

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. EL02-28-004
EL02-28-005
EL02-33-004
EL02-33-005
EL02-38-004
EL02-38-005

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. EL02-29-004
EL02-29-005
EL02-30-004
EL02-30-005
EL02-31-004
EL02-31-005
EL02-32-004
EL02-32-005
EL02-34-004
EL02-34-005
EL02-39-004
EL02-39-005

Southern California Water Company

v.

Mirant Americas Energy Marketing, L.P.

Public Utility District No. 1
Snohomish County, Washington

Docket Nos. EL02-43-004
EL02-43-005

Docket Nos. EL02-56-004
EL02-56-005

v.

Morgan Stanley Capital Group, Inc.

(Consolidated)

ORDER ON REQUESTS
FOR REHEARING AND CLARIFICATION

(Issued November 10, 2003)

1. In this order, we address requests for rehearing and clarification of our June 26, 2003 Order¹ in which we affirmed the Initial Decision² by the Administrative Law Judge (ALJ) denying 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 alleged 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 sought a remedy of contract modification. In this order, we deny the requests for rehearing and we reaffirm our conclusion that the record in this proceeding does not support modification of the contracts at issue for the reasons stated below; and address the request for clarification.

2. In addition, we will address a request for rehearing of the order issued on April 23, 2003³ in response to a motion filed by SCWC and Snohomish in which they requested that the Commission disclose alleged prohibited off-the-record communications during a March 26, 2003 press conference attended by three commissioners and a conference call the same day between two commissioners and a group of Wall Street analysts. In this order, we deny the requests for rehearing of the April 23 Order for the reasons stated below.

3. 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.

¹ Nevada Power Co. and Sierra Pacific Power Co. v. Enron Power Marketing, Inc., et al., 103 FERC ¶ 61,353 (2003), reh'g pending. (June 26 Order).

² Nevada Power Co. and Sierra Pacific Power Co. v. Enron Power Marketing, Inc., et al., 101 FERC ¶ 63,031 (2002) (Initial Decision).

³ Nevada Power Co. and Sierra Pacific Power Co. v. Enron Power Marketing, Inc., et al., FERC ¶ 61,080 (2003), reh'g pending. (April 23 Order).

Background

4. 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. In February 2002, Snohomish filed a complaint against Morgan Stanley. The Nevada Companies and SCWC argued that the dysfunctions in the Power Exchange (PX) and Independent System Operator (ISO) 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 Annex⁴ were unjust and unreasonable. Unlike Nevada Companies and SCWC, Snohomish requested modification of the contract term, not the contract rate.

5. 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.

6. On April 11, 2002, the Commission issued an order setting the instant complaints for a trial-type evidentiary hearing.⁵ 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.

7. 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

⁴ 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.

⁵ 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).

the Mobile-Sierra public interest standard of review⁶ 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.

8. 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 energy crisis of 2000-2001 (100-Day Discovery Proceeding).⁷ The submission of evidence in the 100-Day Discovery Proceeding was completed on March 20, 2003.

9. On March 26, 2003, the Commission released the Commission Staff's Final Report on Price Manipulation in Western Markets in Docket No. PA02-2-000 (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.

10. On June 26, 2003, the Commission issued an order affirming the Initial Decision denying the complaints. In denying the instant complaints, the Commission took into consideration the evidentiary record developed in the instant proceeding, findings of the Staff Report, and evidence submitted in the 100-Day Discovery Proceeding. Specifically, the Commission affirmed the Presiding Judge's findings that the applicable standard of review for the contracts at issue was the public interest standard and that the Complainants failed to meet their burden of proof under this standard of review.

11. Furthermore, based on the review of the evidence and the totality of circumstances, the Commission concluded that the Complainants failed to meet their burden of proof under the public interest standard, as defined in past cases. The Commission found that the challenged contracts were not contrary to the public interest

⁶ 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).

⁷ 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).

because the Complainants 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 record demonstrate that the contracts were contrary to the public interest. The Commission also noted that:

... 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 benefited 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.⁸

12. The following parties filed timely requests for rehearing of the June 26 Order: SCWC, the Public Utilities Commission of Nevada (NPUC), the Office of the Attorney General of the State of Nevada, Bureau of Consumer Protection (NBCP), Nevada Companies, and Snohomish. Allegheny, BP, Calpine, El Paso, Enron, Mirant and Morgan Stanley (collectively, Respondents) also filed a limited request for clarification.

Discussion

Applicable Standard of Review

13. Complainants, NBCP, and NPUC argue that in the June 26 Order, the Commission violated its statutory obligation to ensure just and reasonable rates when it determined that it could impose a higher burden of proof before mitigating unjust and unreasonable prices in the contracts at issue. They state that the Commission can apply the public interest standard to determine whether prices should be mitigated only after it finds that the contract prices at issue here are just and reasonable. NPUC and Complainants state that the contract prices at issue were not just and reasonable at the contract formation because, as determined in the Staff Report, the California PX and ISO spot market dysfunctions adversely affected prices in forward contracts, and the Respondents engaged in fraud, deception and misrepresentation, and market manipulation, resulting in unjust and unreasonable prices. Complainants and NPUC conclude that the forward markets were not competitive during the relevant time and thus could not produce just and reasonable prices. Snohomish adds that pursuant to the Commission precedent, contracts can be modified under the public interest standard where, as here, the contracts were

⁸ See June 26 Order at 62,384.

negotiated during a period of market dysfunction and, after the Commission intervention to correct that market dysfunction, the contracts were no longer economical.

14. In addition, Nevada Companies and SCWC argue that the Commission misread the holding in Sierra when it found that “[u]nder 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.”⁹ According to the Nevada Companies, under the Commission’s interpretation of Sierra, as long as two parties reach a voluntary agreement on a contract price, the Commission is powerless to modify that price even if it finds it to be unjust and unreasonable.

15. As discussed below, the Commission has not violated its statutory obligation with respect to modification of contracts, as interpreted by the U.S. Supreme Court. The Mobile-Sierra doctrine holds that in cases “where parties have negotiated a ... contract that sets firm prices ... and that denies either party the right to change such prices [] unilaterally, [the Commission] may abrogate or modify the contract only if the public interest so requires.”¹⁰ Under the public interest standard, the sole concern of the Commission is whether the challenged rate adversely affects the public interest,¹¹ and the Commission can exercise its authority to modify contracts only where the public interest demands such action.¹² The burden to demonstrate that the contract rates in question in this proceeding are contrary to the public interest is on the Complainants. The Complainants in this proceeding, however, have failed to make such a showing. As established in the June 26 Order and affirmed in this order on rehearing, the contracts at issue are subject to the public interest standard of review. Once a party signs a Mobile-Sierra contract, it cannot escape by later claiming that the rates were not just and reasonable when it signed the contract, unless there is evidence such as the seller fraudulently inducing the buyer to execute the contract. However, no such evidence was found in the evidentiary record, including the Staff Report and the 100-Day Discovery Proceeding submittals.

16. In response to the Complainants’ arguments that the Commission can apply the public interest standard of review only after it finds that the contract rates were just and

⁹ See June 26 Order at 62,397.

