in this proceeding, findings of the Commission Staff's Final Report on Price Manipulation in Western Markets in Docket No. PA02-2-000 (Staff Report), and evidence submitted in the 100-Day Discovery Proceeding in Docket No. EL00-95, et al.[4]

4. Specifically, we affirm the ALJ's findings that the applicable standard of review for the contracts at issue here is the "public interest" standard and that the Complainants have failed to meet their burden of proof under this standard of review.

5. Before discussing the specific facts of the case before us, it is important to understand the historical context in which the "public interest" standard has been applied by the courts, and the legal parameters within which the Commission must address requests for contract reformation. The "public interest" standard of review was first introduced by the U.S. Supreme Court in the 1956 Mobile case[5] and the concurrently decided Sierra case.[6] The U.S. Supreme Court held that, in order to justify modification of its contract, the seller in that case had to show that the contract rate was so low that it was contrary to the public interest. In the Mobile and Sierra decisions, the Court sought to mesh the respect for the sanctity of contracts under the Federal Power Act (FPA)[7] and Natural Gas Act[8] with the traditional scheme of regulation under those statutes. The Court held that, where the utility and its customer contracted for a particular rate and did not reserve for the seller the right to unilaterally propose a rate change, the utility cannot

[3] See United Gas Pipe Line Co. v. Mobile Gas Serv. Corp., 350 U.S. 332 (1956) (Mobile); FPC v. Sierra Pacific Power, 350 U.S. 348 (1956) (Sierra); and United Gas Pipe Line Co. v. Memphis Light, Gas and Water Div., 358 U.S. 103 (1958).

[4] San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Serv., 101 FERC ¶ 61,186 (2002), order on clarification and reh'g, 102 FERC ¶ 61,164 (2003).

[5] United Gas Pipe Line Co. v. Mobile Gas Serv. Corp., 350 U.S. 332 (1956).

[6] See FPC v. Sierra Pacific Power, 350 U.S. 348 (1956).

[7] 16 U.S.C. §§ 796 et seq. (2000).

[8] 15 U.S.C. §§ 717 et seq. (2000).

unilaterally (i.e., without the customer's consent) file a new rate under section 205 of the FPA[9] to supersede the agreed-upon rate. The Court also ruled that the Commission's power under Section 206 of the FPA[10] to alter the existing contract rate, after its acceptance by the Commission, is limited.[11]

6. In the Sierra decision, the Court gave examples of factors that would meet the "public interest" standard and allow the selling utility to modify its contract. The selling utility was required to demonstrate that "the rate is so low as to adversely affect the public interest -- as where it might impair the financial ability of a public utility to continue service, cast upon other [customers] an excessive burden, or be unduly discriminatory."[12]

7. Both Mobile and Sierra addressed seller challenges to contract rates alleged to be too low. In later cases, the Mobile-Sierra doctrine was applied to contracts containing rates that allegedly were too high.[13] The Mobile and Sierra cases were decided in a cost-based rate regime and consequently dealt with changes proposed to contracts that were already on file with the Commission. The application of the Mobile-Sierra doctrine was later extended to contracts that were not on file with the Commission.[14]

8. In a more recent case involving a long-term, fixed-rate contract, the court held that a showing of "a mere rate disparity or a benefit to the purchasing utility or its customers for a rate modification does not suffice, without more, to satisfy [the 'public interest']

---

[9] 16 U.S.C. § 824d (2000).

[10] 16 U.S.C. § 824e (2000).

[11] Boston Edison Co. v. FERC, 233 F.3d 60, 64-65 (2000) (citing Sierra, 350 U.S. at 352-55; accord Mobile, 350 U.S. at 347).

[12] See Sierra at 355.

[13] See, e.g., Public Service Commission of the State of New York v. FPC, 543 F.2d 757, 798 (D.C. Cir. 1974).

[14] See, e.g., Richmond Power & Light v. FPC, 481 F.2d 490, 493 (D.C. Cir. 1973) (holding that "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."). Borough of Lansdale, Pennsylvania v. FPC, 494 F.2d 1104, 1112 (D.C. Cir. 1974).

standard."[15] In PEPCO, the court also noted that the purchaser seeking a lower rate failed to "offer any evidence (beyond speculation) that the only potential non-parties here, its ratepayers, were adversely affected by the existing rates; it did not, for example, even attempt to show how much if any of the rate disparity was passed on to PEPCO ratepayers rather than borne by the utility itself."[16] While PEPCO claimed an excessive burden on its customers and discriminatory impact from the disparity between the contract rates and the OATT rate charged by the same transmission provider, the court said that "other than pointing out that the contract rate is twice [Allegheny's] OATT rate, [PEPCO] has presented no evidence regarding how the contract rates are unduly discriminatory or excessively burdensome on PEPCO ratepayers."[17] The court noted the Commission's precedent which holds that "the fact that a contract has become uneconomic to one of the parties does not necessarily render the contract contrary to the public interest."[18]

9. Based on our review of the evidence and the totality of circumstances, we conclude that the Complainants have failed to meet their burden of proof under the "public interest" standard, as defined in past cases. We find that the challenged contracts are not contrary to the public interest because the Complainants have failed to demonstrate that the contracts in question caused financial distress for the Complainants so as to threaten their ability to continue service, that the contracts cast an excessive burden on their customers, that the contracts were unduly discriminatory to the detriment of other customers that are not parties to this proceeding, or that any other factors on this

---

[15] See Potomac Electric Power Company v. FERC, 210 F.3d 403, 404 (D.C. Cir. 2000).

[16] Id. at 408.

[17] Id. at 409.

[18] See, e.g., Gulf States Utilities Company v. Southern Company Services, Inc., et al., Opinion No. 300, 43 FERC ¶ 61,003, at 61,016, reh'g denied, Opinion No. 300-A, 43 FERC ¶ 61,394 (1988), aff'd sub nom. Gulf States Utilities Company v. FERC, 886 F.2d 442 (1989); accord Soyland Power Cooperative, Inc. v. Central Illinois Public Service Company, 51 FERC ¶ 61,004, at 61,014-15, reh'g dismissed as moot, 52 FERC ¶ 61,149 (1990); Public Service Company of New Mexico, 43 FERC ¶ 61,469, at 62,152, reh'g denied, 45 FERC ¶ 61,034 (1988), aff'd sub nom. San Diego Gas & Electric Company v. FERC, 904 F.2d 727 (D.C. Cir. 1990).

record demonstrate that the contracts are contrary to the public interest. At the time of contract execution, other alternatives were available to the Complainants; however, they chose to enter into the contracts in question, accepting market risks. Complainants benefitted from resales of the energy purchased under these contracts during the relevant period; however, after the drop in prices in mid-2001, Complainants became dissatisfied with their bargains and sought contract modification. The law is quite clear on that point. The fact that a contract becomes uneconomic over time does not render it contrary to the public interest. We, therefore, deny the instant complaints.

10. In addition, we deny requests for rehearing of an order on rehearing, as discussed below. We also address certain procedural motions filed by Snohomish and SCWC.

11. This order is in the public interest because it balances effective rate regulation with respect for the sanctity of contracts, as dictated by the U.S. Supreme Court under the Mobile-Sierra doctrine.

I. Background

12. On July 26, 2000, the Commission issued an order initiating an investigation of the conditions of bulk power markets in various regions of the country.[19] On August 2, 2000, San Diego Gas & Electric Company filed a complaint, requesting that the Commission impose a $250 price cap for sales into the California Independent System Operator (ISO) and Power Exchange (PX) spot markets. The Commission denied the request in an order issued on August 23, 2000.[20] In that order, the Commission instituted hearing procedures to investigate the justness and reasonableness of the rates of public utility sellers into the California ISO and PX markets. The hearing was held in abeyance pending completion of the Commission Staff fact-finding investigation of the conditions of bulk power markets, which was completed in October 2000.

13. On November 1, 2000, the Commission issued an order proposing measures to address the dysfunctions in the California market and remedy the problems identified by the Staff investigation.[21] The Commission specifically identified the following rules and regulatory policies as flawed: the California Public Utilities Commission's (CPUC) requirement that the three California Investor-Owned Utilities (IOUs) buy and sell all

[19] Order Directing Staff Investigation, 92 FERC ¶ 61,160 (2000).

[20] San Diego Gas & Electric Co., 92 FERC ¶ 61,172 (2000).

[21] San Diego Gas & Electric Co., 93 FERC ¶ 61,121 (2000).

their energy needs through the PX; the CPUC restrictions on the IOUs' ability to contract forward; the lack of retail demand responsiveness; and underscheduling due to the ISO's replacement reserves policies.[22] To correct the above identified market design problems, the Commission proposed, among other things, elimination of the requirement that the California IOUs sell all their generation into and buy all their requirements from the PX.

14. On December 15, 2000, the Commission issued an order [23] adopting, among other things, a benchmark price to provide guidance for assessing the prices of long-term electric supply contracts;[24] and market monitoring and price mitigation for the ISO and PX spot markets, including a $150 per MW price breakpoint.

15. Subsequent orders issued on April 26, 2001[25] and June 19, 2001[26] adopted further market monitoring and mitigation measures for the California markets, and extended those measures to all Western markets.

16. To put the contracts at issue in this case in context, the Nevada Companies' contracts were executed between November 2000 to June 2001; the Snohomish contract was executed on January 26, 2001; and the SCWC contract was executed on March 19, 2001. During the relevant period the Complainants entered into a large number of contracts for purchase as well as for sale of energy; however, out of all these contracts the Complainants seek to modify only a relatively small number of contracts included in the instant complaints.

17. In December 2001, Nevada Companies filed separate complaints against the following entities: Duke Energy Trading and Marketing, L.L.C. (Duke), Morgan Stanley Capital Group Inc. (Morgan Stanley), Calpine Energy Services, L.P. (Calpine), Mirant Americas Energy Marketing, L.P. (Mirant), Reliant Energy Services, Inc. (Reliant), El Paso Merchant Energy, L.P. (El Paso), BP Energy Company (BP), American Electric Power Service Corporation (AEP), Enron Power Marketing Inc. (Enron), and Allegheny Energy Supply Company, L.L.C. (Allegheny). SCWC filed a complaint against Mirant.

---

[22] Id. at 61,354-5.

[23] San Diego Gas and Electric v. Sellers of Energy, 93 FERC ¶ 61,294 (2000).

[24] The benchmark for five year contracts for supply around–the-clock was set at $74/MWh. Id. at 61,994.

[25] San Diego Gas & Electric Co., 95 FERC ¶ 61,115 (2001) (April 26 Order).

[26] San Diego Gas & Electric Co., 95 FERC ¶ 61,418 (2001) (June 19 Order) .

In February 2002, Snohomish filed a complaint against Morgan Stanley. The Nevada Companies and SCWC argued that the dysfunctions in the ISO and PX spot markets caused long-term contracts negotiated in California, Washington, and Nevada to be unjust and unreasonable and, consequently, requested modification of their contracts. Snohomish argued that the term of its contract and the Collateral Annex[27] are unjust and unreasonable. Unlike Nevada Companies and SCWC, Snohomish requested modification of the contract term, not the contract rate.

18. On January 10, 2002, Nevada Companies filed a notice of withdrawal with prejudice of complaint against Duke, explaining that Nevada Companies and Duke reached an agreement to modify their contracts, effective June 4, 2002.

19. On April 11, 2002, the Commission issued an order setting the instant complaints for a trial-type evidentiary hearing. In the April 11 Order, the Commission instructed the ALJ to examine the following issues: (1) whether the challenged contracts should be reviewed under the "just and reasonable" standard or the more stringent "public interest" standard of review; and (2) whether the dysfunctional California ISO and PX spot markets adversely affected Western long-term bilateral markets, and if so, whether contract modification is warranted.

20. The hearing on these issues was held from October 7-24, 2002. The Initial Decision was issued on December 19, 2002. In the Initial Decision, the ALJ found that the Mobile-Sierra "public interest" standard of review applies to the contracts at issue. Furthermore, the ALJ concluded that Complainants failed to satisfy their burden of proof to justify contract modification under the "public interest" standard. The following parties filed briefs on and opposing exceptions to the Initial Decision: Nevada Companies, Snohomish, SCWC, the Commission's Trial Staff (Staff), Mirant, Morgan Stanley, Public Utilities Commission of Nevada (PUCN), Allegheny, Enron, AEP, BP, Calpine, El Paso, and Reliant.

21. On November 20, 2002, the Commission issued an order allowing parties in the Docket No. EL00-95, et al. proceeding to adduce evidence that was either indicative or counter-indicative of market manipulation that may have occurred during the California

[27] The Collateral Annex sets forth the conditions under which Snohomish is required to provide collateral, as well as the conditions under which Morgan Stanley will release such collateral.

energy crisis of 2000-2001 (100-Day Discovery Proceeding). [28] The submission of evidence in the 100-Day Discovery Proceeding was completed on March 20, 2003.

22. On March 26, 2003, the Commission released the Staff Report. The Staff Report, among other things, asserted that many spot market trading strategies undertaken by certain sellers were in violation of anti-gaming provisions of the Commission-approved tariffs for the California ISO and PX. Upon Staff's recommendation, the Commission issued certain "show cause" orders requiring the named market participants to respond to market manipulation allegations of the Staff Report. Additionally, the Staff Report addressed the issue of whether the dysfunctional spot market had an impact on the forward prices reflected in long-term power supply contracts. The Staff Report analysis found that spot prices influenced forward prices negotiated during the January 1, 2000 through June 21, 2001 crisis period and that the influence was the greatest for contracts with one to two years terms.

23. Subsequent to release of the Staff Report, Complainants requested an opportunity to have oral argument before the full Commission. On April 14, 2003, the Commission granted this request. The oral argument took place on April 23, 2003.

II. Issues for Discussion

1. Applicable Standard of Review

24. In the April 11 Order, the Commission set for hearing the issue of whether the applicable standard of review for the Complainants to prevail is that a challenged contract was contrary to the public interest, or that the contract was not just and reasonable. The Commission determined that for all but one of the contracts at issue here, Section 6.1 of the umbrella WSPP Agreement[29] was the only specific contractual provision which may affect parties' rights to make changes to contracts entered into under the WSPP Agreement. The Commission noted that this provision addressed sellers' rights under Section 205 of the FPA, not buyers' FPA Section 206 rights, to modify rates affecting transactions under the WSPP Agreement.

---

[28] See supra n.4.

[29] Section 6.1 of the WSPP Agreement states in part as follows: "Nothing contained herein shall be construed as affecting in any way the rights of the Parties to jointly make application to FERC for a change in the rates and charges, classification, service, terms, or conditions affecting WSPP transactions under Section 205 of the Federal Power Act and pursuant to FERC rules and regulations promulgated thereunder..."

25. In the April 11 Order, the Commission also determined that one of the contracts at issue, specifically the contract between Snohomish and Morgan Stanley, includes a separate provision, not contained in the umbrella WSPP Agreement, which addresses both FPA Section 205 rights and FPA Section 206 rights.[30] Initially, the issue of the applicable standard of review for this contract was also set for hearing. On rehearing, however, the Commission ruled that Snohomish must satisfy the "public interest" standard to justify modification of its contract with Morgan Stanley.[31] Snohomish requests rehearing of that determination.

26. Also, on rehearing, the Commission specified that the evidentiary hearing was established to interpret Section 6.1 of the WSPP Agreement and to ascertain the intent of the parties at the time the contracts in question were signed.[32]

A. Initial Decision

27. The ALJ ruled that the applicable standard of review for the instant complaints is the "public interest" standard. In particular, the ALJ found that each contract at issue consists of a Confirmation Agreement, the WSPP Agreement and any amendments, which together form a single, integrated document.[33] The ALJ also found that Section 6.1 of the WSPP Agreement allows parties to jointly seek modification of the rates, terms and conditions of the contracts under Section 205 of the FPA; however, the cited section does not have any language regarding the parties' FPA Section 206 rights.[34]

---

[30] Section 39B of the Confirmation Agreement between Snohomish and Morgan Stanley states: "The rates for service specified in this Agreement shall remain in effect for the term of this Agreement and shall not be subject to change through application to FERC pursuant to the provisions of Section 205 or 206 of the Federal Power Act."

[31] See Nevada Power Co. and Sierra Pacific Power Co. v. Enron Power Marketing, Inc., et al., 100 FERC ¶ 61,273, at 62,047-48 (2002), reh'g pending (Rehearing Order).

[32] Id. at 62,047.

[33] The ALJ relied on Sections 2.2, 26 and 35 of the WSPP Agreement. See Initial Decision at 65,274.

[34] Id.

Accordingly, the ALJ concluded that pursuant to court and Commission precedent,[35] in the absence of clear contractual language allowing unilateral contract modifications under Section 206, Complainants must meet the "public interest" standard of review.[36]

28. In addition, the ALJ found that nothing in Section 6.1 of the WSPP Agreement, nor in the underlying Confirmation Agreements, suggests that the contracting parties intended to give unilateral authority to modify the contracts under Section 206 of the FPA. The drafters of the WSPP Agreement have envisioned a possibility of a joint application to the Commission to change rates, terms and conditions of the WSPP Agreement and transactions entered into thereunder pursuant to Section 205 of the FPA and they could easily have added language to allow other ways of making changes to the WSPP Agreement. Thus, the ALJ concluded that the only rational interpretation of Section 6.1 of the WSPP Agreement would be that it precluded unilateral contract modification.[37]

29. The ALJ also considered the parties' intent at the time the contracts were signed. It was found that the evidence submitted in this case did not support Complainants' allegations concerning intent and that Complainants' witnesses' testimony in this regard was not credible.[38] The ALJ also found that substantial evidence supports Respondents' arguments concerning this issue. In particular, Respondents provided corroborated evidence that the parties' Section 206 rights were never a subject for consideration during negotiations.[39]

30. Furthermore, the ALJ disagreed with the Complainants' contention that the Mobile-Sierra doctrine does not apply to the facts at issue here. The ALJ determined that the Mobile-Sierra doctrine does not distinguish contracts based on the length of the contracts, whether the rates are low or high, or whether the complaint is filed by the

---

[35] The ALJ cited to Texaco Inc. v. FERC, 148 F. 3d 1091, 1096 (D.C. Cir. 1998); Boston Edison Company v. FERC, 233 F.3d 60 (1st Cir. 2000); San Diego Gas & Electric Company v. Public Service Company of New Mexico, 91 FERC ¶ 61,233 at 61,851 (2000); and Metropolitan Co. v. FERC, 595 F.2d 851, 855 (D.C. Cir. 1979). Id. at 65,275.

[36] Id.

[37] Id. at 65,276.

[38] Id. 65,276-77.

[39] Id. at 65,277.

buyer or the seller.[40] It was also found that the Commission had not prejudged the issue of the applicable standard of review when the Commission suggested that market participants could file complaints if they believed that their contracts are unjust and unreasonable.[41] The ALJ also dismissed PUCN's argument that the Commission should apply here a more flexible "public interest" standard.[42]

B. Exceptions

31. Complainants and PUCN assert as error the ALJ's determination that the "public interest" standard applies to the contracts at issue. Complainants argue that the Commission may apply the "public interest" standard only if it first finds the contract prices to be just and reasonable. They state that because the contracts at issue were market-based rate contracts, they were never filed with or approved by the Commission. As such, it is claimed, these contracts were never intended to be regarded as inviolable, since the Commission is required, in these cases, to monitor and, if necessary, ensure that the markets in which these contracts are performed, continue to function in a manner that will support or justify a continuation of market-based pricing.

32. In response, Respondents and Staff state that the ALJ correctly found that an initial review of the challenged contracts has already occurred under Section 205 when the Commission approved the WSPP Agreement, and after further proceedings, found that all Respondents are authorized to sell power at market-based rates and that they did not possess the ability to exercise market power. Staff adds that by virtue of the granted market-based rate authority, the rates, terms and conditions Respondents negotiate are deemed to be just and reasonable. Staff argues that inasmuch as the rates, terms and conditions included within the Confirmation Agreements are presumed to be just and reasonable, any need for prior Commission approval has been met. To that end, Mirant further asserts that the Commission previously has held that, in the case of market-based rates, the "just and reasonable" standard of Section 205 is satisfied by the Commission's determination, prior to the effectiveness of those rates, that the utility and its affiliates lack market power or have taken steps to mitigate market power. Moreover, Respondents and Staff state that parties to whom the Commission has granted market-based rate authority file contracts for informational purposes only. Therefore, assert Respondents, application of the Mobile-Sierra doctrine cannot depend upon the filing

---

[40] Id.

[41] Id.

[42] Id.

and approval of a contract where no such approval process is available from, or required by, the Commission.

33. Complainants and PUCN further argue that the ALJ erred in ruling that the "public interest" standard applies in the absence of an express clause granting the parties the right to seek revisions to their contracts pursuant to Section 206 of the FPA. These parties assert that such a clause should not be required as a prerequisite to the exercise of their Section 206 rights. They argue that in the absence of this language, the parties should be deemed to be bound only by the "just and reasonable" standard and should be free to seek unilateral changes to their contracts under the "just and reasonable" standard. Complainants and PUCN also argue that there was no evidence in this case that any party to the contracts at issue intended to be bound by the "public interest" standard. They state that if the parties had intended to limit their Section 206 rights in this way, they could have done so expressly.

34. In response, Respondents argue that the record shows that the subject contracts were voluntarily negotiated by sophisticated parties and no party expressly reserved the right to seek unilateral modifications under the "just and reasonable" standard of review. Respondents and Staff state that courts and the Commission have consistently applied the "public interest" standard of review to contracts, such as those at issue here, that contain a specific, fixed rate and where a party has not expressly preserved its right to seek unilateral modification to the contract rates.

35. While PUCN argues that third parties, including Nevada ratepayers, should not be bound by the Mobile-Sierra doctrine because they are not parties to the challenged contracts, Allegheny states that PUCN's argument, if accepted, would effectively eliminate the "public interest" standard altogether. Moreover, Allegheny states that a utility cannot simply claim that it is acting on behalf of its customers to avoid the "public interest" standard of review.[43] To that end, Respondents contend that the potential excessive burden on customers is not a basis for determining whether the "public interest" standard applies, but rather, is part of the "public interest" test itself. Respondents further assert that to allow the mere presence of an intervenor, such as PUCN, to lower the standard of review would invite any future complainant to simply line up a supporting intervenor so that the lower standard would apply to the complaint.

C. Commission Determination

---

[43] See Potomac Elec. Power Co. v. Allegheny Power System, 85 FERC ¶ 61,633 (1998).

36. The issue of the applicable standard of review was set for hearing because we did not believe that we had a sufficient record to definitively address the Mobile-Sierra issue. We now have the benefit of a complete evidentiary record, including witness testimony, on the issue of the applicable standard of review. The record shows that the challenged contracts were entered into under an umbrella WSPP Agreement and consequently incorporate terms and conditions of the WSPP Agreement, including Section 6.1.[44] Section 6.1 of the WSPP Agreement allows parties to jointly seek modification of the rates, terms and conditions of the contracts under Section 205 of the FPA; however, it does not address the parties' FPA Section 206 rights. This is the provision that the ALJ was instructed to interpret. We agree with the ALJ's interpretation of Section 6.1 of the WSPP Agreement. Section 6.1 of the WSPP Agreement allows parties to jointly seek modification of the rates, terms and conditions of a contract under FPA Section 205, but does not address customer rights to file a complaint pursuant to FPA Section 206. On first glance, Section 6.1 is confusing since Section 205 is the statutory provision by which a seller makes a rate change filing[45] and Section 206 is the provision by which a non-seller (purchaser or other affected person) may seek a rate change. However, we conclude that the reference to a "joint" Section 205 filing evidences an intent that neither seller nor buyer be able to seek changes under Section 205 or 206 of the FPA other than under the "public interest" standard of review. Although the parties could have used specific language disallowing a unilateral filing by the seller under Section 205, or the filing of a complaint by the buyer under Section 206 of the FPA, the most reasonable reading of Section 6.1 is that they intended to exclude any unilateral filings at the Commission. As the ALJ explained, "under the maxim 'expressio unius est exclusio alterius,' (the expression of one thing is the exclusion of the other), the only interpretation of Section 6.1 of the [WSPP Agreement] is that the parties thought about, contemplated, and provided for applications to FERC, excluding all applications not specifically provided for in the contracts."[46] Therefore, the parties to the challenged contracts did not

---

[44] Ex. NPC-14, Section 26 and NPC-14 at 56.

[45] Section 205 applies only to rate changes by public utility sellers. Thus, a buyer under a contract does not file either individually or jointly for a rate change under Section 205. It may intervene in support of a public utility's Section 205 rate filing but does not institute rate change filings under that section.

[46] Initial Decision at 65,276. An opposite interpretation would fly in the face of the D.C. Circuit Court decision in Texaco Inc. v. FERC, 148 F.3d 1091 (D.C. Cir. 1998). Mojave, a natural gas pipeline company, and Texaco, a shipper, entered into service agreements that established a formula rate for transportation services and in which

(continued...)

intend to retain for Complainants the right to unilaterally seek changes to their contracts. Thus, we conclude that Complainants must demonstrate that the contracts in question are contrary to the public interest in order to support modification of the contracts.

37. Complainants also argue that the "public interest" standard does not apply to the market-based rate contracts at issue here because these contracts have not been previously reviewed and accepted for filing by the Commission. The need for prior Commission review in these circumstances was met when, after determining that the Respondents lacked market power or had taken steps to mitigate it, the Commission authorized all of the Respondents in this proceeding to make sales of power at market-based rates.[47] A seller that has been granted market-based rate authority may enter into power sales contracts without first seeking Commission authorization of the provisions of an individual contract (except for certain affiliate contracts). The Commission is not

---

[46](...continued)
Mojave agreed that it "shall not exercise [its] rights under Section 4 of the [NGA] to change the rates to be paid by the Shipper." Id. at 1095. In subsequent proceedings to reform the contracts, the Commission found that the contracts were not subject to the Mobile-Sierra doctrine because "by expressly prohibiting only unilateral rate changes proposed under NGA Section 4, the contracts . . . implicitly recognize the Commission's ability to take the instant Section 5 action." Id., quoting Mojave Pipeline Co., 62 FERC ¶ 61,195 at 62,365 (1993). The Court rejected the Commission's approach and explained that "the law is quite clear: absent contractual language 'susceptible to the construction that the rate may be altered while the contract[] subsists,' the Mobile-Sierra doctrine applies." Id., 158 F.3d at 1096, quoting Appalachian Power Co. v. FPC, 529 F.2d 342, 348 (D.C. Cir. 1976). Sections 4 and 5 of the NGA are similar to Sections 205 and 206 of the FPA and should be interpreted consistently. Transmission Access Policy Study Group v. FERC, 225 F.3d 667, 686 (D.C. Cir. 2000). Our conclusion that contracts entered into pursuant to the terms and conditions set forth in the WSPP Agreement are subject to the Mobile-Sierra doctrine is consistent with Texaco.

[47] See Allegheny Energy Supply Company, 88 FERC ¶ 61,303 (1999); American Electric Power Service Corporation, 81 FERC ¶ 61,129 (1997); BP Energy Company, Director Letter Order, Docket No. ER00-3614-000 (Oct. 18, 2000); Calpine Energy Services , L.P., Director Letter Order, Docket No. ER00-3562-000 (Sept. 21, 2000.); Tenneco Energy Marketing Company, Director Letter Order, Docket No. ER95-428-000 (March 30 ,1995); Enron Power Marketing, Inc., 65 FERC ¶ 61,305 (1993); Southern Company Energy Marketing, LP, 72 FERC ¶ 61,324 (1995); Morgan Stanley Capital Group, Inc., 69 FERC ¶ 61,175 (1994); Noram Energy Services Inc., Director Letter Order, Docket No. ER94-1247-000 (July 25, 1994).

required specifically to review each agreement since the Commission, when it grants umbrella market-based rate authorization, pre-determines that rates under future contracts entered into pursuant to the market-based rate authorization will be just and reasonable. The "just and reasonable" standard of Section 205(e) of the FPA[48] is satisfied by the Commission's determination that the utility (and its affiliates) lacks market power or has taken sufficient steps to mitigate market power. [49] As noted in GWF Energy, LLC,[50] if we were required to examine every long-term service agreement as if the seller was seeking new market-based rate authority, it would make the original grant of market-based rate authority (i.e., the original acceptance of the market-based rate tariff) a pointless exercise of no value to anyone. For these reasons, the Commission has expressly excluded from the subjects set for hearing issues concerning the Commission's policies on granting market-based rate authority or on regulation of sellers with such authority.[51]

D. Requests for Rehearing

38. We will also address Snohomish's and Senator Cantwell's requests for rehearing of the Rehearing Order. In that order, we granted Morgan Stanley's request for rehearing of the April 11 Order and ruled that its contract with Snohomish should be examined under the "public interest" standard of review upon the finding that Section 39B of the Morgan Stanley-Snohomish Confirmation Agreement explicitly restricts the parties' rights to propose changes to the contract under Sections 205 and 206 of the FPA[52]. On rehearing, Snohomish and Senator Cantwell challenge this Commission determination.

39. In particular, Snohomish argues that Section 39B of its contract with Morgan Stanley is not applicable to the instant complaint because it only addresses unilateral challenges of the contract rate, but not other terms, whereas Snohomish seeks to shorten the length of the term of the contract. We disagree. In a contract entered into pursuant to market-based rate authority, the negotiated term is intricately linked to the contract rate. The primary basis for Snohomish's complaint is the allegation that the rate in its contract

---

[48] 16 U.S.C. § 824d(e) (2000).

[49] See, e.g., State of California ex rel. Bill Lockyer v. British Columbia Power Exchange Corp., et al., 99 FERC ¶ 61,247, at 62,063 (2002).

[50] See GWF Energy, LLC, et al., 98 FERC ¶ 61,330, at 62,390 (2002).

[51] See April 11 Order at 61,191.