¹⁰ Texaco, Inc. v. FERC, 148 F.3d 1091, 1095 (D.C. Cir. 1998).

¹¹ FPC v. Sierra Pacific Power Co., 350 U.S. 348, 354-5 (1956).

¹² Union Pacific Fuels, Inc., 129 F.3d 157, 161 (D.C. Cir. 1997)(quoting Metropolitan Edison Co. v. FERC, 595 F.2d 851, 856 n.29 (D.C. Cir. 1979)).

reasonable, Complainants fail to acknowledge that the contracts were lawfully entered into pursuant to prior findings and authorization by the Commission under Section 205 of the Federal Power Act (FPA).¹³ Upon a showing that the seller lacks or has mitigated market power in the relevant market, the Commission pre-determines under Section 205 of the FPA that sales at market-based rates will be just and reasonable.¹⁴ In effect, the Commission makes a “blanket” just and reasonable determination which applies to subsequent market-based sales made by the seller. As we explained in our June 26 Order, 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 authority a pointless exercise of no value to anyone.

17. The Commission has held that this grant of market-based rate authority constitutes what is known as the “initial review” of rates in the cost-based rate context. Then, if the parties have not agreed to apply the public interest standard to future challenges, a party may come to the Commission pursuant to Section 206 of the FPA¹⁵ and demonstrate that the rate is no longer just and reasonable. Alternatively, a party who does not have such a right may seek changes by demonstrating that the contract rate is contrary to the public interest. In essence, the Complainants attempt to add another layer to this two-step process, claiming that parties to contracts that are subject to the public interest standard of review should have another opportunity to argue that the rate was not just and reasonable at the outset. This argument, however, has no support in either the statute or the relevant Commission or Court precedent. Indeed, the Complainants’ suggested approach would create uncertainty in the market, as a party who suddenly finds that its deal has become uneconomical, can undo the terms to which it was contractually bound. This is precisely what the Mobile-Sierra doctrine was designed to avoid, and we see no support for an exception to this established doctrine simply because a party has contracted in a market-based rate regime.

18. Our decision in Lockyer¹⁶ supports this result. The “view that only cost-based or formula rate models satisfy the statutory framework fundamentally misapprehends the Commission’s ratemaking authority.”¹⁷ Lockyer held that market-based rate certificates

¹³ 16 U.S.C. § 824d (2000).

¹⁴ Louisiana Power Authority v. FERC, 141 F.3d 364, 365 (D.C. Cir. 1998); Elizabethtown Gas Co. v. FERC, 10 F.3d 866, 870 (D.C. Cir. 1993).

¹⁵ 16 U.S.C. § 824e (2000).

¹⁶ State of California ex re Lockyer v. British Columbia Power Exchange Corp, et al., 99 FERC ¶ 61,247 (2002) (Lockyer).

¹⁷ Id. at 62,062.

satisfy the FPA Section 205(c)¹⁸ requirement that rates be on file with the Commission and recognized that the Commission reviews the reasonableness of the use of market-based rates prior to their effectiveness. “Prior review consists, however, not of the particular prices agreed to by willing buyers and sellers. Rather, it consists of analysis to assure that the seller lacks or has mitigated market power so that its prices will fall within a zone of reasonableness.”¹⁹

19. Thus, at the time sellers are granted market-based rate certificates, their rates are subject to the initial review required by the FPA. This review is different than that conducted for cost-based rates because “[t]he availability of genuine alternatives provides a sufficient basis . . . to conclude that ‘market discipline’ will be sufficient to keep the prices that sellers charge within the statutorily-prescribed just and reasonable zone.”²⁰ We reject the parties’ argument that this approach is insufficient to satisfy the statute. Our decision in Lockyer is on all fours with our finding here.

20. Respondents seek clarification that the public interest standard of review does not authorize unjust and unreasonable rates. We clarify as follows. Respondents are correct that rates initially must be just and reasonable. For market-based rates, this determination is made when the authorization for market-based rates is granted. However, if rates subsequently become unjust and unreasonable and the contract at issue is subject to the Mobile-Sierra standard of review, the Commission under court precedent may not change the contract simply because it is no longer just and reasonable. If parties’ market-based rate contracts provide for the public interest standard of review, the Commission is bound to a higher burden to support modification of such contracts. The public interest standard applies to changes to contract rates and “represents the Supreme Court’s attempt to strike a balance between private contractual rights and the regulatory power to modify contracts when necessary to protect the public interest.”²¹ Our finding that changes to the challenged contracts should be evaluated under the public interest standard does not equate to a finding that the underlying rates are not just and reasonable. To the extent Respondents request for clarification asks the Commission to opine on matters not before us in this case, we decline to do so.

¹⁸ 16 U.S.C. § 824d(c) (2000).

¹⁹ Id. at 61,247. 62,063.

²⁰ Id.

²¹ Northeast Util. Serv. Co., v FERC, 55 F.3d 686, 689 (1st Cir. 1995).

21. Complainants further argue that the Commission erred in finding that the public interest standard of review is applicable under Section 6.1 of the WSPP Agreement.²² In particular, they state that the Commission failed to provide explanation for its decision, while disregarding Nevada Companies' and SCWC's witness testimony that they did not intend to bargain away their rights under Section 206 of the FPA.

22. Parties' testimonies and other evidence (such as recordings of trader telephone conversations) provided no indication that the issue of the applicable standard of review was ever mentioned by either Complainants or their counterparties at the time the contracts at issue were negotiated and executed. The burden was on the Complainants to prove that the intent of the parties was to allow for Complainants to make unilateral changes to the terms of the contracts in question. Complainants failed to present any evidence on this issue. For this reason, in our decision, we affirmed the Presiding Judge's finding 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.²³

23. SCWC and Snohomish argue that Section 6.1 does not apply to individual transactions under the WSPP Agreement. In their opinion, it only applies to adding or removing Service Schedules under the WSPP Agreement.

24. We disagree. The relevant language in Section 6.1 of the WSPP Agreement explicitly refers to possible changes in the rates, charges, classification, service, terms, or conditions for transactions entered into pursuant to the WSPP Agreement, and not just Service Schedules appearing in the last part of the WSPP Agreement. In particular,

²² 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..."

²³ See June 26 Order at 62,388.

Section 6.1 of the WSPP Agreement states in pertinent 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... (Emphasis added).

25. In addition, Respondents ask the Commission to clarify that in the absence of explicit contractual language allowing unilateral contract modifications under Section 206 of the FPA, the party seeking change must meet the public interest standard. As we explained in the Rehearing Order,²⁴ “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.”²⁵ In the June 26 Order, based on the evidence developed at the hearing and the Presiding Judge’s conclusions, we determined that “the parties to the challenged contracts did not intend to retain for Complainants the right to unilaterally seek changes to their contracts.”²⁶ Thus, we concluded that the Complainants must meet the burden of proof under the public interest standard of review to justify modification of the contracts.