[52] See Rehearing Order at 62,047-48.

with Morgan Stanley is unjust and unreasonable, not that the term of the contract is unjustifiably long.[53]

40. Furthermore, even if Snohomish's contention that Section 39B applies only to challenges of the contract rate were true, the Snohomish-Morgan Stanley contract would still be subject to the "public interest" standard of review in light of our adoption of the ALJ's interpretation of Section 6.1 of the WSPP Agreement. If Section 39B were not dispositive in regard to the length of the contract, then Section 6.1 of the WSPP Agreement would apply. Section 6.1 explicitly applies to "rates, charges, classifications, service, terms, or conditions affecting the WSPP transactions" and, as we held above, it reveals the parties' intention to disallow any unilateral changes. Thus, any proposed modifications to the WSPP Agreement and contracts entered thereunder will be evaluated under the "public interest" standard of review.

41. Additionally, Senator Cantwell asserts that the Commission should not apply the "public interest" standard of review to the Snohomish-Morgan Stanley contract, but should apply the "just and reasonable" standard of review, because the Mobile-Sierra doctrine does not apply to parties in this proceeding, such as Senator Cantwell, who are not signatories to the Snohomish-Morgan Stanley contract. We cannot find any legal precedent to support this distinction. There is no Commission or court precedent that supports a finding that a non-signatory party may challenge a Mobile-Sierra contract under the "just and reasonable" standard of review, as opposed to the "public interest" standard of review.[54]

2. Whether Contract Modification is Warranted under the "Public Interest" Standard of Review

42. In their complaints, Complainants alleged that the prices in their forward bilateral contracts were the product of the California ISO and PX spot market dysfunctions. In the April 11 Order, we concluded that in the evidence presented thus far, the

[53] See Public Utility District No. 1 of Snohomish County, Washington v. American Electric Power Service Corporation, et al., 100 FERC ¶ 61,296, at 62,340 (2002) (rejecting the same contention by Snohomish in regard to the identical provision in its contract with a different seller).

[54] Carolina Power and Light Co., 69 FERC ¶ 61,078 (1994), cited by Senator Cantwell, is inapposite. It involved a Commission directive to revise a settlement agreement that had been submitted for Commission acceptance, and not, as in this case, a complaint challenging an existing market-based rate contract for the sale of power.

Complainants failed to show that the dysfunctional California ISO and PX spot markets had an adverse effect on the long-term, bilateral markets in California, Nevada and Washington. We further stated that in order to meet their burden of proof to reform these market-based contracts, Complainants would need to demonstrate that there was such an adverse effect and, if so, whether modification of any individual contract at issue is warranted.[55]

43. To this end, the Commission instructed the ALJ to consider and the parties to submit evidence on the totality of purchases and sales and the conditions present at the time the contracts were entered into. In particular, the Commission proposed the following list of evidentiary factors: (1) Complainants' overall portfolio as well as their own sales (e.g., pattern, duration, price); (2) whether Complainants' transactions were physical or financial in nature and designed to serve Complainants' load; (3) the terms, conditions and rate over the entire duration of each contract (e.g., whether the contract is front-end loaded); (4) what other alternatives were available to buyers and sellers; (5) whether at the time it was a reasonable decision to enter into these contracts (e.g., duration, scope and time period, and the participants' expectations as to the duration of dysfunctions in the California ISO and PX markets); (6) the terms and conditions of any request for proposals, and the process and procedures the complainants used to evaluate the contracts, including any changes in offered rates, terms, and conditions mandated or negotiated by the Complainants; and (7) the relation of the contract rates to the Commission's previously identified benchmark for long-term contracts. The parties were also encouraged to present evidence on: (1) the effect of the contracts on the financial health of Complainants; (2) the effect of the contracts on wholesale and retail customers; (3) the impacts contract modification may have on the nation's energy markets, including, but not limited to, impacts on investment in new generation and transmission infrastructure, and effect on confidence in competitive markets; (4) the willingness of market participants to enter into long-term contracts in the future and the prices and terms and conditions of such contracts; and (5) the potential modification of other existing energy contracts.

A. Initial Decision

44. As an initial matter, the ALJ concluded that Complainants failed to prove that the dysfunctional ISO and PX spot markets adversely affected the Western long-term bilateral markets. In particular, it was established that Complainants did not perform any

---

[55] See April 11 Order at 61,191.

analysis regarding the impact of market fundamentals on the forward prices.[56] It was also found that Complainants' witnesses who tried to do analyses only measured one factor, and they did not account for all of the changing market fundamentals which impacted forward prices.[57] Furthermore, according to the ALJ's findings, Complainants did not provide any evidence that the ISO and PX spot market prices drove the spot prices throughout the West.[58] The ALJ also found that Complainants did not perform any survey or study to determine the market participants' expectations concerning the continuation of spot market dysfunctions.[59] Complainants did not prove what role any factors, including market fundamentals, had in the development of any forward price curves.[60]

45. In addition, the ALJ also found that Complainants did not present any evidence of specific manipulation by any Respondents which impacted the forward markets generally or any contract at issue in this case specifically. It was established that Respondents' witnesses refuted the allegations that the impacts of Enron's trading strategies, withholding and exercise of market power in the ISO and PX spot markets, inflated prices in the forward markets.[61] According to the ALJ's finding, the allegations of withholding in the ISO and PX markets did not contain any specific studies proving withholding by any Respondent in any market, spot or forward.[62] Moreover, it was found that no evidence was presented that any seller actually engaged in discriminatory pricing regarding the contracts at issue in this proceeding.[63]

46. Further, the ALJ examined the totality of circumstances surrounding the contracts at issue and then considered whether the Complainants have met their burden of proof

---

[56] Initial Decision at 65,290.

[57] Id.

[58] Id.

[59] Id. at 65,289.

[60] Id. at 65,295.

[61] Id. at 65,294.

[62] Id.

[63] Id.

under the "public interest" standard. As a result, the ALJ found that substantial evidence in this case demonstrated that the contracts should not be modified or abrogated.[64]

47. In particular, it was established that the Nevada Companies' contracts were entered into pursuant to an Accelerated Procurement Strategy (APS), which was a "radical proposal" unsupported by any analysis or quantitative studies concerning the Companies' exposure in the event of the fall in prices.[65] The ALJ also found that the APS was undertaken due to the Nevada Companies' perceived need to secure "reliability at any price" and desire to buy as much power as they could before their counterparties discovered their already "precarious financial position."[66]

48. It was also found that the Nevada Companies did not pursue a mix of products, which was contrary to the recommendation contained in their Comprehensive Energy Plan (CEP) submitted to the PUCN in January 2001.[67] Instead, the Nevada Companies focused only on standardized products available in the broker markets. The ALJ determined that each of the Nevada Companies' transactions was a "brokered" transaction, i.e., it was entered into by the parties using an independent, third-party broker without Nevada Companies' knowledge of the counter party's identity.[68]

49. The ALJ also established that even though the Nevada Companies had authority to enter into forward contracts of up to three years of duration without additional regulatory approval, virtually all of their contracts at issue in this proceeding were for terms of one year or less and many of the contracts were for terms of only 90 days.[69] Moreover, it was determined that there had been long-term, structured transactions offered, but not accepted by the Nevada Companies.[70] The ALJ concluded that since the

[64] Id. at 65,298.

[65] Id. at 65,299.

[66] Id.

[67] Id.

[68] Id. at 65,273.

[69] Id.

[70] Id. at 65,302 n.357.

forward curve at the time reflected backwardation,[71] lower average prices could have been obtained by entering into longer-term contracts.[72]

50. Additionally, the ALJ found that the Nevada Companies purchased more power than necessary to cover their load requirements.[73] However, they ignored the prospect that power prices could decrease. It was also established that the Nevada Companies relied on prices reflected in broker sheets, checking price quotes and reading a few trade publications to guide their expectations about the future of energy prices.[74] As determined by the ALJ, the Nevada Companies, however, did not analyze the impact of new generation on forward prices, or the supply situation for 2002 and 2003.[75] The ALJ concluded that the purchases were not made for reliability purposes.[76]

51. The ALJ further established that the Respondents were price takers. They did not set the price, but instead were subject to the prevailing market prices.[77] The ALJ also found that the Nevada Companies were not forced to enter into any of the contracts.[78] According to the ALJ's finding, the transactions often occurred in a matter of seconds and the evidence did not show any pressure, uncertainty, hesitancy, or a lack of understanding about what Nevada Companies were purchasing.[79]

52. It was further established that Nevada Power's contracts with Mirant, Reliant, and Morgan Stanley were sleeve transactions, i.e., transactions in which a third party enters into contracts with two other parties in order to facilitate a transaction between the two

[71] Backwardation denotes the excess of spot prices over the Long Run Marginal Costs. Id. at 65,278.

[72] Id. at 65,300.

[73] Id. at 65,301.

[74] Id.

[75] Id.

[76] Id.

[77] Id. at 65,302.

[78] Id.

[79] Id.

parties. The ALJ found that Nevada Power negotiated the transaction price with another third-party seller, and the sleeving Respondents facilitated the transactions by taking on Nevada Power's credit risk. It was also determined that in return for this sleeving service, Mirant, Reliant and Morgan Stanley received no or minimal fees per megawatt traded.[80] The ALJ thus concluded that it would be unfair to require any Respondent who sleeved on behalf of the Nevada Companies to pay refunds or receive a downward price adjustment for transactions that were a service to the Nevada Companies, particularly when the Respondents cannot seek recovery from the third-party market participant who sold the Respondents power.[81]

53. It was also found that certain transactions challenged by the Nevada Companies were structured as locational basis swaps. The ALJ determined that the Nevada Companies entered into these swap transactions to effectively move power to a desired delivery point without having to secure transmission capacity and presented no evidence that these arrangements were unjust, unreasonable or otherwise improper in any way.[82]

54. As for Snohomish's complaint, the ALJ found that Snohomish profited from reselling power that it had purchased in the wholesale market during 2000 and early 2001.[83] The ALJ also concluded that Snohomish's decision to enter into the contract with Morgan Stanley was reasonable given the circumstances at the time.[84] Finally, it was also found that Snohomish had other alternatives available to it.[85]

55. In particular, it was found that after Snohomish's Board resolved to raise retail rates an average of thirty-five percent,[86] Snohomish started its bid solicitation process by issuing a Request for Proposal (RFP) containing three bid options. Under Snohomish's

---

[80] Id. at 65,319.

[81] Id.

[82] Id.

[83] Id. at 65,323.

[84] Id. at 65,303.

[85] Id.

[86] Id.

RFP, Snohomish was not required to select any of the bids submitted in response to the RFP and could reject any and all bids and terminate negotiations at any time.[87]

56. The Initial Decision gives an elaborate account of negotiations that took place between Snohomish and Morgan Stanley. In particular, the ALJ found that Morgan Stanley had to resubmit a bid twice with modified terms suggested by Snohomish.[88] It was further established that throughout the negotiations, Snohomish's goal was to keep the price of the contract to under the $125 "placeholder" established by the Snohomish Board in December 2000, long before the RFP was announced.[89] Shorter terms at market rates were available to Snohomish, but rejected. Morgan Stanley's proposal to enter into an alternative arrangement of two separate deals, one for five years (at above market prices) and another for five to seven years (at below market prices) was also rejected by Snohomish. According to the ALJ, Snohomish had a choice of passing the risk of price volatility to the seller and pay a below market rate of $105 for the first five years, even if the contract had to be for a longer term. Moreover, it was determined that Snohomish had the choice of a shorter contract at higher prices, but rejected that choice.[90] In addition, the ALJ inferred from the corroborated testimony by one of Snohomish's witnesses that Snohomish's primary goal was to get a below market rate at any term. The ALJ thus concluded that Snohomish voluntarily chose the term of its contract.[91]

57. Furthermore, it was found that the negotiations (which included amendments to the WSPP Agreement, the form of confirmation and a collateral annex to manage the parties' credit risks) took place by telephone calls and electronic mail and Snohomish was represented by counsel at all times. It was established that Snohomish dictated the deadlines to complete negotiations and several of the contract terms.[92] The ALJ also found that shortly after Snohomish entered into the contract, it touted to its customers that the Morgan Stanley and other long-term contracts "give us a lot of security against the uncertainty of market fluctuations," and that the contracts insulate the ratepayers from

---

[87] Id.

[88] Id. at 65,304.

[89] Id. at 65,303.

[90] Id. at 65,304.

[91] Id.

[92] Id.

market volatility.[93] According to the ALJ's findings, it was Snohomish's expectation that, based on its forward curve , its contract with Morgan Stanley would provide Snohomish with power at a price far below market for at least two years.[94]

58. Finally, the ALJ also found that Snohomish had several other available alternatives, such as: (1) continuing to purchase power in the spot market; (2) executing a forward contract for a term shorter than the term of the Morgan Stanley contract; (3) contracting for a share of a new generation plant or building its own generation; (4) purchasing a put option contract; and/or (5) entering into two separate agreements with a total term of nine years with one or two counterparties.[95]

59. In regard to SCWC's complaint, the ALJ found that SCWC was aware that spot market prices had risen substantially above historical levels.[96] Notwithstanding the high prices that SCWC was observing and the increased market volatility, SCWC made a decision to wait until early March 2001 to issue an RFP to replace the one-year contract it knew would expire on May 1, 2001.[97] The ALJ afforded no weight to SCWC's testimony that it had to issue an RFP at the "peak" of the energy crisis through no fault of its own and found that there is a lack of evidence of any reasons that prevented SCWC from seriously pursuing other options well before March 2001.[98] Thus, the ALJ concluded that SCWC simply chose to wait until that time before it was willing to issue an RFP and negotiate a new contract.[99]

60. It was further found that the SCWC-issued RFP was sent to the restricted list of six recipients, including Mirant. The RFP restricted bidders to terms ranging from one to seven years, indicated a preference for fixed price offers and a price in the range of

[93] Id.

[94] Id.

[95] Id.

[96] Id. at 65,305.

[97] Id.

[98] Id.

[99] Id.

$90.[100] The ALJ also determined that SCWC received three different responses with varying options, which permitted SCWC to choose the most favorable offer.[101] According to the ALJ, SCWC made no subsequent effort to seek out other offers, consult a broker, or reissue an RFP to get other proposals.[102]

61. The ALJ also found that the negotiations between Mirant and SCWC focused only on the price and there is no evidence that anyone from SCWC attempted to negotiate non-price terms during the parties' discussions from March 14 to March 16, 2001, including any specific modifications to the WSPP Agreement to permit SCWC to seek unilateral modifications to the contract.[103]

62. The ALJ also established that the $95/MWh price was substantially below the then prevailing expected future spot market prices for the remainder of 2001 through the summer of 2002.[104] According to the ALJ's findings, SCWC expected prices to drop in the fall of 2001; notwithstanding this fact, it chose to enter into this contract. The ALJ concluded that as a result, Mirant took on the market risk when it agreed to sell to SCWC at $95/MWh. The ALJ thus concluded that the savings to SCWC were front-end loaded and provided stability and price protection from volatility for SCWC; conversely, Mirant agreed to take an up-front loss in the early years of the contract, with the expectation that the losses would be made up in later years.[105]

63. In addition, the ALJ found SCWC's witness testimony concerning SCWC's expectations regarding the duration of the California crisis to be contradictory and thus not credible.[106] It was also found that SCWC had available to it and actively explored a

---

[100] Id.

[101] Id.

[102] Id.

[103] Id. at 65,306.

[104] Id.

[105] Id.

[106] Id.

variety of resource options.[107] For instance, in October 2000 (after a summer of high prices) Dynegy Inc. offered to extend its contract with SCWC, based on a "blend and extend" rate of between $46.50/MWh to $54.50/MWh, depending on the term of the extension. Moreover, the ALJ found that SCWC and Enron discussed in November 2000 a contract for differences by which SCWC could hedge costs at $55.73/MWh.[108] Also, SCWC could have chosen to rely on the spot market. Additionally, SCWC could have entered into a shorter term block forward contract for the Summer of 2001. It was also established that SCWC had a variety of responses to its RFP, from which it could have chosen a proposal other than Mirant's, including contracts for less than five years.[109]

64. The ALJ further found that contract modification will harm credit and investor confidence by altering the perception of a formerly stable cash flow into an undependable, risky cash flow.[110] The ALJ also determined that modification of the contracts would cause market participants to suffer adverse credit and financial consequences, which could lead to hesitancy to enter into forward contracts, because of the uncertainty of the enforceability of such contracts.[111] This, it was found, could erode investor confidence and willingness to invest in merchant energy projects, which, in turn, could have an adverse effect on infrastructure development, especially at a time when Western markets need new generation and transmission. Additionally, the ALJ established that contract modification in this case could result in increased prices to compensate for increased risks.[112]

65. Additionally, the ALJ concluded that modification of these long-term contracts may preclude sellers from ever making a profit on the transaction.[113] The ALJ explained that the sellers in this case had to purchase power in the open market at prevailing market rates because they did not own generation to serve the market in question. Respondents

---

[107] Id. at 65,307.

[108] Id.

[109] Id.

[110] Id. at 65,308.

[111] Id.

[112] Id.

[113] Id. at 65,306 and 65,309.

thus covered their forward contracts by purchasing hedges, or forward contracts of their own when the overall balance of their portfolios demanded it.[114] The ALJ further found that Respondents were paying prices in the same price range as those reflected in the contracts in dispute due to the fact that they were buying the hedges in the same market as they were selling to the Complainants in this case. Additionally, the ALJ determined that to the extent a seller was hedging a long-term contract, such as Snohomish's or SCWC's, which have prices below market up-front, the seller likely hedged the contract with high-cost power up-front for which it will not be reimbursed until later years. Consequently, the ALJ concluded that the contract reformation would deprive Respondents of the benefits of their bargains, since they have already incurred costs associated with these contracts, either through hedging the contracts or delivery of the power.[115]

66. Furthermore, the ALJ found that the Complainants did not offer any evidence to overcome their high burden under the "public interest" standard.[116] Specifically, it was established that evidence in the record does not show any discriminatory treatment of the Nevada Companies by Respondents. All contracts were standard products arranged through independent third-party brokers at or below prevailing market prices.[117]

67. The ALJ also found that the contracts in question do not impose an "excessive burden" on Complainants' customers.[118] It was determined that the Nevada Companies' projections assumed that they would file for a rate decrease in excess of 20 percent in November 2002 in their base tariff energy rate cases. In addition, the ALJ found that the Nevada Companies' cash-flow projections assume that full payment will be made to all Respondents, except Enron; however, even if they are required to pay Enron, any rate increase would be no more than five percent. Moreover, according to the ALJ, the Nevada Companies' cash flow projections show positive cash balances for each of the next several years, even assuming dividend payments and scheduled debt repayments,

[114] Id. at 65,309.

[115] Id.

[116] Id. at 65,310.

[117] Id. at 65,320.

[118] Id.

which indicates that the Nevada Companies are financially healthy companies with a sufficient equity ratio to make such payments.[119]

68. Further, the ALJ found no evidence that Complainants' ability to serve their customers is threatened. Specifically, according to the ALJ, the Nevada Companies' allegations of financial distress are not supported by record evidence. The ALJ also held that the drop in the Nevada Companies' credit rating to below investment grade occurred only after issuance of the PUCN's order and thus was not the result of the contracts at issue.[120]

69. The ALJ also found that SCWC did not adduce any evidence of financial hardships either for itself or its ratepayers.[121] In accordance with the terms of the retail rate settlement reached with the CPUC, there is no rate increase at all for ratepayers who are permanent residents of SCWC's service territory and other ratepayers will face an average monthly electric bill of $35.13.[122]

70. The ALJ further found that the record does not establish that SCWC's ability to continue doing business is in any way threatened if the contract is not reformed or that the contract has a negative impact on its financial health or the financial health of its shareholders.[123] According to the ALJ's findings, the contract commenced in April, but SCWC did not need it until May when it bought the power from Mirant at $95/MWh, and sold it back to Mirant at $173/MWh, thus realizing a healthy profit.[124]

71. The ALJ also found the price of the SCWC contract to be reasonable, especially in light of the fact that Mirant, as a power marketer, had to purchase power in the market in order to resell it to SCWC. Moreover, according to the ALJ, the SCWC contract provides significant benefits, including the fact that Mirant took on the risk of supplying

---

[119] Id.

[120] Id. at 65,321.

[121] Id.

[122] Id.

[123] Id.

[124] Id.

SCWC with a 15-MW "odd lot" sale, whereas energy is typically traded in 25-MW blocks.[125]

72. The ALJ also noted the fact that Mirant will be directly harmed if the SCWC contract is modified. According to the record, Mirant lost a substantial amount of money on the SCWC contract from April 1 to December 31, 2001 and would be able to earn any profit margin on the SCWC contract only if the contract price is honored through the term.[126]

73. As for Snohomish's contract, the ALJ concluded that Snohomish failed to meet its burden of proof because the record did not have any evidence regarding the impact of the contract upon ratepayers. The ALJ gave no weight to the testimony from six Snohomish ratepayers describing how rate increases impacted them because the rate increase preceded the contract at issue.[127] The ALJ also found irrelevant Snohomish's claim of unequal bargaining power.[128] Additionally, Snohomish's allegation regarding the discriminatory nature of the challenged contract was also found to be without merit. The ALJ explained that the Mobile-Sierra doctrine had been applied to allegations of discriminatory or preferential treatment to the detriment of other purchasers who were not parties to the contract, whereas Snohomish's claim was based on the fact that other parties who contracted with Morgan Stanley had other contract terms.[129]

74. Additionally, it was established that Snohomish derived a net profit of over $17 million in the first five months of 2001 by selling power at an average price of $134 MWh at the same time when it was purchasing power from Morgan Stanley at $105/MWh.[130] The ALJ also found that the Snohomish-Morgan Stanley contract was no more than five percent of Snohomish's current portfolio costs and had a small impact on

[125] Id.

[126] Id. at 65,322.

[127] Id. at 65,311 and 65,322.

[128] Id. at 65,322.

[129] Id. at 65,322-33.

[130] Id.

rates.[131] It was determined that the contract at issue was only three percent of Snohomish's load and resulted in an eight percent increase over existing rates in 2001, while other contracts accounted for an increase of fifty-one percent over existing rates.[132]

75. Based on the above, the ALJ concluded that the Complainants failed to meet their burden of proof under the"public interest" standard and that even under the"just and reasonable" standard their complaints would not suffice.[133]

76. In addition, the ALJ addressed Morgan Stanley, Reliant, El Paso and Enron's contention that their contracts with the Nevada Companies had been terminated on the ground that the Nevada Companies failed to satisfy the credit requirements of the WSPP Agreement. The ALJ ruled that the Commission retained jurisdiction over the contracts which had been set for hearing and subsequently terminated and that the contract termination issue would be more pertinent to remedies if the Commission found that the contracts should be modified.[134]

B. Exceptions

77. Complainants assert that the ALJ erroneously found that the dysfunctional California ISO and PX spot markets did not adversely affect the Western long-term bilateral market. In Nevada Companies' opinion, the ALJ erred in considering whether and why the California ISO and PX spot markets were dysfunctional, because these issues have already been determined by the Commission and were not set for hearing. Nevada Power also asserts that the ALJ's erroneous determination that the short-term energy markets were not dysfunctional during most of the relevant period influenced, in turn, the ALJ's erroneous determination that the spot markets could not have adversely affected prices in the forward markets.

78. SCWC adds that spot and forward market prices were moving together and were increasing when it executed the Mirant contract (in March 2001), and that these price increases were attributable to market dysfunction or market power, not changes in market fundamentals, as the ALJ concluded. The PUCN asserts that the relevant markets were

---

[131] Id.

[132] Id.

[133] Id. at 65,325.

[134] Id.

subject to market manipulation and other forms of anti-competitive behavior, and that these conditions led to the market dysfunctions, which resulted in excessive forward contract prices.

79. Complainants further allege that the ALJ erred in concluding that contract modification is not warranted and that the Complainants failed to meet the "public interest" standard of review. The PUCN argues that modifying the excessive contract prices at issue would not be contrary to the public interest, given the harm that these costs pose to the Nevada Companies, their ratepayers, and the market as a whole. SCWC asserts that the Mirant contract constitutes the major part of SCWC's wholesale energy purchases, and that the costs under this contract over and above the $74/MWh benchmark established by the Commission warrants contract revision, even under the "public interest" standard.

80. Respondents and Staff assert that the ALJ correctly determined that Complainants failed to demonstrate that dysfunctional ISO and PX spot markets adversely affected the long-term bilateral markets. They further argue that the ALJ properly determined that market fundamentals were a significant contributor to high prices in the spot markets during the relevant period. Mirant adds that, contrary to SCWC's assertion, the ALJ's findings are fully consistent with prior Commission findings that the ISO and PX spot markets were impacted both by dysfunctions, and also by dramatic changes in market fundamentals and competitive market conditions. Morgan Stanley argues that although prior Commission orders found that the spot and forward markets are linked, the Commission did not determine whether dysfunctions that existed solely in the centralized California spot markets had any effect on the forward markets in California and the rest of the West.

81. Respondents and Staff argue that the ALJ properly determined that any adverse effect of the alleged dysfunctions in the ISO and PX spot markets on the Western bilateral forward market was not of a magnitude warranting modification of the challenged contract prices. In line with the Initial Decision, Respondents argue that the testimony offered by Complainants on this point was not entitled to substantial weight. Respondents assert that Complainants' witnesses assumed the conclusions they set out to prove, failed to consider relevant input costs and other factors in their analyses (such as long-run marginal costs, emissions costs, and scarcity rents), or simply presented irrelevant testimony.

82. In addition, Respondents and Staff asserts that, contrary to the Nevada Companies' assertion, it was reasonable for the ALJ to consider Complainants' purchasing practices in considering whether modification of the contracts is warranted. Staff states that in

light of the directives in the April 11 Order, the rationale underlying the Nevada Companies' purchasing practices, and the extent to which they left the Nevada Companies open to unnecessary risks, was a legitimate and relevant subject for inquiry.

83. Respondents also argue that the ALJ correctly concluded that Complainants failed to meet their burden of proof under the "public interest" standard. With regard to the Nevada Companies' contract, Allegheny and Staff assert that the Nevada Companies failed each prong of the Mobile-Sierra test. Specifically, Allegheny states that the Nevada Companies never alleged, or presented any evidence showing, that the challenged contract prices were unduly discriminatory, resulted in an imposition of an "excessive burden" on other customers, or threatened their ability to service their customers. Allegheny asserts that the Nevada Companies made only generalized assertions, without factual support.

84. With regard to SCWC, Staff agrees with the ALJ that there is a lack of substantial evidence showing that the financial health of SCWC has been negatively impacted by the subject contract, particularly in light of a recent settlement approved by the CPUC. Staff asserts that while SCWC contests most of the ALJ's findings, it denies virtually none of the facts adduced by the ALJ and offers no probative evidence that the contract with Mirant produces an excessive burden.

85. As for Snohomish's complaint, Morgan Stanley and Staff argue that Snohomish failed to demonstrate that the term of its contract with Morgan Stanley might impair its financial ability to continue service. On the contrary, Morgan Stanley contends that the ALJ correctly determined that Snohomish's 2001 Financial Statement shows that its financial condition is strong. In any case, Morgan Stanley argues that the ALJ rightly determined that there are complicating factors in any Commission effort to apply the excessive burden test to mostly retail customers of complainants like Snohomish, since the Commission has no jurisdiction over the rates charged by a buyer, such as Snohomish, to its retail customers.

86. In addition, Enron challenges the ALJ's finding that further examination of the Enron contracts with the Nevada Companies in this case may be necessary pending the outcome of two other cases involving Enron now before the Commission.[135] Enron argues that issues related to the Enron contracts were litigated to finality in this proceeding.

[135] The two referenced cases are Public Utilities Comm'n of the State of California v. El Paso Natural Gas Co., Docket No. RP00-241-000 and El Paso Electric Co., Docket No. EL02-113-000.

87. In response to Enron, SCWC, Nevada Companies, and Staff note that the April 11 Order specifically stated that issues relating to Respondents' exercise of market power or market manipulation were excluded from the proceeding, because that nature of inquiry was considered duplicative of matters pending before the Commission in Fact-Finding Investigation into Possible Manipulation of Electric and Natural Gas Prices, Docket No. PA02-2-000. SCWC and Nevada Companies further assert that pursuant to the Commission's admonishment, the ALJ prohibited parties from introducing evidence to demonstrate that any of the terms and conditions in the contracts at issue resulted from the exercise of market power or market manipulation. Accordingly, SCWC and Nevada Companies dispute Enron's assertion that, if the Commission upholds the Initial Decision, Complainants are barred by the operation of res judicata and collateral estoppel from seeking any further review of those contracts based on the possible market manipulation by Respondents.

88. SCWC further asserts that if the Commission upholds the ALJ's conclusion that the public interest standard applies to the contracts at issue, the Commission should not reach a final decision on the merits of SCWC's complaint until the investigation in Docket No. PA02-2-000 is complete and SCWC is afforded an opportunity to demonstrate that market abuses and manipulation adversely affected the Mirant contract.

89. Staff, however, argues that Complainants were not required to demonstrate market power or manipulation to prevail and that therefore, it is unnecessary to reopen the record in this proceeding unless the investigation in Docket No. PA02-2-000 suggests it is so warranted.

90. Nevada Companies and Staff also urge rejection of Enron's alternative request that the Commission find that its unilateral termination of its contracts with Nevada Companies extinguished the Commission's jurisdiction over the contracts from the moment of termination. Nevada Companies state that the contract termination issue has never been set for hearing by the Commission and the ALJ never reached a conclusion on Enron's claim that it had terminated its contracts with Nevada Companies. Even if Enron had terminated the contracts, Nevada Companies and Staff argue that unilateral termination would not extinguish the Commission's jurisdiction over the issue of whether the contract prices are just and reasonable under Section 206. Staff adds that Enron's suggestion that Commission jurisdiction is predicated on physical delivery is misguided. Staff states that the history of Commission actions, which has been affirmed by the courts, shows that cancellation of a plant before completion, or the cancellation of deliveries, does not end the Commission's jurisdiction over a facility or contract.