26. Nevada Companies, however, argue that pursuant to Union Pacific,²⁷ the parties’ failure to explicitly address the issue of the applicable standard of review signifies the parties’ intent to apply the just and reasonable standard of review. Union Pacific is inapposite in the instant circumstances. First, the contracts at issue in Union Pacific contained a so-called Memphis²⁸ clause allowing unilateral contract changes. Second, the issue in Union Pacific was whether or not the Commission acting sua sponte is bound by the public interest standard. The Court in Union Pacific distinguished between restrictions on the contracting parties’ rights to unilaterally change rates and the

²⁴ Nevada Power Co. and Sierra Pacific Power Co. v. Enron Power Marketing, Inc., et al., 100 FERC ¶61,273 (2002) (Rehearing Order).

²⁵ Id. at 62,047.

²⁶ See June 26 Order at 62,388.

²⁷ Union Pacific Fuels, Inc. v. FERC, 129 F.3d 157 (D.C. Cir. 1997).

²⁸ See United Gas Pipe Line Co. v. Memphis Light, Gas and Water Division, et al., 358 U.S. 103 (1958).

Commission's right to modify contractual rates. The Court thus concluded that absent explicit language limiting the Commission's authority to modify the contract, the Mobile-Sierra doctrine is inapplicable to rate changes initiated by the Commission.

27. NPUC also argues that the appropriate standard of review for the contracts at issue is the just and reasonable standard and that the Commission set the public interest standard as the default standard for contract modification when parties are silent on the standard of review in their agreements, which contradicts court and Commission precedent. NPUC's contention is incorrect. We set the issue of the applicable standard of review for hearing to determine the intent of the parties. Consequently, our decision in the June 26 Order rests on the testimony and the Presiding Judge's conclusions interpreting the intent of the parties, as reflected in Section 6.1 of the WSPP Agreement.

28. SCWC further argues that Texaco²⁹ cited in the June 26 Order is also inapposite in the instant case because the WSPP Agreement is not a fixed-rate contract addressed in Texaco. SCWC's contention is without merit. Confirmation Agreements at issue here have a fixed price. Section 38 of the WSPP Agreement cited by SCWC in support of its position requires the parties to the WSPP Agreement to specify a floating price when they intend that the price for a transaction be based on an index. Moreover, the Court in Texaco held that the Mobile-Sierra doctrine applies regardless of whether parties to a contract agreed to a specific rate or whether they agreed to a rate changeable in a specific manner.³⁰

29. Snohomish and NBCP also contend that the application of the Mobile-Sierra public interest standard of review to market-based rate contracts is inappropriate and contrary to law. We addressed this issue in the June 26 Order on pages 62,388-89, paragraph 37. In response to the contention 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, we stated that:

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. 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 required specifically to review each agreement since the Commission, when it grants umbrella market-based rate

²⁹See Texaco Inc. v. FERC, 148 F. 3d 1091 (D.C. Cir. 1998).

³⁰ See id. at 1096.

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 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. As noted in GWF Energy, LLC,³¹ 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. (Footnotes omitted).

30. In addition, Snohomish argues that the Mobile-Sierra doctrine applies only in situations where a regulated utility is challenging a contract with a rate it argues is too low. As we stated in the June 26 Order on page 62,384, paragraph 7, "[i]n later cases, the Mobile-Sierra doctrine was applied to contracts containing rates that allegedly were too high." Snohomish, however, believes that the PSC of New York³² case the Commission relied on is inapposite. We disagree. The Court in PSC of New York held that the Mobile-Sierra doctrine protects contracts, not rates; it obligates both buyers and sellers, and the Commission is no more at liberty to alter a contract "to the prejudice of the producers than to do so in their favor."³³ In addition, the Mobile-Sierra doctrine has been applied in other cases where a complainant sought to reduce the existing rate.³⁴

31. Snohomish further argues that the Commission should have reviewed the contracts at issue under the just and reasonable standard to protect the rights of third parties, specifically, Snohomish's ratepayers who intervened in this case. In addition,

³¹ See GWF Energy, LLC, et al., 98 FERC ¶ 61,330, at 62,390 (2002).

³² See, e.g., Public Service Commission of the State of New York v. FPC, 543 F.2d 757 (D.C. Cir. 1974) (PSC of New York).

³³ Id. at 798.

³⁴ See, e.g., Potomac Electric Power Company v. FERC, 210 F.3d 403 (D.C. Cir. 2000).

Snohomish, NBCP, and NPUC contend that the Commission at the very least should have applied the flexible public interest standard.³⁵

32. As we stated in the June 26 Order on page 62,389, paragraph 41, “[t]here 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.” The cases cited by Snohomish as dictating application of the just and reasonable standard of review are inapposite. In PJM Interconnection, LLC,³⁶ the Reliability Assurance Agreement explicitly permitted PJM to submit filings under Section 206 of the FPA.³⁷ In the instant proceeding, the contract in question does not contain such a provision. Snohomish also cites to Carolina Power and Light Co.,³⁸ which 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. Finally, Snohomish refers to Pennsylvania Electric Co.,³⁹ which speaks in general terms about the Commission’s statutory duty to ensure just and reasonable rates. However, the Commission has applied the public interest standard to challenges brought by non-contractual parties.⁴⁰ In addition, we found no basis for applying a more flexible public interest standard to the contracts at issue. The record shows that the third-party intervenors, i.e., Snohomish’s retail ratepayers, were not adversely affected by the contract at issue. As we found in the June 26 Order:

The Snohomish-Morgan Stanley contract is no more than five percent of Snohomish's portfolio costs 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 fifty-one percent. Moreover, Snohomish's rate increase occurred prior to Snohomish's

³⁵ They cite to Northeast Utilities Service Co., 66 FERC ¶ 61,332 (1994).

³⁶ PJM Interconnection, LLC, 96 FERC ¶ 61,206 (2001).

³⁷ See id. at 61,878 n.12.

³⁸ Carolina Power and Light Co., 69 FERC ¶ 61,078 (1994).

³⁹ Pennsylvania Electric Co. v. FERC, 11 F3d 207 (D.C. Cir. 1993).

⁴⁰ See, e.g., Public Utility Commission of the State of California v. Sellers of Long Term Contracts, et al., 100 FERC ¶ 61,098, at 61,396 (2002).

negotiating its contract with Morgan Stanley, and prior to issuing the RFP for the power purchase in question. (Footnotes omitted).⁴¹

33. Similarly, the Nevada Companies failed to show that the contracts at issue imposed an excessive burden on their ratepayers.

34. Nevada Companies further argue that the holding in the June 26 Order contradicts the approach taken by the Commission in its Proposed Policy Statement.⁴² Under the Proposed Policy Statement, unless a contract contains the proposed language, the just and reasonable standard of review would apply to the contract. If adopted, the Policy Statement will apply on the prospective basis only, specifically, to contracts entered into 30 days after the date of issuance of the Final Policy Statement. Numerous parties filed comments to the Proposed Policy Statement raising various issues. The Commission is currently reviewing all of the comments.

35. Snohomish argues that Section 39B in its contract with Morgan Stanley⁴³ bars unilateral changes affecting only rates for service, while Snohomish challenges the term of the contract in this proceeding. We addressed this issue in the June 26 Order on page 62,389, paragraph 39. Specifically, we stated that:

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

Challenges to the Findings Involving the Sierra Three-Prong Test

36. On the question of whether the Nevada Companies' contracts imposed an excessive burden on their customers, NBPC acknowledges that the retail rates decreased,

⁴¹ See June 26 Order 62,398.