C. Oral Argument

91. At the April 23 oral argument, the Complainants argued that in light of the market manipulation findings made in the Staff Report released on March 26, 2003, additional grounds exist to abrogate the contracts in question. In particular, Complainants argued that the Mobile-Sierra "public interest" standard has been met because the Staff investigation revealed that sellers engaged in the exercise of market power and /or market manipulation which significantly affected the forward market at the time the contracts were negotiated. Nevada Companies further stated that the contracts should not be upheld because they were obtained by fraud, misrepresentation and bad faith. Nevada Companies explained that Respondents were unlawfully manipulating market prices, thereby engaging in fraud and deception in violation of their market-based rate tariffs.

92. Furthermore, Nevada Companies requested that at the very least the Commission remand this case to the ALJ to allow Complainants to introduce evidence on market manipulation, which they were precluded from submitting by the order setting the complaints for hearing. Nevada Companies added that until on-going and future investigations of the Respondents' conduct during the relevant period of time are completed, the Commission cannot determine whether contract reformation is in the public interest.

93. Respondents argued that the Staff Report does not purport to show the effect of the California spot market dysfunctions on forward prices in the West, but rather represents a correlation analysis. In Respondents' opinion, the Staff Report does not reveal new facts warranting a remand to the ALJ. Respondents stated that the market manipulation findings in the Staff Report are irrelevant in this case, since the market manipulation factor could only be relevant in determining the cause of the spot market dysfunctions. The dysfunctional nature of the California spot market was presumed from the very beginning and all that Complainants were required to show is the causal connection between those dysfunctions and forward market prices, which, in Respondents' opinion, Complainants failed to do.

D. Commission Determination

94. In deciding whether the Complainants have met their burden of proof under the "public interest" standard of review to justify contract modification in these cases, we rely on the evidentiary record developed in this proceeding and also take into consideration the findings of the Staff Report and evidence submitted in the 100-Day Discovery Proceeding. The Staff Report found that spot market distortions flowed

through to forward power prices, particularly those for contracts of a short-term nature, i.e., one to two years time to delivery. In addition, the Staff Report and the 100-Day Discovery Proceeding suggest that the California ISO and PX markets were subjected to market manipulation and gaming. The Staff Report conclusions and the 100-Day Discovery Proceeding documents are being contested in "show cause" proceedings involving allegations and/or findings of manipulation in the spot markets. However, even if we were to assume that these allegations and/or findings were true, they would not be determinative of the issues in the instant proceeding. The Commission has already concluded that the California ISO and PX spot markets were dysfunctional during the relevant period and that rates in those markets were unjust and unreasonable.[136] Evidence of market manipulation merely suggests yet another cause of the spot market dysfunctions and the unjust and unreasonable rates in the spot markets. However, a finding that the unjust and unreasonable spot market prices caused forward bilateral prices to be unjust and unreasonable would be relevant to contract modification only where there is a "just and reasonable" standard of review.[137] As we have previously concluded, the contracts at issue in this proceeding do not provide for such a standard but rather evidence an intent that the contracts may be changed only pursuant to the "public interest" standard of review. Under the "public interest" standard, to justify contract modification it is not enough to show that forward prices became unjust and unreasonable due to the impact of spot market dysfunctions; it must be shown that the rates, terms, and conditions are contrary to the public interest.[138] As fully discussed below, we conclude that the Complainants failed to make such a showing.

95. As determined by the ALJ and affirmed in this order, Complainants in this proceeding must meet the "public interest" standard in order to justify the requested contract modification. Based on the record, we conclude that the Complainants have failed to demonstrate that any of the three prongs announced in the Sierra case has been met or that any other factor introduced into evidence warrants a finding that any of the contracts is contrary to the public interest and should be modified.

---

[136] See, e.g., San Diego Gas & Electric Co. v. Sellers and Ancillary Serv., 93 FERC ¶ 61,121, at 61,359-60 and 61,372 (2000); order on reh'g and clarification, 97 FERC ¶ 61,275, at 62,225 (2001).

[137] This conclusion is consistent with the Staff Report recommendation that, only for contracts subject to the "just and reasonable" standard of review, the Commission should send the Staff Report findings on the influence of the spot prices on forward prices to the ALJs to use as they see fit to resolve complaints. See Staff Report at V-19.

[138] See, e.g., FPC v. Sierra Pacific Power Co., 350 U.S. 348, 354-5 (1956).

Sierra Three-Prong Test

96. We find that there is no credible record evidence that the contracts at issue are placing the Complainants in financial distress so as to threaten their ability to continue service or that other customers will bear an excessive burden as a result of upholding the challenged contracts. In addition, there is no evidence that the contracts terms are unduly discriminatory.

97. The record demonstrates that the Nevada Companies' cash flow projections show positive cash balances for each of the next several years, even assuming dividend payments and scheduled debt repayments.[139] The Nevada Companies' cash flow projections indicate that they continue to have adequate access to capital markets.[140] All that the Nevada Companies offered in support of their position are unsupported assertions of financial hardship. The record shows that the Nevada Companies' financial condition was not caused by the contracts at issue here. By admission of Nevada Companies' own witness, the Nevada Companies were in a precarious financial position by November 2000, well before the majority of the challenged contracts were executed.[141] Any additional financial distress by the Nevada Companies resulted from the PUCN's decision disallowing recovery of costs associated with contracts that are not at issue in this proceeding.[142] The drop in the Nevada Companies' credit rating also occurred in response to this PUCN decision.[143]

98. Nevada Companies failed to show that the contract terms at issue impose an excessive burden on their customers. The record shows that in November 2002, Nevada Companies projected rate decreases of approximately 20 percent for retail service commencing June 1 and August 1, 2003.[144] According to Nevada Companies' own

---

[139] Ex. CES-18, CES-19, and CES-20.

[140] Tr. at 2494:1-5 (Shiffel); Ex. CES-20 at ¶ ¶ 32-33, 36, and 42.

[141] Ex. NPC-8 at 3:18.

[142] Ex. CES-2 at 26-27; Tr. at 2336 and 2676.

[143] Ex. CES-2 at 23:7-8.

[144] Ex. CES-20 at ¶ ¶ 5, 9-10; see also, Ex. CES-17 at 1-2.

witness, in the event that Nevada Companies are required to pay all the Respondents, including Enron, the resulting rate increase would be no more than 5 percent.[145]

99. As for SCWC , there is no evidence that the challenged contract placed SCWC in financial distress threatening its ability to continue service. [146] In fact, SCWC realized a profit when it sold power purchased under the SCWC-Mirant agreement back to Mirant at a higher price.[147] Also, by entering into the contract with Mirant, SCWC avoided the risk of price volatility and achieved rate certainty.[148] The savings to SCWC resulting from its forward contracting and marketing strategy amounted to $13.26 million.[149] Similarly to Nevada Companies, SCWC offered no evidence showing that the challenged contracts impose an excessive burden on its customers. The record evidence establishes that there was no rate increase for SCWC's ratepayers who are permanent residents of SCWC's service territory pursuant to the terms of the settlement between SCWC and CPUC.[150] Under the terms of the settlement, the other group of SCWC's ratepayers, owners of second homes in SCWC's service area, were to face an average monthly electric bill of $ 35.13.[151]

100. The record also demonstrates that Snohomish presented no evidence that its contract with Morgan Stanley adversely affected Snohomish or its ratepayers. The Snohomish-Morgan Stanley contract is no more than five percent of Snohomish's portfolio costs[152] and constitutes only three percent of Snohomish's load, resulting in an eight percent increase over 2001 rates, while other contracts account for rate increase of

[145] Tr. at 2545:15-16.

[146] Tr. at 2933:22-2934:1.

[147] SCWC bought the power from Mirant at $95/MWh and sold it back to Mirant at $173/MWh. Tr. 2907-08.

[148] Tr. at 2943-44.

[149] Ex. SCW-1 at 11:1-14.

[150] Tr. at 2934:8:16.

[151] Tr. at 2933:22-2934:1.

[152] Tr. at 1661.

fifty-one percent.[153] Moreover, Snohomish's rate increase occurred prior to Snohomish's negotiating its contract with Morgan Stanley, and prior to issuing the RFP for the power purchase in question.[154]

101. Furthermore, Complainants have failed to present evidence showing that the challenged contracts are unduly discriminatory. Only Snohomish alleged that its contract with Morgan Stanley is discriminatory because other parties who contracted with Morgan Stanley have other terms. This is not the type of discrimination contemplated by the Mobile-Sierra doctrine. Other terms in other contracts are not relevant to the determination that the contract at issue in this case is discriminatory. In the past, the Mobile-Sierra doctrine has been applied to allegations of discriminatory or preferential treatment to the detriment of other purchasers who are not parties to the contract.[155] No such showing has been made by Complainants.

Evidence on Totality of Circumstances

102. In addition to the evidence on the effects of the challenged contracts on the parties and Complainants' customers, the ALJ has developed an extensive evidentiary record on the totality of circumstances preceding and following the execution of the contracts at issue. Specifically, the record shows that the Nevada Companies' contracts were standard products arranged through independent third-party brokers [156] and, consequently, the Respondents were price takers.[157] It also appears from the record that the Nevada Companies were trying to buy as much power as they could before sellers

[153] Staff IB at 55; Tr. 1661-62 and 1770.

[154] On December 13, 2000, Snohomish's Board resolved to raise retail rates an average of thirty-five percent, which allowed Snohomish to purchase up to 100 MW of power at a melded cost of up to $125/MWh. Ex. MSC-116 at 910; SNO-1 at 4:195:2; Tr. at 1723 and 1724.

[155] See Papago Tribal Authority v. FERC, 723 F.2d 950, 953 n. 4 (D.C. Cir. 1983).

[156] Tr. at 2252:12-17; Ex. CES-1 at 3:15-27; AEP-1 at 3:21-4:16; EPME-22 at 18:6-14; MSC-21 at 8:19-9:8; RES-1 at 4:14-17.

[157] Ex. S-1 at 28:14-16; CES-1 at 4:2-15; EPME-22 at 19:7-8.

discovered their already precarious financial position.[158] To this end, the Nevada Companies abandoned their usual practice of issuing monthly RFPs to procure power[159] and employed a rather aggressive procurement strategy.[160] As a result, the Nevada Companies purchased more power than was necessary to serve their native load.[161] In fact, the Nevada Companies doubled their wholesale power purchases from the previous year, buying in excess of their own sales to retail customers, and selling more than four times as much wholesale power as they did in 2000.[162]

103. Additionally, the Nevada Companies failed to hedge for the possible risk that spot market prices might fall,[163] and did not pursue a mix of products to reduce risks associated with market volatility through portfolio diversification. Contrary to the recommendations in their Comprehensive Energy Plan filed with PUCN in January 2001,[164] Nevada Companies bought standardized, fixed-price products.[165] In fact, Nevada Companies rejected longer-term transactions that were offered. The evidence establishes that the Nevada Companies considered two Calpine proposals at prices substantially lower than the challenged contract rate.[166] Nevada Power also concurrently considered a ten-year proposal from Duke at a similarly lower price.[167] The Nevada Companies, however, did not pursue these options.

---

[158] Ex. CES-2 at 22:16-24:3; Tr. at 2273:10-2274:16.

[159] Ex. CES-2 at 18; CES-8; Ex. CES-39; S-6 at 16-17; Tr. 2328, 2581-83, and 2614-15.

[160] Ex. CES-2 at 18:12-13; Tr. at 2655:22-2656:2; Ex. CES-2 at 15:8; Tr. at 2629:24-2630:1.

[161] Ex. S-6 at 28:15-29:2.

[162] Ex. EPME-18.

[163] Tr. at 2583-86; 2596-97.

[164] Ex. CES-2 at 20:18-21:7 and CES-9 at 17.

[165] Tr. at 2336:23-2337:1.

[166] Ex. CES-35.

[167] Ex. CES-34; CES-35; Tr. at 2573:10; 2576:13-15.

104. Furthermore, the record demonstrates that the Nevada Companies made wholesale purchases of firm power from thirty-nine separate providers in 2000 and 2001, and Sierra Pacific reported purchases from forty-five to forty-seven separate providers in the same time frame.[168] Thus, considering the number of sellers available, it can be reasonably concluded that Complainants had choices, i.e., they were free to reject offers and turn to other suppliers.

105. As for the Snohomish-Morgan Stanley contract, the record establishes that the execution of this contract was preceded by extensive bid solicitation process and negotiations of the terms of the contract. Snohomish issued an RFP to 17 suppliers and in response received five bids, including Morgan Stanley's.[169] In fact, Snohomish required Morgan Stanley to submit its bid twice with modified terms suggested by Snohomish.[170] The record is also quite clear that Snohomish voluntarily chose the length of its contract that it now challenges. Shorter terms at lower rates were available to Snohomish but were rejected.[171] In addition, the price Snohomish negotiated for its contract with Morgan Stanley is substantially lower than the "placeholder" price of $125/MWh authorized by Snohomish's Board.[172]

106. Moreover, Snohomish made a profit from reselling the power it purchased from Morgan Stanley under the challenged contract. During the first five months of 2001, Snohomish sold power for a net profit of $17 million, at an average price of $134/MWh,[173] while at the same time buying power from Morgan Stanley for $105/MWh.

107. In regard to the SCWC-Mirant contract, the record demonstrates that it was SCWC's choice to wait until March 2001 when the energy prices were at their peak to start a bid solicitation process to replace its contract with Dynegy Inc. that was to expire

[168] Ex. RES-12 at 2.

[169] Ex. SNO-4 at 5:6-8; Ex. SNO-5. Tr. at 1796:1-15.

[170] Tr. at 1743:20-1744:5; 1752-53; 3984-85; Ex. MSC-8 at 10.

[171] Tr. at 1586-87, 1592; 1758, 1776.

[172] Staff IB at 55; Tr. at 1793.

[173] Tr. at 2405:1-2410:5 and 2408-09.

in May 2001.[174] SCWC's issued RFP indicated a preference for fixed price offers for terms ranging from one to seven years at a price within the range of $90/MWh.[175] Despite the restrictive nature of the bid solicitation process employed by SCWC,[176] it received three different responses to its proposal with varying options.[177] By SCWC's own admission, at the time of contract execution, it expected the prices to drop;[178] however, such expectations did not prevent it from entering into the challenged contract. Moreover, the rate agreed upon in the SCWC-Mirant contract was lower than the expected future spot market price.[179] SCWC recognized in its CPUC testimony that a 15 MW block of energy should carry "a slight pricing premium"[180] because energy is typically traded in 25 MW blocks. Moreover, SCWC realized a profit by buying the power from Mirant at $95/MWh, and selling it back to Mirant at $173/MWh,[181] whereas Mirant lost a substantial amount of money on the SCWC contract from April 1 to December 31, 2001.[182]

Conclusion

108. Based on the above, we conclude that the contracts at issue were the result of choices voluntarily made by the Complainants and to the extent the Complainants left themselves open to unnecessary risks, it was also their choice. The record also establishes that the Complainants had better alternatives and were not compelled to enter into the contracts at issue here. For example, the Nevada Companies could have pursued a more balanced purchasing strategy, that is, instead of buying standard products with

---

[174] Ex. SCW-1 at 12:5-10.

[175] Tr. at 2900-02 and 2903; Ex. MAEM-2 at 13; MAEM-9; Tr. 2904-5. Tr. at 2901:1-4; 2903:3-7; Ex. SCW-4 at 12.

[176] Tr. at 2893:19-2894:20 and 2897:8-18; Ex. SCW-1 at 17:18.

[177] Tr. at 2894:21-24; 2944:10-17.

[178] Tr. at 2927:11-2928:1.

[179] Ex. MAEM-2 at 13:24-28 & 20:8-9; SCWC-4 at 4.

[180] Ex. MAEM-30 at JAD-10-11.

[181] Tr. at 2907-08.

[182] Ex. MAEM-16 at 32:14-16.

three to twelve months to delivery, Nevada Companies could have pursued a diversified portfolio of contracts of different length arranged through the RFP process, as well as independent brokers. Snohomish had an option of executing a contract for a shorter term than its contract with Morgan Stanley or entering into two separate agreements with a total term of the challenged contract. SCWC also had available to it and explored a variety of resource options. For example, the record demonstrates that it turned down the proposal by Dynegy Inc. to renew their existing contract at a rate substantially lower than the contract rate in question.[183]

109. Finally, there is nothing in the record before the ALJ, in the Staff Final Report, or in the 100-Day Discovery Proceeding evidence to support a finding that there was market manipulation specific to the long-term contracts at issue here.

110. Therefore, based on the record, it appears that the Complainants' only basis for contract modification is their dissatisfaction with the bargain. Commission and court precedent clearly establish that allegations that contracts have become uneconomic by the passage of time do not render them contrary to the public interest under the FPA.[184] The record clearly indicates that the challenged transactions were the result of Complainants' voluntary choices. Therefore, because there is no evidence of unfairness, bad faith, or duress in the original negotiations, the Complainants are not entitled to change their bargains.[185]

111. For these reasons, we affirm the ALJ's ruling and find that the Complainants have failed to meet their burden of proof under the "public interest" standard and contract modification in this case is thus not warranted. Accordingly, we deny the exceptions.

112. In addition, we will address Enron's contention that the Commission determination in this case should preclude further challenges to its contracts with Nevada Power. In this order, we base our decision on the record in this proceeding and will not prejudge the Commission determination to be made in another proceeding involving

---

[183] Ex. MAEM-16 at 21:6-22:2.

[184] See Potomac Elec. Power Co. v. FERC, 210 F.3d 403, 409 (D.C. Cir. 2000) (citing Soyland Power Coop. Inc. v. Central Illinois Pub. Serv. Co., 51 FERC ¶ 61,004, at 61,013 (1990). See also Papago, 723 F.2d at 953. Sierra, 350 U.S. at 354-355.

[185] See Potomac Electric Power Company v. FERC, 210 F.3d 403, 410 (D.C. Cir. 2000).

Enron based on the record in that proceeding.

3. Miscellaneous Issues

113. Other issues litigated at the hearing were: (1) whether the Collateral Annex of the Snohomish-Morgan Stanley contract is contrary to the public interest; and (2) whether Merrill Lynch Capital Services (Merrill Lynch) or Allegheny was the real party in interest in the transactions identified in the Nevada Power's complaint against Allegheny. We address these issues below, as well as certain motions filed by Snohomish and SCWC.

A. Collateral Annex

114. Snohomish requests that the Commission either immediately terminate or substantially reform the Collateral Annex. In connection with this, Snohomish argues that the "just and reasonable" standard, rather than the "public interest" standard, applies to the evaluation of the Collateral Annex.

115. The ALJ found that by virtue of Section 35 of the WSPP Agreement,[186] the Collateral Annex is part of the WSPP Agreement and thus is governed by Section 6.1, which demonstrates the intent of the parties to disallow unilateral filings. The ALJ, therefore, concluded that the Collateral Annex is also subject to the "public interest" standard and thus will not be reformed.[187]

116. On exceptions, Snohomish and Staff assert as error the ALJ's determination regarding the Collateral Annex. Staff argues that the "public interest" standard does not apply in this case because the Commission never reviewed the amended Collateral Annex provision included in the Morgan Stanley-Snohomish contract, thus it has never been determined to be just and reasonable. For this same reason, Staff asserts that if the

---

[186] Section 35 of the WSPP Agreement provides in pertinent part: ". . . that all transactions, together with this Agreement and the related Confirmation Agreement(s) form a single, integrated agreement, and agreements and transactions are entered into in reliance on the fact that the agreements and each transaction form a single agreement between the Parties.@

[187] Initial Decision at 65,313-15.

"public interest" standard is to be applied in this case, the Commission's more flexible standard is warranted.

117. Staff further asserts that because Section 39B of the contract limits the parties' rights to seek unilateral changes to "rates," it must be concluded that the parties did not intend to prohibit unilateral changes to such non-rate provisions as the Collateral Annex. Staff also argues that modification is warranted because the Collateral Annex, by making Morgan Stanley the sole Valuation Agent, unduly favors Morgan Stanley at the expense of Snohomish.

118. Morgan Stanley states the Collateral Annex should not be subject to a modified, or "flexible," "public interest" standard. Morgan Stanley maintains that, consistent with the ALJ's finding, the WSPP Agreement, Confirmation Agreement, Attachment A, and the Collateral Annex form a single, integrated document, which is wholly subject to the Mobile-Sierra standard of review. Morgan Stanley states that although the Commission has at times expressed an intent to apply a standard that is more flexible than the "public interest" standard, that has only occurred under limited circumstances (such as when the subject contract is between affiliates and not the result of an arm's length negotiation) not present here.[188]

119. We affirm the ALJ's ruling. We find that the WSPP Agreement, Collateral Annex, Confirmation Agreement and Attachment A form a single, integrated agreement, which, as we held above, is to be reviewed under the "public interest" standard. Consistent with our conclusions above, Snohomish has failed to justify modification of the Collateral Annex.

B. Real Party in Interest

120. Allegheny asserts that it is not the right respondent in this case because the contracts submitted with Nevada Power's complaint list Merrill Lynch as the other counter party to the contracts. Initially, these contracts were executed by Merrill Lynch. Subsequently, Merrill Lynch and Allegheny entered into the Asset Contribution and Purchase Agreement (APA) pursuant to which Merrill Lynch transferred all of its rights, title, and interest in certain wholesale power sales agreements and associated books and

---

[188] Morgan Stanley cites to Northeast Utilities Serv. Co., 66 FERC ¶ 61,3332 at 62,087-87 (1994).

records to Allegheny.[189] Allegheny, however, argues that the Nevada Power contracts were not assigned to Allegheny because Nevada Power never provided its written consent to the assignment, as required by Section 14 of the WSPP Agreement.[190]

121. In response, Nevada Power argues that the assignment of the contracts in question occurred pursuant to Section 14 of the WSPP Agreement because the transfer to Allegheny was to a successor in operation with comparable or higher creditworthiness.

122. Allegheny argues that the parties' dealings after closing of the APA demonstrate that Allegheny is not the successor in operation to Merrill Lynch. In particular, Allegheny states that after the sale of assets, Merrill Lynch retained its status of a seller with respect to the contracts at issue and entered into the hedge contracts with Allegheny, whereby Allegheny would financially benefit from the Nevada Power contracts via a back-to-back hedge agreement. In addition, according to Allegheny, Nevada Power conducted business as though Merrill Lynch were the counterparty, as evidenced by Merrill Lynch's sending invoices to Nevada Power, which then made payment directly to Merrill Lynch. Allegheny further explains that Merrill Lynch's representations in the Section 203 application to the Commission for authorization of transfer of its jurisdictional facilities to Allegheny does not contradict Allegheny's position that no contract assignment has taken place. Allegheny contends that the parties intended to assign the Nevada Power contracts to Allegheny upon the closing of the APA, but then abandoned this intention when Nevada Power refused to sign a collateral agreement with Allegheny.

123. The ALJ found that the contracts were not assigned pursuant to the WSPP Agreement because Allegheny is not "a successor in operation" to Merrill Lynch. After closing of the APA, Merrill Lynch continued its wholesale electricity trading operation on a reduced basis. The ALJ further found that no assignment of the Nevada Power

---

[189] Merrill Lynch Capital Services, Inc., 94 FERC ¶ 62,114 (2001).

[190] Section 14 of the WSPP Agreement covering a “Transfer of Interest in Agreement" states: "No party shall voluntarily transfer its membership under this Agreement without the written consent and approval of all other Parties except to a successor in operation of the applicable properties of such Party. With regard to the transfer of the rights and obligations of any Party associated with transactions under the Service Schedules, neither Party may assign such rights or obligations unless a) the other Party provides its prior written consent which shall not be unreasonably withheld; or b) the assignment is to a successor in operation whose creditworthiness is comparable to or higher than that of the assigning Party."

contracts occurred because Nevada Power did not consent to the assignment. As a result, in accordance with Section 5.05 of the APA,[191] Merrill Lynch acted as Allegheny's agent and trustee with respect to these contracts. The ALJ thus concluded that based on the nature of the Merrill Lynch-Allegheny relationship, Allegheny is the right respondent in this case because it is the principal, while Merrill Lynch is merely an agent.[192]

124. On exceptions, Allegheny claims that the ALJ misinterpreted the APA between Allegheny and Merrill Lynch. Nevada Power, however, asserts that the ALJ correctly found that the APA transferred the contracts to Allegheny. Nevada Power states that evidence of the transfer includes Allegheny's purchase of Merrill Lynch's entire wholesale electric energy trading business, including the Nevada Power contracts; the numerous representations made to the public, Merrill Lynch's customers and the Commission regarding the purchase; and Allegheny's performance under the contracts. In addition, Nevada Power states that whether Allegheny is the seller is irrelevant to whether the Commission has jurisdiction to determine the justness and reasonableness of the rates at issue here and the Commission's jurisdiction over the contracts in this case is not dependent on the identity of the parties currently before it.

125. We agree with Nevada Power that our decision to uphold these contracts does not depend on whether the seller for one of the contracts was Merrill Lynch or Allegheny. Moreover, since our decision to uphold the contracts means that we will not require

---

[191] Section 5.05 of the APA states: " If any consent for any agreement is not obtained and such agreement shall not be assigned, transferred, leased, subleased, licensed or sublicensed, the Sellers shall, to the extent possible without incurring any liability to any third party for which the Purchasers have not agreed to reimburse the Sellers, keep the agreement in effect (such agreements kept in effect are referred to herein as the “Seller Maintained Agreements”) and to the extent reasonably possible give the Purchasers the benefit without limitation: (I) cooperating with the Purchasers in holding any rights under agreements for which no consent to assign rights to Purchaser is obtained (“Non-Assignable Rights”) in trust for the Purchasers or acting as agent for the Purchasers; (ii) enforcing any rights of the Sellers arising from such Non-Assignable Rights against the issuers thereof or the other party or parties thereto; (iii) taking all such actions and doing, or causing to be done, all such things at the request of the Purchasers as shall be reasonably necessary and proper in order that the value of any Non-Assignable Rights shall be preserved and shall inure to the benefit of Purchasers; and (iv) paying over to the Purchase[r]s all monies or other assets collected by or paid to the Sellers in respect of such Non-Assignable Rights.

[192] Initial Decision at 65,328-32.

refunds, this issue becomes moot and thus need not be addressed on the merits in this order.

4. Procedural Motions

A. Snohomish's Motion to Reopen the Record

126. Snohomish filed a motion to reopen the record to admit, or in the alternative, take official notice of the Staff Report on price manipulation in the Western markets; evidence submitted in the 100-Day Discovery Proceeding, the Puget Sound proceeding in Docket No. EL01-10, et al.,[193] and the Enron investigation proceedings in Docket Nos. EL02-113, EL02-114 and EL02-115; and all public documents relating to the settlement in Docket No. IN01-3[194] and the public records from other pending Western forward contract proceedings.[195] Snohomish argues that the records of the above-listed proceedings contain substantial evidence that plainly contradicts the Initial Decision and the positions taken by the Respondents.

127. PUCN filed an answer in support of Snohomish's motion. PUCN also believes that the Commission should reopen the record or take official notice of evidence of market abuse submitted in other Western market proceedings. PUCN believes that evidence in those proceedings shows that manipulation and other market abuses negatively impacted forward prices. PUCN also suggests introducing in the record of the instant proceeding evidence produced in the Docket No. PA03-1-000, et al. proceeding.[196]

---

[193] Puget Sound Energy, Inc. v. Jurisdictional Sellers of Energy, 101 FERC ¶ 61,304 (2002), order on clarification, 102 FERC ¶ 61,163 (2003).

[194] AES Southland, Inc. & Williams Energy Marketing & Trading Co., 95 FERC ¶ 61,167 (2001).

[195] Public Utilities Com'n of the State of California v. Sellers of Long-Term Contracts to the California Dep't of Water Resources, et al., 99 FERC ¶ 61,087 (2002), order on reh'g, 100 FERC ¶ 61,098 (2002); and PacifiCorp v. Reliant Energy Serv., Inc., et al., 99 FERC ¶ 61,381 (2002), reh'g pending.

[196] America Electric Power Co., 103 FERC ¶ 61,089 (2003) (directing submission of information with respect to internal processes for reporting trading data).

128. Indicated Sellers[197] and Morgan Stanley argue that there is no procedural basis for reopening the record because Snohomish has failed to show that an extraordinary change in core circumstances has occurred since the record was closed on October 24, 2002. Similarly, Indicated Sellers object to Snohomish's alternative request to take official notice of evidence from other proceedings. In their opinion, these materials are not subject to official notice because they are being contested. Indicated Sellers also argue that the Commission should not consider either reopening the record or taking official notice of evidence from other proceedings because addition of new material to the record in this proceeding will not change the outcome of this proceeding. Morgan Stanley adds that the information Snohomish seeks to introduce into the record of this proceeding is outside the scope of the instant proceeding and is irrelevant for determination of the issues being litigated. Morgan Stanley further argues that contrary to Snohomish's allegations, the phone transcripts submitted in the Docket Nos. EL02-60 and EL02-62 proceeding are not new evidence. According to Morgan Stanley, these transcripts were produced to Snohomish prior to the closing of the evidentiary record in the instant proceeding.

129. In its answer, Morgan Stanley included a motion requesting that the Commission impose sanctions on Snohomish for burdening Morgan Stanley and the Commission with its baseless motion to reopen the record. Snohomish responds that the imposition of sanctions is not warranted because Snohomish did not make false statement in its previous motion.

130. Snohomish and SCWC filed answers to Indicated Sellers' and Morgan Stanley's answers to Snohomish's motion. Morgan Stanley filed an answer to Snohomish's answer to its motion for sanctions. Answers to answers are generally not permitted pursuant to Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2), unless otherwise permitted by the decisional authority. We are not persuaded to allow these answers to answers.

131. The Commission may reopen the record in its discretion where there is good cause.[198] The Commission views good cause as consisting of extraordinary circumstances, that is, a change in circumstances that is more than just material, but goes

---

[197]Indicated Sellers are comprised of Allegheny, BP, Calpine, Enron, Mirant, and Reliant. El Paso and Morgan Stanley support certain parts of the pleading.

[198]18 C.F.R. § 385.716 (2003).

to the very heart of the case.[199] In deciding whether to exercise its discretion, "the Commission looks to whether or not the movant has demonstrated the existence of extraordinary circumstances that outweigh the need for finality in the administrative process."[200] As the Commission explained in Opinion No. 238, "we recognize of course that changes have occurred since the close of the record. But such changes always occur.