⁴² Standard of Review for Proposed Changes of Market-Based Rate Contracts for Wholesale Sales of Electric Energy by Public Utilities, 100 FERC ¶ 61,145 (2002).

⁴³ 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."

but argues that the Nevada Companies' customers paid significantly more than they would have if the prices had been reasonable. However, Complainants failed to produce record evidence on the effect of the contracts at issue on Nevada Companies' customers.

37. SCWC argues that the Commission erred in finding that the SCWC-Mirant contract's effect on SCWC retail customers was minimal. According to SCWC, its ratepayers have seen an overall 38 percent increase in their electric bills. As a result of this rate increase, as approved by the California Public Utilities Commission (CPUC), SCWC was allowed to recover a portion of the costs of the Mirant contract up to a weighted average cost of energy of \$77/MWh.

38. In the June 26 Order, we stated:

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. 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. (Footnotes omitted).⁴⁴

The bottom line for the public interest test is not the percentage increase as compared to prior rates. The public interest test requires a showing that the contract places an excessive burden on ratepayers sufficient to modify the contract. SCWC has not shown how a \$35.13 monthly electric bill amounts to an excessive burden on the ratepayers. Moreover, the weighted average cost of energy of \$77/MWh, which SCWC cites as a compelling piece of evidence, is only \$3 more than the \$74 advisory benchmark that SCWC believes would be a just and reasonable price for its contract with Mirant.

39. Snohomish also disagrees with the Commission's conclusion that its contract with Morgan Stanley did not impose an excessive burden on its ratepayers. Snohomish does not challenge the Commission's finding that "[t]he Snohomish-Morgan Stanley contract is no more than five percent of Snohomish's portfolio costs [] 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 fifty-one percent []."⁴⁵ However, Snohomish

⁴⁴ See June 26 Order at 62,398.

⁴⁵ See id.

argues that the five percent threshold is arbitrary. Snohomish also provides the amounts representing the burden imposed on Snohomish's ratepayers by the contract in question.

40. In our decision on this issue, we relied on the following record evidence. The Morgan Stanley contract resulted in an eight percent increase over 2001 rates, while other Snohomish contracts account for a rate increase of fifty-one percent. Moreover, Snohomish's rate increase occurred prior to Snohomish's negotiating its contract with Morgan Stanley, and prior to issuing a Request for Proposals (RFP) for the power purchase in question.⁴⁶

41. Snohomish further argues that the Commission's finding that Snohomish started the RFP process after the Snohomish Board authorized the retail rate increase is a non sequitur. According to Snohomish, the rate increase approval was directly related to the Snohomish-Morgan Stanley contract because the rate increase allowed Snohomish to pay the exorbitant cost of the contract in question.

42. Snohomish's Board approved the rate increase on December 13, 2000,⁴⁷ while Snohomish issued the RFP on December 22, 2000.⁴⁸ In other words, the rate increase took place prior to the initiation of the RFP process. We do not see the causal link between the contract in question and the rate increase, since the latter preceded even the solicitation of power.

43. Similarly, Snohomish challenges the Commission's determination that Snohomish failed to present evidence that its contract with Morgan Stanley was unduly discriminatory to the detriment of other purchasers who are not parties to the contract at issue. Snohomish contends that the Commission ignored evidence demonstrating that the contract has produced devastating consequences for electric customers in Snohomish County.

44. We are aware that Snohomish's retail rates are higher than the historical average; however, as we stated above, there is no evidence in the record that the rate hike was caused by the contract at issue.

⁴⁶ Id.

⁴⁷ Ex. SNO-1 at 4:19-5:2; Tr. at 1720-23; 1724.

⁴⁸ Ex. MSC-8 at 3-4; Tr. 1735, 1737.

The Commission's \$74/MWh Advisory Benchmark

45. Complainants also argue that the Commission failed to offer any justification for upholding the contract prices in excess of its \$74/MWh benchmark price.

46. Complainants refer to our December 15, 2000 Order⁴⁹ in which we declined to extend the California spot market mitigation measures to forward markets.⁵⁰ In that order, we also adopted an advisory benchmark of \$74/MWh for five-year contracts for supply around-the-clock to be used as a reference point in addressing any complaints regarding the pricing of contracts negotiated in forward markets. While we expected that the benchmark would be helpful in assessing possible complaints challenging forward prices, we never suggested that a contractual price exceeding the benchmark would be all by itself a sufficient ground for abrogating a contract. Quite to the contrary, we expected that “buyers may elect to negotiate above [the benchmark] to the extent they believe the particular contract or supplier brings value which suits their needs (e.g. shorter-term contracts, favorable terms and conditions, assignment of the risk of variable cost exposure, the particular characteristics of the supplier or its resource portfolio, etc.).”⁵¹

47. The record in this case shows that the SCWC contract provides a significant benefit, which SCWC emphasized when testifying before the CPUC. Energy is typically traded in 25-MW blocks, and Mirant took on the risk of supplying SCWC with a 15-MW “odd lot” sale. SCWC recognized in its CPUC testimony that a 15 MW block of energy should carry “a slight pricing premium.”⁵² A reliable supply of firm energy was particularly important to SCWC, since it had no resources of its own. Mirant’s contract offered greater capacity-like reliability benefits than a unit-specific contract. A unit-specific contract would have resulted in too much system unreliability for such a small system.⁵³ Moreover, SCWC’s RFP never specified a target price of \$74/MWh and there is no record evidence that any representative from SCWC told Mirant that it sought a price of \$74/MWh.⁵⁴

⁴⁹ San Diego Gas and Electric Co. v. Sellers of Energy and Ancillary Services, 93 FERC ¶ 61,294 (2000).

⁵⁰ Id. at 61,994.

⁵¹ Id. at 61,995.

⁵² Ex. MAEM-30 at JAD-10-11.

⁵³ Id.

⁵⁴ See Initial Decision at 65,307 n.444.

48. Similarly, the record shows that Snohomish did not specify in its RFP the target price of \$74/MWh. Quite to the contrary, Snohomish was specifically authorized by its Board to enter into a contract with a price as high as \$125/MWh.

49. Moreover, for comparison purposes, the advisory benchmark cannot be taken at face value. The \$74/MWh advisory benchmark represents a suggested price for five-year contracts for supply around-the-clock, whereas all Nevada Companies' contracts are for 12 months or shorter for standard on-peak 6x16 blocks of power. Nevada Companies failed to provide any calculations adjusting the \$74/MWh benchmark to reflect the terms of their specific contracts. As a result, neither the Presiding Judge nor the Commission had any evidence on which to assess the Complainants' arguments regarding the relationship of the challenged contract prices to the advisory benchmark.

50. Furthermore, Complainants argue that the Commission, while providing relief to purchasers in the California spot market, reneged its promise to assess complaints regarding the justness and reasonableness of prices in forward bilateral contracts executed during the time the spot market was dysfunctional. SCWC adds that, in accordance with the December 15 Order, it believed that the price in its contract with Mirant would be modified if proved to be unjust and unreasonable.