Yet litigation must come to an end at some point. Hence the general rule is that the record once closed will not be reopened."[201]

132. The information now in the record provides a sufficient basis for our conclusions here. The evidence that Complainants seek to introduce into the record will not change the outcome of this proceeding, as more fully discussed above.

133. Now we turn to Snohomish's alternative request to take official notice of the Staff Report and evidence submitted in the proceedings specified by Snohomish. We find that Snohomish's request inasmuch it pertains to the Staff Report and 100-Day Discovery evidence to be moot because we have considered these findings and evidence as part of the record of this proceeding. As previously discussed, we conclude that, even if we assume that the allegations and findings contained in the Staff Report and the 100-Day Discovery Proceeding were true, they would not be determinative of the issues in this proceeding. However, we deny Snohomish's request to take official notice of evidence submitted in other proceedings. The records of those proceedings contain thousands of submittals, most of which are case-specific and not relevant to the issues in the instant proceeding; the documents that could be relevant have been submitted in the 100-Day Discovery Proceeding.

134. We also deny Morgan Stanley's motion requesting imposition of sanctions on Snohomish. We do not find sanctions warranted in these circumstances.

---

[199] CMS Midland, Inc., 56 FERC ¶ 61,177 at 61,624, reh'g denied, 56 FERC ¶ 61,361 (1991).

[200] East Texas Electric Coop., Inc. v. Central and South West Serv., Inc., 94 FERC ¶ 61,218 at 61,801 (2001) (denying reopening of record where movant sought to use actual data which became available after the close of the record in place of hypothetical data used at hearing).

[201] Transwestern Pipeline Co., Opinion No. 238, 32 FERC ¶ 61,009 (1985), reh'g denied, Opinion No. 238-A, 36 FERC ¶ 61,175 at 61,453 (1986).

B. SCWC's Motion to Lodge Oral Argument Exhibits

135. Subsequent to the April 23 oral argument, SCWC filed a motion to lodge the exhibits it presented during oral argument. SCWC contends that the oral argument exhibits should be lodged into the evidentiary record because they clarify certain statements made by SCWC at the April 23 oral argument. In response, Morgan Stanley argue that SCWC's motion should be denied because it does not meet the requirements necessary to reopen the evidentiary record under Rule 716 of the Commission's Rules of Practice and Procedure.[202]

136. SCWC's motion to lodge the oral argument exhibits is an attempt to reopen the evidentiary record of this proceeding to submit an additional exhibit that represents a new calculation. We are not persuaded that good cause exists to reopen the record. The need for finality in this proceeding outweighs the reasons put forward by Snohomish for reopening the record. Accordingly, we deny SCWC's motion.

C. Snohomish's Motion to Stay

137. On May 30, 2003, Snohomish filed a motion to stay the instant proceeding pending the resolution of the complaint Snohomish filed in the U.S. District Court for the District of Columbia. In that complaint, Snohomish alleges that two members of the Commission violated the Sunshine Act[203] by conducting a private telephone conference on March 26, 2003. Snohomish's instant motion is based on the same allegations which the Commission rejected in the April 23, 2003 order addressing Snohomish's motion for recusal.[204] Accordingly, we deny Snohomish' request for stay.

The Commission orders:

(A) The Initial Decision is affirmed, as discussed in the body of this order.

(B) The complaints are hereby denied.

---

[202] 18 C.F.R. § 385.716 (2003).

[203] 5 U.S.C. § 552(b) (2000).

[204] Nevada Power Co. and Sierra Pacific Power Co. v. Enron Power Marketing, Inc., et al., 103 FERC 61,080 (2003), reh'g pending.

(C) Snohomish's and Senator Cantwell's requests for rehearing are hereby denied, as discussed in the body of this order.

(D) Snohomish's motion to reopen the record is hereby denied, as discussed in the body of this order.

(E) Snohomish's motion to take official notice is hereby denied in part and granted in part, as discussed in the body of this order.

(F) SCWC's motion to lodge is hereby denied, as discussed in the body of this order.

(G) Snohomish's motion to stay the proceeding is hereby denied, as discussed in the body of this order.

By the Commission. Commissioner Massey dissented with a separate statement attached.
(S E A L) Commissioner Brownell concurred with a separate statement attached.

Magalie R. Salas,
Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Nevada Power Company and Sierra Pacific Power Company v. Enron Power Marketing, Inc. El Paso Merchant Energy American Electric Power Services, Corp.	Docket Nos. EL02-28-000 EL02-28-002 EL02-33-000 EL02-33-002 EL02-38-000 EL02-38-002
Nevada Power Company v. Morgan Stanley Capital Group Calpine Energy Services Mirant Americas Energy Marketing, L.P. Reliant Energy Services BP Energy Company Allegheny Energy Supply Company, L.L.C.	Docket Nos. EL02-29-000 EL02-29-002 EL02-30-000 EL02-30-002 EL02-31-000 EL02-31-002 EL02-32-000 EL02-32-002 EL02-34-000 EL02-34-002 EL02-39-000 EL02-39-002
Southern California Water Company v. Mirant Americas Energy Marketing, L.P.	Docket Nos. EL02-43-000 EL02-43-002
Public Utility District No. 1 Snohomish County, Washington v. Morgan Stanley Capital Group, Inc.	Docket Nos. EL02-56-000 EL02-56-002

(Consolidated)

(Issued June 26, 2003)

MASSEY, Commissioner, dissenting:

I am dissenting from this order, not because I relish abrogating contracts because I do not, but because I believe this Commission has a higher calling than simply the sanctification of long term contracts with prices reaching as high as $290 per MWh, contract prices that were multiples of traditional prices, shockingly high prices, completely unprecedented by historic standards. Our primary calling under the Federal Power Act is to ensure that prices are just and reasonable 24 hours a day, seven days a week. When prices soar to unprecedented levels, when prices exceed a just and reasonable level by multiples, we have the obligation to make it right. That is the way I read the law.

Many of the contracts challenged here provide for prices that are unlawful by any reasonable measure, and there is no persuasive public interest rationale for sanctifying contracts negotiated during the height of the Western electricity crisis, where the skyrocketing prices in an out of control spot market in California strongly influenced long term contract prices, wildly dysfunctional market conditions clearly allowed for the exercise of market power, and there was "epidemic" manipulation of the market according to our staff's Western Markets Report.

Protecting contracts entered into in this horribly tainted environment violates the Federal Power Act's forceful declaration that contracts are absolutely unlawful and must be reformed if not just and reasonable. Turning Commission policy on its head, today's order will encourage wholesale electricity purchasers to "ride the spot market" because the Commission has shown a willingness to mitigate, and provide refund protection from, unjust and unreasonable spot market prices, at least in the California spot markets.[1] By the same token, buyers will be discouraged from forward contracting because they will not enjoy protection from unlawful contract prices. Power buyers, consumers and retail policymakers will lose faith in the concept of wholesale electricity markets if they cannot trust the Commission to protect them from unjust and unreasonable contract terms resulting from a wildly dysfunctional market, market power and epidemic market manipulation.

---

[1]In an case decided today, the Commission denies refund protection to spot market buyers in the Pacific Northwest during the crisis period. Puget Sound Energy, Inc, 103 FERC ¶ 61,348 (2003).

The J&R standard is the appropriate standard of review in this instance

One of the fundamental questions that must be addressed in evaluating whether a contract must be reformed is the standard of review. Where there is clear language in the contract indicating that the parties intended that the "public interest" standard must be met before terms may be modified, then that is the appropriate standard. Where the contract lacks a clear statement of intent, the correct standard to apply is not that clear. Today's order finds that the more stringent public interest standard must be satisfied even for contracts with no clear statement of intent. I do not agree.

It is my view that except where the contract has a Mobile-Sierra clause restricting the right of the buyer to file a section 206 complaint, the just and reasonable standard applies. I concede that the law in this area is not the model of clarity, and the argument that the public interest standard controls is not without merit. Nevertheless, I believe a customer's waiver of section 206 just and reasonable rights must be explicit. As the Commission observed in Order 888-A:

> We note that the fact that a contract may bind a utility to a Mobile-Sierra public interest standard does not necessarily mean that the customer is also bound to that standard. Unless a customer specifically waives its section 206 just and reasonable rights, the Commission construes the issue in favor of the customer.[2]

The Commission's proposed policy statement on standard of review is consistent with that position. The Commission would apply the just and reasonable standard of review unless specific language to the contrary is concluded in the contract.[3]

Perhaps more important, the just and reasonable standard should control the review of contracts negotiated *in the circumstances of this case* where the sellers were acting under a market-based pricing authorization granted by the Commission. The Mobile-Sierra doctrine arose in a cost-of-service regime. Once approved by the Commission as just and reasonable, a contract, rate or classification should not be modified unless a higher standard justifies the modification. This makes sense. Most

---

[2]Order No. 888-A, FERC Stats. & Regs. ¶ 31,048 (1997) at 30, 191, footnote 31.

[3]Standard of Review for Proposed Changes to Market-Based Rate Contracts for Wholesale Sales of Electric Energy by Public Utilities, 100 FERC ¶61,145 (2002) at paragraph 7.

cases arose in the context of a seller making a filing to justify a higher rate. In such a case, the doctrine appeared to have a customer protection rationale.

Today's order states that in a market based regime, the Commission's authorization for a public utility to sell at prices set by the discipline of the market, based upon a finding that the seller cannot exercise or has mitigated market power, amounts to a "predetermination" that any contract negotiated by such seller is just and reasonable. Hence, according to the majority, the just and reasonable standard of section 205 is satisfied, and a later contract modification would have to be justified by the higher public interest standard.

There are three flaws in this logic as applied here. First, virtually all of the Commission's orders granting market based pricing authority to the public utility sellers in the West explicitly declared that the Commission's action could not be construed as approving any contract negotiated pursuant thereto. These orders say:

> (t)his action does not constitute approval of any service, rate, charge, classification...or any...contract...affecting such rate or service..., nor shall such action be deemed as recognition of any claimed contractual right or obligation affecting or relating to such service or rate; and such action is without prejudice to any findings or orders which have been or may hereafter be made by the Commission in any proceeding...

Based upon this language, it seems clear that these contracts have never been approved as just and reasonable under section 205.

Second, even ignoring the rather plain language of the above-quoted paragraph, any possible presumption of the justness and reasonableness of contracts negotiated pursuant to the blanket authorization was flatly contradicted by the conclusions reached in the Commission's November 1, 2000 and December 15, 2000 orders, and in the July 2001 order requiring refunds. The November order found the market in California to be seriously flawed, and market conditions "have caused and continue to have the potential to cause, unjust and unreasonable rates for short term energy." Further: "There is clear evidence that the California market structure and rules provide the opportunity to exercise market power when supply is tight and can result in unjust and unreasonable rates."[4] In the December 15 order the Commission said that "we reaffirm our findings that unjust and unreasonable rates were charged and could continue to be charged, unless

[4]San Diego Gas & Electric Company, 93 FERC ¶ 61,121 (2000) at 61,349.

remedies are implemented."[5] It should be clear from both the breathtaking rise in prices after the December order and the June 2001 intervention by the Commission that the remedies in the December order did not work. Effective remedies were not put in place until June 2001 when the Commission imposed full time price controls. I would also note that the Commission's grant of market based pricing authority "depends on a functioning competitive market... unimpaired by market manipulation." Implicit in the grant of such authority is "a presumption that a company's behavior will not involve fraud or deception."[6] Circumstances indicate that this condition and presumption were not fulfilled. The Commission has found evidence of market manipulation in the California markets and is also investigating whether sellers withheld power from the market or engaged in excessive bidding.

In light of all of these circumstances, the predetermination rationale is without merit. The Commission's July 2001 order granting refunds for a nine month period beginning October 2, 2000 and ending June 19, 2001 was based upon a finding that during such period spot prices were not just and reasonable. It defies logic to rely upon a "predetermination" of justness and reasonableness contradicted by later Commission orders that reviewed real market conditions, found the opportunity to exercise market power, and required several billions of dollars in refunds based upon the explicit conclusion that actual prices charged in fact were not just and reasonable.

Third, the rates charged by sellers in the California spot markets were under the same regulatory scheme that produced the forward contracts at issue here, i.e., a preliminary finding at the certificate stage that a seller lacked or had mitigated market power and, hence, rates sought to be charged by such seller would by definition be just and reasonable. This "predetermination" applied equally to spot prices and to long term contract prices. Yet, in July 2001 the Commission wisely and correctly decided to apply the just and reasonable standard to justify modifying the California spot prices and ordering refunds. Satisfying the public interest standard was not required. The Commission did not protect unjust and unreasonable spot prices (which were derived under tariff conditions and are akin to hourly contracts), yet decides today to protect unjust and unreasonable longer term transactions negotiated under the same regulatory framework. This distinction in the standard of review, based solely upon the length of the transaction, does not comply with sections 205 and 206 of the Act, and in my view is not reasoned decision making.

---

[5] San Diego Gas & Electric Company, 93 FERC ¶ 61,294 (2000) at 61,999.

[6] Reliant Energy Services, et al, 102 FERC 61,315 (2003) at paragraph 12; and Enron Power Marketing Inc., et al, 102 FERC¶ 61,316 (2003).

There is an additional reason that the just and reasonable standard should govern in this case. It is obvious that the buyers detrimentally relied upon the Commission's admonition in the December 2000 order that market participants enter into long term contracts.[7] In that same order, the Commission assured buyers that they would be protected from the exercise of market power. The Commission set a $74 MWh benchmark to use "in assessing any complaints regarding the justness and reasonableness of pricing of such long-term contracts negotiated under current market conditions."[8] The Commission promised to monitor prices "to address concerns about potentially unjust and unreasonable rates" in the long term markets.[9]

The buyers reasonably relied upon the Commission's declaration that complaints about long term contracts would be judged according to just and reasonable standards and they would be protected. Given that reliance, it is simply unfair to adopt a standard of review today that gives these buyers substantially less protection. In addition, after the Commission declared in December 2000 that $74 MWh was a just and reasonable benchmark for long term contracts negotiated thereafter, it seems unconscionable now to validate contracts that allowed sellers to fetch upwards of $250 MWh, $260 MWh, and $290 MWh - - multiples of the benchmark. The Commission effectively said to buyers "get into long term contracts, $74 is a reasonable benchmark price and, hey, don't worry, we'll protect you from unjust and unreasonable contract prices." Today's order utterly fails to keep that commitment.

The nexus between the California spot market and the forward contract market

A second fundamental issue in this case is whether the dysfunctional California spot markets adversely affected the long-term bilateral markets. I frankly do not understand why the hearing order in this case treated this as an open issue, and I said so at the time. The relationship between the spot market prices and long term contract prices seems rather obvious, and the Commission has explicitly recognized that "maintaining an accurately priced spot market is the single most important element for

---

[7] "...those who remain in the spot market for buying their residual load or selling their residual supply should be there in full recognition of the effects on price of last minute sales and purchases." 93 FERC at 61,996.

[8] 93 FERC at 61,982.

[9] 93 FERC at 61,994.

disciplining longer term transactions."[10] In our Standard Market Design proposal, the Commission found that:

> Bilateral contracts generally reflect buyer and seller expectations of prices in spot markets. Therefore, market power mitigation in the organized spot market will effectively discipline market power in the bilateral markets as well [footnote omitted].[11]

More to the point, the Commission has specifically recognized the relationship between the California spot markets and bilateral markets in the West. Our November 1, 2000 order stated:

> Therefore, the operation of the California electricity market can affect prices throughout the entire Western Interconnection. The Staff Report demonstrates that during the summer of 2000 correlations between PX prices and Western bilateral prices were quite strong.[12]

And our June 19, 2001 mitigation order recognizes that "(t)here is a critical interdependence among the prices in the ISO's organized spot markets, the prices in the bilateral spot markets in California and the rest of the West, and the prices in forward markets."[13] Thus, it is beyond comprehension why there is any doubt on this issue.

But if there was any doubt whatsoever regarding whether there was a nexus between the spot and forward markets, the staff's Western Markets Report should dispel it. Staff's analysis found that there was a statistically significant relationship between spot and forward power prices during the period January 1, 2000 through June 30, 2001.[14] The contracts at issue here were negotiated during this time period. The Commission should respect staff's analysis. It was performed by a nationally recognized econometrician with a specialty in energy futures markets and with access to the most comprehensive database of forward power contracts for the period and locations in

---

[10]AEP Power Marketing, 97 FERC ¶ 61,219 (2001) at 61,972.

[11]Standard Market Design NOPR, 100 FERC ¶ 61,138 (2002) at paragraph 405.

[12]93 FERC at 61,357 to 358.

[13]San Diego Gas & Electric Company, 95 FERC ¶ 61,418 (2001) at 62,547.

[14]Western Markets Report at VI-18.

question. Thus, based on logic, the Commission's prior statements, and the conclusions of our staff's strong analysis, it is beyond dispute that the prices and other terms of the forward contracts at issue here were influenced by the California spot markets.

The just and reasonable standard is met

The prices and other terms of the forward contracts at issue here are unjust and unreasonable and should be reformed. I base this conclusion on three factors. First, the Commission has found that the California spot markets resulted in unjust and unreasonable rates for the refund period (October 2, 2000 to June 19, 2001). This is the period during which the contracts at issue here were negotiated. Second, the California markets were subjected to various forms of manipulation, which may have included withholding.[15] Third, there was a clear nexus between the California spot market and the forward contract markets. The unlawful California spot prices strongly influenced forward contract prices. And fourth, the prices in many of these contracts are multiples of the $74 MWh price the Commission had declared would be used as a rough just and reasonable benchmark.

The public interest standard is met

Even if the majority is correct and the appropriate standard of review is the public interest standard, these agreements still do not withstand scrutiny and must be reformed. The tone of today's order is that the Mobile-Sierra line of cases places a thumb heavily on the scale in favor of sanctity of contracts, and thus sets an exceptionally high threshold in meeting the public interest standard. While the threshold may be high, it is not as high as today's order would place it for the particular contracts at issue.

The Mobile-Sierra case law involves contracts negotiated under a cost of service regime, and thus we do not know how the courts would instruct the Commission to

---

[15]See Enron Power Marketing, Inc., et al, 103 FERC ¶ 61,343 (2003) where the Commission revokes the market-based authorities and terminates the blanket marketing certificates of various Enron affiliates. See also American Electric Power Service Companies, et al, 103 FERC ¶ 61,345 (2003), Enron Power Marketing, Inc. et al (2003) and Investigation of Anomalous Bidding Behavior and Practices in the Western Markets, 103 FERC ¶ 61,347 (2003) where the Commission establishes proceedings to investigate manipulative and questionable bidding behavior.

address contracts negotiated in a market-based regime, especially under market conditions characterized by dysfunctional market rules, widespread manipulative conduct, and a lack of effective regulatory oversight. We are on new ground here, and the Commission is free to decide what circumstances give rise to the public interest.[16] We are clearly not limited to the traditional three-prong test that gets so much attention. Today's order as well as court precedent point out that those three factors are only examples of what to consider in determining the public interest.[17] Indeed, the Commission has great discretion in carrying out its statutory responsibilities, even where the public interest standard controls:

> ... even if contracts fall within the scope of the Mobile-Sierra decisions, the Supreme Court has emphasized that the relevant agency, here FERC, may always reform a contract found to be 'unlawful" or 'contrary to the public interest,' i.e., that "contracts remain fully subject to the paramount power of the Commission to modify them when necessary in the public interest."[18]

The Commission's order setting this case for hearing implicitly recognized our discretion in evaluating these contracts under the public interest standard when it held that "the Commission will not modify market based contracts unless there are extraordinary circumstances."[19] We are instructed by the courts that "(w)hen there is no reason to question what occurred at the contract formation stage, the parties may be required to live with their bargains."[20] What's at issue then is rendering judgement regarding whether

---

[16]"...nowhere in the Supreme Court opinion is the term 'public interest' defined. Indeed, the Court seems to assume that the Commission decides what circumstances give rise to the public interest." Northeast Utilities Service Company v. FERC, 55 F.3d 686, 690 (1st Circuit 1995).

[17]"This definition of what is necessary in the public interest was formulated in the context of a low-rate case. It was not and could not be an across-the-board definition of what constitutes the public interest in other types of cases." Northeast Utilities, 55 F.3d at 690. Also see today's order at paragraph 6.

[18]Northeast Utilities, 55 F.3d at 693.

[19]Nevada Power Co. and Sierra Pacific Power Co., v. Enron Power Marketing, Inc., et al, 99 FERC ¶ 61,047 (2002) at 61,190

[20]Town of Norwood v. FERC, 587 F.2d 1306, 1312 (D.C. Cir. 1978).

there were extraordinary circumstances at play during the contract formation stage that warrant contract reformation.

In evaluating whether to reform contracts involving a seller with market-based authority, we must be guided by the market circumstances that affected the negotiations and contract terms. It has already been established that the conditions in the California markets infected markets across the West, including the forward contracts, such as those at issue in this case. What were the circumstances under which buyers negotiated these contracts?

- The structure and rules of California markets were flawed, market power could be exercised in them, unjust and unreasonable rates had been charged and the potential existed that unlawful rates could be charged in the future. This is what the Commission found in November and December of 2000.

- Due to a combination of factors, there was a shortage of electricity that resulted in unprecedented, high, volatile, and unjust and unreasonable prices in the spot markets. As a result, the Commission admonished buyers to move load into forward contracts or suffer the consequences.

- The electricity market during this same time frame was manipulated through a number of strategies by sellers. These are documented in the Western Markets Report and in orders decided today where the Commission requires more than fifty power sellers to defend against charges that they engaged in one or more manipulative strategies to pump up electricity prices.[21] The Commission is still investigating whether generation was strategically withheld from the market.

- During this same time frame, the price of natural gas, the fuel input for the marginal generation resources in the West, was manipulated by epidemic false reporting. This is documented in the Western Markets Report.

- As prices soared out of control, buyers had no basis to expect that this Commission would act forcefully to control them. The measures imposed in the December

[21]See American Electric Power Service Companies, et al, 103 FERC ¶ 61,345 (2003), Enron Power Marketing, Inc. et al (2003) and Investigation of Anomalous Bidding Behavior and Practices in the Western Markets, 103 FERC ¶ 61,347 (2003) where the Commission establishes proceedings to investigate manipulative and questionable bidding behavior.

2000 order were clearly ineffective and prices continued to rise. The Commission approved as just and reasonable spot prices of $273 MWh, $430 MWh and $300 MWh for the first three months of 2001, respectively,[22] and the Commission's then chairman reportedly advised Californians at the time that the only way out of the crisis was to "start putting shovels in the ground."[23]

This is the unprecedented environment in which these contracts were negotiated. The economic signals that formed the basis of the negotiations, and consequently the contract terms, were severely tainted. Buyers had their backs to the wall under these circumstances and essentially negotiated out of fears of yet higher prices or blackouts for their customers. Such conditions, spread over an area as large as the western United States, are truly extraordinary. And those conditions had extraordinary effects. For example:

- This Commission found it necessary in June 2001 to cap prices across this entire thirteen state region, 24 hours a day, seven days a week.[24] Such broad market intervention by this agency was unprecedented.

- A major California utility, Pacific Gas and Electric, declared bankruptcy as a direct result of the crisis and a second utility, Southern California Edison, teetered on the edge of bankruptcy.

- Local economies suffered devastating effects as a result of these market conditions. In the Pacific Northwest, factories closed and jobs were lost. The aluminum industry has exited the region for all intents and purposes.

- The movement toward competitive electricity markets at the national and state levels was almost brought to a halt. Consumers and policymakers were shocked and outraged that an out of control electricity market could wreak such havoc.

---

[22]See, respectively, 94 FERC ¶ 61,245 (2001), 94 FERC ¶ 62,245 (2001), and an unpublished Notice of Proxy Price for April Wholesale Transactions in the California Wholesale Electric Market issue by the Director, Office of Markets, Tariffs and Rates, April 16, 2001.

[23]Statement attributed to Chairman Hebert, San Francisco Chronicle, April 12, 2001 (as reported on the San Francisco Chronicle's web site - - www.sfgate.com.)

[24]San Diego Gas & Electric Company, 95 FERC ¶ 61,418 (2001).

The tainted atmosphere in which these contracts were negotiated was unprecedented and extraordinary. The most influential benchmark used in negotiating forward contracts - - the spot market and expectations of future spot prices - - was wildly dysfunctional. When these contracts were negotiated, the Commission had already declared that conditions in the California markets allowed the exercise of market power and rates were unjust and unreasonable. And we now know that there was unprecedented manipulation of both the natural gas and electricity markets and epidemic false reporting of natural gas trading data.

There is simply no persuasive public interest rationale for protecting and sanctifying contracts negotiated in this unprecedented and extraordinary environment. Those market conditions certainly tainted any contracts negotiated during this time frame. It would simply defy logic to conclude that the high prices in these contracts were not adversely influenced by market conditions that included the exercise of market power and widespread market manipulation. Upholding such contracts violates the public interest. These contracts must be reformed.

Remedy

I would remand this case to an Administrative Law Judge to determine specifically how each contract should be reformed. I would also recommend that the judge use the method set out in staff's Western Markets Report for determining the mitigated price in each contract. I suggest this method because staff's analysis has great credibility - - it had access to the most comprehensive data base of forward price contracts for the period and locations in question.

Staff's econometric analysis estimates the statistical relationship between spot power prices and forward contract prices (the "spot power elasticity"). This relationship shows how much forward prices rise for each percentage increase in spot prices. Staff also developed a formula representing the relationship between the degree to which spot power prices were excessive and the appropriate level for mitigated forward prices. This formula can be used to set mitigated forward contract prices. The excessiveness of spot prices (or the "spot power distortion" in staff's formulation) can be estimated by using the mitigated market clearing prices (MMCPs) being developed in the California refund proceeding. The MMCPs will represent the just and reasonable prices in the California spot markets. The spot power distortion can then be plugged into staff's formula to develop the mitigated forward prices.[25]

For these reasons, I dissent from today's order.

William L. Massey
Commissioner

[25]See pages V-16 to V-18 of the Western Markets Report.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Nevada Power Company and Sierra Pacific Power Company v. Enron Power Marketing, Inc. El Paso Merchant Energy American Electric Power Services Corp.	Docket Nos. EL02-28-000 EL02-28-002 EL02-33-000 EL02-33-002 EL02-38-000 EL02-38-002
Nevada Power Company v. Morgan Stanley Capital Group Calpine Energy Services Mirant Americas Energy Marketing, L.P. Reliant Energy Services BP Energy Company Allegheny Energy Supply Company, L.L.C.	Docket Nos. EL02-29-000 EL02-29-002 EL02-30-000 EL02-30-002 EL02-31-000 EL02-31-002 EL02-32-000 EL02-32-002 EL02-34-000 EL02-34-002 EL02-39-000 EL02-39-002
Southern California Water Company v. Mirant Americas Energy Marketing, L.P.	Docket Nos. EL02-43-000 EL02-43-002
Public Utility District No. 1 Snohomish County, Washington v. Morgan Stanley Capital Group, Inc.	Docket Nos. EL02-56-000 EL02-56-002

(Consolidated)

(Issued June 26, 2003)

BROWNELL, Commissioner, concurring

1. I have been very clear in my prior statements about my belief in the sanctity of contracts. However, the issue of how to weigh contract sanctity in the context of the Western power crisis is, to say the least, a very difficult one, and I have struggled with it. The parties in this case were afforded the opportunity of a trial-type hearing and I have reviewed the evidence developed during that hearing. I have read the ALJ's Initial Decision and considered the parties' briefs on that Decision. I have also reviewed Staff's Final Report on Price Manipulation in Western Markets and the evidence submitted in the 100-Day Discovery Proceeding in the context of this case. Finally, the Commission took the unusual step of providing the parties an additional opportunity to address the issues in an oral argument before the Commission itself, and I have carefully considered all points raised during that oral argument. After reviewing all of this information, I agree with the order's conclusion that these were contracts voluntarily entered into and the Complainants have not met their burden of proving that the contracts are contrary to the public interest.

2. I am writing separately to express my concern about one aspect of the order: the rationale for concluding that modification of the contracts is subject to the public interest standard of review. When these cases were set for hearing, I noted that existing judicial case law seemed to indicate that the public interest standard applied to all of these contracts based solely on the contracts' silence as to the buyer's right to seek unilateral changes under section 206.[1] Nevertheless, I was willing to set the issue for hearing so that the parties and the ALJ could have an opportunity to further explore whether my understanding of the case law was accurate. Three ALJs have now independently come to the same conclusion: judicial case law establishes that in the absence of clear contractual language allowing unilateral contract modification, the party seeking the change must meet the public interest standard.[2]

---

[1]Nevada Power Company and Sierra Pacific Power Company v. Duke Energy Trading and Marketing, L.L.C., et al., 99 FERC ¶ 61,047 (2002) (citing Texaco Inc. v. FERC, 148 F.3d 1091, 1096 (D.C. Cir. 1998) and Boston Edison Co. v. FERC, 233 F.3d 60, 67 (1st Cir. 2000)).

[2]Public Utilities Commission of the State of California v. Sellers of Long-Term Contracts to the California Department of Water Resources, et al., 102 FERC ¶ 63,013 at P 28 (2003); Nevada Power Company and Sierra Pacific Power Company v. Duke

(continued...)

3. This order could have simply affirmed the ALJ's conclusion on this point and ended there the analysis of which standard to apply. That is what I am voting to do. Unfortunately, today's order fails to do so and instead bases the finding of the applicable standard on an analysis of the extrinsic evidence that parties did or did not present at hearing. By doing so, the order ignores the law. The Mobile-Sierra doctrine is not an invention of the FERC that we are free to mold as we wish; it is a directive from the Supreme Court. Moreover, the order misses an opportunity to provide clarity and certainty to all market participants and leaves open the possibility that the Commission may order unnecessary fact-finding on the parties' intent in future contract abrogation cases.

Nora Mead Brownell

[2](...continued)
Energy Trading and Marketing, L.L.C., et al., 101 FERC ¶ 63,031 at P 27 (2002); and PacifiCorp v. Reliant Energy Services, Inc., et al., 102 FERC ¶ 63,030 at P 18 (2003).