51. These contentions are without merit. The December 15 Order never mandated the application of the "just and reasonable" standard of review to forward contracts. Under the "public interest" standard applicable to the SCWC-Mirant contract, SCWC was required to show that the contract price at issue is contrary to the public interest, which it failed to do.

Totality of Circumstances

52. Nevada Companies and NBCP state that in its analysis of the "totality of circumstances," the Commission inappropriately focused on the Complainants' buying practices and ignored many other factors. Nevada Companies argue that whether they had other alternatives is irrelevant to the issues in this case. Furthermore, they contend that the alternatives available at the time of formation of the contracts were not true alternatives because Nevada Companies were prohibited by the state law from entering into any contracts with a term longer than three years.

53. The availability of other alternatives and the Complainants' buying practices are indicative of circumstances under which the transactions in question were executed. The availability of more competitively priced products demonstrates that the Complainants were not induced to enter into the transactions at issue. They were free to reject offers that led to execution of the contracts in question, and turn to other suppliers. In response to Nevada Companies' contention that it was prohibited to enter into contracts with a term longer than three years, we note that all of the contracts at issue here are 12 months

or shorter, even though (according to the Nevada Companies) the state law allowed contracts up to three years long.

54. Snohomish also argues that it did not have any meaningful alternatives at the time the contract was executed. According to Snohomish, the Western forward market was illiquid; the response rate to its RFP was very low; and two of the five bidders that responded refused to offer the firm, around-the-clock, quality of power service needed to serve Snohomish's customers reliably. The three remaining bids, Snohomish continues, were not meaningful alternatives either because they did not offer supply of sufficient quantity. Furthermore, Snohomish argues that contrary to the Commission's finding in the June 26 Order, it was never offered shorter-term contracts.

55. The record shows that 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. Specifically, one of the alternative bids from Morgan Stanley provided for power for periods of one, two or three years with gradually decreasing prices, respectively.⁵⁵ Morgan Stanley also offered Snohomish to enter into an alternative arrangement of two separate deals, one for five years (at above market prices) and another for five-seven years (at below market prices).⁵⁶ Snohomish rejected either of these alternatives. Instead, Snohomish chose to pass the risk of price volatility to Morgan Stanley and pay a below market rate of \$105 for the first several years, even if the contract had to be for a longer term. Snohomish expected, based on its forward curve dated April 2001, that its contract with Morgan Stanley would provide Snohomish with power at a price far below market for at least two years.⁵⁷

56. SCWC also takes issue with the Commission's determination that it had alternatives to the Mirant contract. It agrees with the Commission's finding that, in response to its RFP, it received three different proposals with varying options. However, according to SCWC, none of these responses were acceptable because they were tainted by the dysfunctions in the spot market.

57. The record shows that the price and the term of the contract SCWC is now challenging were consistent with SCWC's RFP, which contained a target price of \$90/MWh and requested bids for one-to-seven year contracts.⁵⁸ SCWC issued the RFP to

⁵⁵ Tr. 1735, MSC-10.

⁵⁶ Tr. 3992-93.

⁵⁷ Ex. MSC-37 at 22:22-23:3, Ex. MSC-50.

⁵⁸ Tr. 2900-02 and Ex. MAEM-2 at 13; MAEM-9; Tr. 2901:1-4, 2903:3-7; and 2904-5; Ex. SCW-4 at 12; SCW-1 at 12:5-10:24:10-12.

only six suppliers,⁵⁹ and as a result, received three responses containing varying options.⁶⁰ SCWC chose the contract terms suggested by Mirant. Even though the contract price offered by Mirant was slightly higher than the RFP target price, it was accepted by SCWC because, as recognized by SCWC in its testimony to CPUC, a 15 MW block of energy should carry a slight pricing premium.⁶¹

58. SCWC further challenges the Commission's finding 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 in May 2001."⁶² SCWC states that it could not have forecasted that in March 2001 prices would be at their peak because there was no information at the time to support such forecast. SCWC adds that it started the RFP process seven weeks prior to expiration of its previous contract with Dynegy Inc., which is, in SCWC's opinion, a reasonable time beforehand.

59. We made the challenged finding based on the record, which shows that in October 2000, after a summer of high prices, SCWC rejected an offer by Dynegy Inc. to extend its contract with SCWC on a "blend and extend" rate of between \$46.50/MWh to \$54.50/MWh, depending on the length of the proposed contract.⁶³ At that time, SCWC knew that the prices had risen substantially above the historical levels, and were well above the \$35.50/MWh price in its one-year contract with Dynegy Inc. However, SCWC failed to act to secure supply until March 2001 when the prices were at their peak.

60. SCWC further argues that while it is true that the SCWC-Mirant contract did not impose a financial burden on SCWC, the Commission was wrong to determine that SCWC derived profit from its sale of energy back to Mirant. SCWC contends that the money received from Mirant was credited to SCWC's retail customers.

61. We do not see how this fact should change the outcome of our analysis in the June 26 Order. The burden was on SCWC to show that SCWC and its retail customers

⁵⁹ Tr. 2893:19-2894:20; Ex. SCW-1 at 17:1-8.

⁶⁰ Tr. 2894:21-24; 2944:10-17.

⁶¹ Ex. MAEM-30.

⁶² See June 26 Order at 62,399.

⁶³ See Ex. MAEM-16 at 21:6-22:2, MAEM-24, and MAEM-25.

suffered financial hardship as a result of its contract with Mirant. SCWC also agrees on rehearing that the SCWC-Mirant contract did not impose a financial burden on SCWC.⁶⁴

62. SCWC further contends that the Commission's finding that by entering into the contract with Mirant, SCWC avoided the risk of price volatility and achieved rate certainty" is irrelevant because that is the effect of any fixed-rate forward contract, by definition.

63. The record shows that SCWC was willing to enter into a contract of a considerable length in order to secure the price it wanted.⁶⁵ The record evidence also establishes that SCWC agreed to the contract in spite of the fact that it did not expect high prices to persist for long due to a number of things, such as California streamlining authorizations for new generation; demand shifts from spot to forward markets; etc.⁶⁶ Thus, SCWC chose to avoid price volatility by shifting the risks on to Mirant. However, after the spot market prices fell below the level SCWC expected, SCWC became dissatisfied with the bargain.

64. Furthermore, Snohomish argues that the June 26 Order suggests two contradictory tests for meeting the burden of proof under the public interest standard of review. According to Snohomish, these tests are the Sierra three-prong test and the requirement to show market manipulation specific to the contracts at issue, as well as "unfairness, bad faith, or duress during the original negotiations." In the alternative, Snohomish and Nevada Companies argue that their contracts were the product of market manipulation by Enron, Morgan Stanley and other Respondents, which, as established by the Commission Staff, engaged in market manipulation. NPUC and NBCP add that the June 26 Order contradicts the Commission's findings regarding two Enron power marketers, which were found by the Commission to have manipulated spot markets.

65. We disagree. In the June 26 Order, we did not create two different public interest tests. Our statement that "there [was] 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" was in response to the Complainants contention that contract modification is warranted based on the Staff Report findings and the 100-Day Discovery Proceeding allegations of

⁶⁴ See SCWC's Rehearing Request at 74.

⁶⁵ See Initial Decision at 65,307.

⁶⁶ Id.

manipulation in the spot market. We reviewed the Staff Report findings and evidence submitted in the 100-Day Discovery Proceeding and found no evidence to support a finding of market manipulation that specifically affected the contracts at issue.

66. SCWC and Snohomish also challenge the Commission's finding that "because there is no evidence of unfairness, bad faith, or duress in the original negotiations, the Complainants are not entitled to change their bargains." In SCWC's opinion, this finding is outside the scope of the hearing. Snohomish contends that the showing of unfairness, bad faith, or duress is not required to meet the public interest standard.

67. We disagree. In the April 11 Order, we instructed the Presiding Judge 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. As we stated in the Rehearing Order, the instructions were tailored to "assist the judge in focusing on the main issue that the hearing is intended to resolve."⁶⁷ Whereas "unfairness, bad faith, or duress in the original negotiations" were not explicitly mentioned, such evidence could be relevant to the conditions present at the time of contract formation and whether the Commission should uphold or modify the challenged contracts. Moreover, as we stated in the Rehearing Order, the list of evidentiary requirements was not exclusive; the parties were free to offer other evidence deemed by the Presiding Judge to be relevant to the Commission-prescribed scope of the hearing.⁶⁸

68. In response to Snohomish's contention, we believe that a showing of fraud, duress, or bad faith between the parties at the contract formation stage could be an alternative ground for modifying the challenged contracts. Our review of a broader range of evidence concerning the circumstances surrounding formation of the contracts at issue imposed no harm on the Complainants. However, the Complainants failed to make this showing; they also failed to meet the Sierra three-prong test or demonstrate the contract abrogation is justified based on the totality of circumstances.

69. Snohomish further argues that the evidentiary record contains evidence of duress and exercise of market power by Morgan Stanley. According to Snohomish, Morgan Stanley was aware of Snohomish's need to conclude the transactions as soon as possible and that Snohomish had no other suppliers to turn to. In Snohomish's opinion, the fact that Morgan Stanley refreshed offer prices constitutes a compelling evidence of an exercise of market power. Snohomish adds that Snohomish was afforded by Morgan Stanley very little time to review the proposed contract.

⁶⁷ See Rehearing Order at 62,048.

⁶⁸ Id.

70. The evidentiary record does not support Snohomish's allegations. The record demonstrates that Snohomish required Morgan Stanley to submit its bid twice with modified terms suggested by Snohomish.⁶⁹ Snohomish was represented by counsel during the negotiations of the contract.⁷⁰ Snohomish dictated the deadlines to complete negotiations and several of the contract terms.⁷¹ The evidence also demonstrates that, shortly after Snohomish entered into the contract, it stated to its customers that the Morgan Stanley and other forward contracts "give [it] a lot of security against the uncertainty of market fluctuations," and that the contracts insulate the ratepayers from market volatility.⁷²

71. In addition, Nevada Companies and Snohomish further contend that the Commission erred in relying in its decision on PEPCO in which 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'] standard."⁷³ In Nevada Companies' and Snohomish's opinion, PEPCO and the instant case are factually different and thus PEPCO is inapplicable.

72. In deciding whether the Complainants met their burden of proof under the public interest standard of review, we were guided by the court case law developed over several decades. Upon the review of the evidentiary record developed in this proceeding, the findings of the Staff Report, and evidence submitted in the 100-Day Discovery Proceeding, we concluded that the challenged contracts were not contrary to the public interest because the Complainants 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 were not parties to this proceeding, or that any other factors in the record of this proceeding demonstrated that the contracts were contrary to the public interest.⁷⁴

⁶⁹ Tr. at 1743:20-1744:5; 1752-53; 3984-85; Ex. MSC-8 at 10.

⁷⁰ Ex. MSC-55 at 7:21-23.

⁷¹ Tr. at 1762:15-17; 1762:18-22.

⁷² Ex. MSC-83 at 6; Ex. MSC-78 at 7:10-12.

⁷³ See *Potomac Electric Power Company v. FERC*, 210 F.3d 403, 404 (D.C. Cir. 2000).

⁷⁴ See June 26 Order at 62,382 & 62,384.

Snohomish's Motion to Reopen the Record

73. Further Snohomish argues that it was denied an opportunity to address and/or rebut conclusions set forth in the Staff Report and the 100-Day Discovery Proceeding. In deciding this case, the Commission considered the Staff Report findings and the evidence submitted in the 100-Day Discovery Proceeding upon the Complainants' request. When Snohomish requested the Commission to take official notice of these two proceedings, it was well aware that findings and allegations in these proceedings were contested. We, however, agreed to consider evidence contained in these two proceedings as part of the evidentiary record developed in the instant case.

74. Snohomish further challenges the Commission's decision not to consider evidence submitted in other California-related proceedings. As we explained in the June 26 Order on page 62,402, paragraphs 131-32:

The Commission may reopen the record in its discretion where there is good cause. The Commission views good cause as consisting of extraordinary circumstances, that is, a change in circumstances that is more than just material, but goes to the very heart of the case. 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.' 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.'

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... (Footnotes omitted).

Collateral Annex

75. Snohomish argues that the Commission should reconsider its decision upholding the Collateral Annex.

76. In the June 26 Order, we found 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.⁷⁵

77. On rehearing, we reiterate that the WSPP Agreement, Collateral Annex, Confirmation Agreement and Attachment A form a single, integrated agreement, and that the Collateral Annex should be reviewed under the public interest standard. Even if Snohomish's contention that Section 39B does not apply to the Collateral Annex were correct, the Collateral Annex would still be subject to the public interest standard of review in light of our finding that, in accordance with Section 6.1 of the WSPP Agreement, the parties intended the application of the public interest standard of review. If Section 39B were not dispositive in regard to the Collateral Annex, then Section 6.1 of the WSPP Agreement would apply. Thus, any challenges to the Collateral Annex should be evaluated under the public interest standard of review. Furthermore, because the Collateral Annex is an integral part of the Snohomish-Morgan Stanley contract, the Collateral Annex cannot be examined separately from the rest of the contract. In the June 26 Order, we extensively analyzed all the evidence pertaining to the Snohomish-Morgan Stanley contract and concluded that Snohomish failed to present sufficient evidence showing that its contract with Morgan Stanley is contrary to the public interest.

Mirant Bankruptcy

78. On September 12, 2003, the Bankruptcy Court for the Northern District of Texas issued a “Temporary Restraining Order Against the Federal Energy Regulatory Commission” (“TRO”) in In re Mirant Corp. (Mirant Corp. v. FERC), Adversary Proceeding No. 03-4355, which enjoins the Commission “from taking any action, directly or indirectly, to require or coerce the [Mirant] Debtors to abide by the terms of any Wholesale Contract [to which a Mirant Debtor is a party] which Debtors are substantially performing or which Debtors are not performing pursuant to an order of the Court unless FERC shall have provided the Debtors with ten (10) days’ written notice setting forth in detail the action which FERC seeks to take with respect to any Wholesale Contract which is the subject of this paragraph.”

79. Should the TRO be converted into a preliminary injunction, an action that the Commission opposes, the Commission will appeal that order. Despite the Commission’s disagreement with the validity of the TRO and its expectation that the TRO (or a preliminary injunction) will be vacated on appeal, the Commission must comply with it until vacated. The TRO requires ten days’ written notice before the Commission takes a proscribed action with respect to a covered Mirant Wholesale Contract. Accordingly, to the extent that this Order requires Mirant to act in a manner proscribed by the TRO, the Order will provide written notice to Mirant of the action that FERC will take with respect

⁷⁵ See June 26 Order at 62,400.

to a covered Mirant Wholesale Contract, which action will not become effective until ten (10) days after issuance of this Order. In all other respects, this Order is effective immediately.

Requests for Rehearing of the April 23 Order

80. The April 23, 2003 was issued in response to a motion filed by SCWC and Snohomish in which they requested that the Commission disclose alleged prohibited off-the-record communications during a March 26, 2003 press conference attended by three commissioners and a conference call the same day between two commissioners and a group of Wall Street analysts. The Commission disagreed with movants' characterization of the briefings as prohibited off-the-record communications; nevertheless, to allay any concerns, the Commission granted movants' request for disclosure and directed its staff to place a transcript of the press conference and a summary of the telephone conference in the decisional record in this proceeding. The Commission stated that the transcript and summary would apprise the parties of any non-public communication, thereby maintaining the integrity of the process and curing any possible prejudice that the contacts may have caused in this proceeding. Accordingly, the Commission also denied Snohomish's additional request that Chairman Wood and Commissioner Brownell recuse themselves from the oral argument scheduled for that day and from any further decision making in this proceeding.

81. On May 23, 2003, SCWC and Snohomish filed a timely request for rehearing of the April 23 Order.

Ex Parte Allegations

82. SCWC and Snohomish first contend that the Commission erred in finding that the conference call did not violate Rule 2201 of the Commission's regulations, 18 C.F.R. § 385.2201, and that Chairman Wood and Commissioner Brownell were not required to recuse themselves from further participation in this proceeding. They claim specifically that the Commission's Revised Summary of Events and Invitation List show that Chairman Wood and Commissioner Brownell violated Rule 2201 in the conference call by offering opinions about the merits and their likely votes in this and other contract proceedings. They also point to portions of an April 8, 2003 news article by Jason Leopold, which claimed that analysts from Schwab Capital Markets, Lehman Bros., Prudential, and Morgan Stanley stated that Commissioner Brownell said she and Chairman Wood would vote to uphold the contracts. They argue that even if the Commissioners only repeated what they said at the open meeting, the conversation still violated Rule 2201.

83. SCWC and Snohomish's arguments are without merit. The summary of the call demonstrates what it was -- an effort to brief the financial community on action taken by

the Commission that same day at its public meeting with respect to important and controversial cases involving the California and Western energy markets. Understandably, the major impact those actions could have on the market would interest the financial community. Likewise of interest were the actions scheduled to be taken and postponed, but nevertheless discussed at the public meeting, in particular as relevant here Nevada Power's long-term contracts. Naturally, the analysts also inquired about these cases. Such inquiries in the context of a briefing, however, do not constitute a communication on the merits capable of influencing a decision, the prerequisite for an ex parte violation.⁷⁶ If that were the case, the Commission's ex parte rule could impede the Commissioners from expressing themselves or offering their opinions to the public, a common and necessary part of their jobs as public servants.

84. To be sure, there is a fine line between a briefing or a speech and a discussion on the merits capable of influencing a decision. But clearly that line was not crossed here. First, contrary to what SCWC and Snohomish gleaned from Mr. Leopold's news article, nothing particularly new was discussed in the relatively brief (approximately 45 minutes) conference call. Also, there is no indication even from that article or from the Summary that anyone tried to influence the decision in this proceeding. In fact, the Inspector General of the Department of Energy, who was asked by two U.S. Senators to investigate the matter, "did not identify evidence, based on that available record, substantiating the allegation that the conduct of the call violated any Commission procedural rule."⁷⁷ For this purpose, the Inspector General interviewed 17 Wall Street representatives from 12 companies, nine of whom acknowledged participating in some or all of the conference call.⁷⁸ As the Inspector General found, "[n]one of [them] stated that Chairman Wood or Commissioner Brownell explicitly indicated, during the conference call, how they would vote on the contract cases."⁷⁹

85. SCWC and Snohomish's concern that the Commissioners' statements might bind them to a particular vote is likewise unfounded. The cases they cite are inapposite,

⁷⁶ See 18 C.F.R. § 2201(c)(5) (2003).

⁷⁷ U.S. Department of Energy Office of Inspector General Special Inquiry, DOE/IG – 0610 June 2003.

⁷⁸ Wall Street representatives identified as participants and interviewed by the Inspector General were from Fitch Ratings, Lehman Brothers, Duquesne Capital Management, Merrill Lynch, Howard Weil (Legg Mason), Morgan Stanley, Moodys, Credit Lyonnais, S.A., Prudential Securities, Inc., Standard and Poor, Goldman Sachs, and Schwab Capital Markets.

⁷⁹ DOE/IG – 0610 June 2003, Results of the Inquiry p. 3.

because those cases involved public statements made by decision makers that they would vote a certain way prior to examining the evidence.⁸⁰ Chairman Wood and Commissioner Brownell stated repeatedly in public, however, they were still examining the evidence and had not made a final decision. Moreover, at the time of the conference call, a massive record had already been compiled and reviewed by the Commission. The record, which started to be compiled as early as December 2001, included by the time of the conference call numerous pleadings, trial testimony, exhibits, initial and reply briefs, an ALJ initial decision, and briefs on and opposing exceptions. Indeed, the filing of briefs opposing exceptions normally closes the record in an adjudication. While the Commission took the extraordinary step here of holding an oral argument (subsequent to the time of the conference call), that does not change the fact that the record was complete and reviewed, and the Commission was poised to act that day on the issues in the cases. To think that the Commissioners had not formed some preliminary opinions in these circumstances is simply unrealistic. Accordingly, the conference call at issue here reflected no prejudgment on the part of Chairman Wood and Commissioner Brownell.

86. Even assuming the conference call was a prohibited off-the-record communication, the violation has already been remedied. Recusal is not the remedy, disclosure is. Administrative proceedings blemished by ex parte communications may be remedied administratively by disclosing the communication and its contents.⁸¹ In this regard, in the context of a Commission case, the court found that by placing summaries of meetings Commission officials held with industry officials, other parties were apprised “of any argument that may have been presented privately, thereby maintaining the integrity of the process and curing any possible prejudice that the contacts may have caused.”⁸²

⁸⁰ SCWC and Snohomish cite *Antoniou v. SEC*, 877 F.2d 721, 724 (8th Cir. 1989); *McClure v. Independent School District No. 16*, 228 F.3d 1205 (10th Cir. 2000); *Staton v. Mayes*, 552 F.2d 908 (10th Cir. 1977); and *Cinderella Career & Finishing Schools, Inc. v. FTC*, 425 F.2d 583 (D.C. Cir. 1970).

⁸¹ See 5 U.S.C. § 557(d)(1)(C)&(D); *Professional Air Traffic Controllers Organization v. Federal Labor Relations Authority*, 685 F.2d 547, 565 n.36 (1982).

⁸² See *Louisiana Ass’n of Indep. Producers v. FERC*, 958 F.2d 1101, 1112 (D.C. Cir. 1992)(Louisiana).

87. In addition, in Louisiana, the court made clear that recusal was not necessary or desirable even though there may have been ex parte communications.⁸³ Recusal here, therefore, would be an extraordinary and unwarranted remedy.⁸⁴ The court further explained,

recusal would be required only if the communications posed a serious likelihood of affecting the agency's ability to act fairly and impartially in the matter before it. In resolving that issue, one must look to the nature of the communications and particularly to whether they contain factual matter or other information outside of the record, which the parties did not have an opportunity to rebut.⁸⁵

88. As described above, the conference call contained no factual matter or other information outside the record, and even assuming it did, SCWC and Snohomish had ample chance to rebut it at the oral argument or by filing a response.

89. SCWC and Snohomish also argue on rehearing that the Commission's disclosure of the conference call was not adequate for a prohibited off-the-record communication in that (1) it was not recorded, (2) roll call was not taken and the identity of the participants is not known with certainty, (3) separate summaries of the communication were not prepared by Chairman Wood and Commissioner Brownell, and Kevin Cadden is not eligible under the rules to write the summary, (4) the summary was not available within 14 days of the communication, and (5) the investigation of the call for this and other possible off-the-record communications was not sufficient. SCWC and Snohomish are wrong on all counts.

90. Even assuming the APA and Rule 2201 required disclosure of the conference call, the Commission plainly met the disclosure requirements. For this purpose, Rule 2201 mirrors the APA disclosure requirements at 5 U.S.C. § 557(d)(1)(C). It requires that any decisional employee who makes or receives a prohibited off-the-record communication

⁸³ Id. at 1112 (citing FTC v. Cement Inst., 333 U.S. 683, 702 (1948) (“It is expected that administrative official will build up expertise through experience with recurring issues.”) and Laird v. Tatum, 409 U.S. 824, 837 (1972) (“Such expertise should not lightly be tossed aside.”)).

⁸⁴ See Power Authority of the State of New York v. FERC, 743 F.2d 93, 110 (2d Cir. 1984) (“The mere existence of such communications hardly requires a court or administrative body to disqualify itself.”).

⁸⁵ Id. at 110.

will promptly submit to the Commission's Secretary that communication, if written, or a summary of the substance of that communication, if oral. See 18 C.F.R. § 385.2201(f)(2). Any party may file a response to the communication. See 18 C.F.R. § 385.2201(f)(3). The Secretary will then, not less than every 14 days, issue a public notice listing any prohibited off-the-record communications or summaries of the communication received by her office. See 18 C.F.R. § 385.2201(h)(1). That is exactly what happened here, albeit in response to SCWC and Snohomish's motion: a summary of the communication, to which these parties could have responded, was publicly noticed by the Secretary within moments of the Commission's treatment of the conference call as if it were an off-the-record communication.

91. SCWC and Snohomish's attempt in effect to impose their own additional requirements on the Commission must be rebuffed. There is no requirement that the conference call had to be recorded or all of the participants identified. Nevertheless, Mr. Cadden contacted numerous invitees asking if they had recorded the conference call; no one had. The Commission also disclosed a list of invitees since the participants did not take roll call. More the point, SCWC and Snohomish's concerns about the identity of the outside participants are irrelevant. The communication is the target of the APA and Rule 2201, not the persons to whom the communication is made. Indeed, Rule 2201 prohibits certain off-the-record communications with all persons, not just parties or interested persons, outside the Commission. See 18 C.F.R. § 385.2201(b).

92. There is also no requirement that every Commission participant involved in an off-the-record communication file a separate summary. Mr. Cadden, who was present during the call, drafted the summary, and Chairman Wood and Commissioner Brownell reviewed and edited it. Contrary to SCWC and Snohomish's assertion, Mr. Cadden, Director of the Office of External Affairs, is a decisional employee and eligible under Rule 2201 to write the summary.⁸⁶ Along the same lines, Rule 2201 does not require multiple summaries, nor should it. Such duplicative effort would be administratively inefficient and burdensome.

93. There is likewise no requirement that a summary must be available within 14 days of the communication. Rule 2201 requires a Commission participant in a prohibited off-the-record communication to submit to the Secretary promptly that communication, if written, or a summary of the substance of that communication, if oral. See 18 C.F.R. § 385.2201(f)(2). Only then must she publish a notice. SCWC and Snohomish thus confuse the requirement of Rule 2201 that the Secretary release within 14 days of her receipt any such communications or summaries and the requirement that Commission participants in the communication promptly submit these items to the Secretary. Here, as

⁸⁶ See Policy Statement on Separation of Functions, 101 FERC ¶ 61,340, at 47 and 48.

noted, Mr. Cadden promptly submitted a summary of the substance of the communication in the conference call to the Secretary after the Commission chose to treat the call as if it involved an off-the-record communication. Within 14 days, in fact within hours, the Secretary released the summary received by her office.

94. As a final matter, neither the APA nor Rule 2201 requires an investigation.⁸⁷ As noted, however, the Office of the Inspector General for the Department of Energy conducted a thorough investigation of the matter at the request of Senators Joseph Lieberman and Maria Cantwell. The Inspector General's report, which was issued on June 27, 2003, found that the Commission had not violated any procedural rules. Any further investigation would place a tremendous and unnecessary burden on the Commission, and effectively require the Commission to poll all of its employees.⁸⁸ Commission employees already have an affirmative obligation under Rule 2201 to report off-the-record communications should they occur. Similarly untenable is SCWC and Snohomish's request that invitees to the March 26 conference call be subpoenaed, required to state under oath whether they participated in the meeting or recorded the call, and required to provide their notes.⁸⁹

Alleged Sunshine Act Violations

95. On July 28, 2003, Snohomish filed a supplemental request for rehearing alleging that the March 26 conference call violated the Sunshine Act, because no public notice was published and the meeting was not recorded.⁹⁰ Snohomish is wrong. The Sunshine

⁸⁷ SCWC and Snohomish's reliance on *Professional Air Traffic Controllers Organization v. FLRA*, 672 F.2d 109 (D.C. Cir. 1982)(PATCO), is without merit. In PATCO, the court ordered an investigation because of an allegation that a well-known organized labor figure had attempted to influence the vote of one of the FLRA members. There is no allegation of such an attempt to influence here.

⁸⁸ For like reasons, the Commission will not address or pursue further the allegations made by Morgan Stanley in its April 22, 2003 motion against Commissioner Massey who supposedly received ex parte communications about these contract cases from Senator Cantwell.

⁸⁹ In addition to the summary disclosed by the Commission, on June 3, 2003, in response to separate FOIA requests, the Commission released to the SCWC and Snohomish more than 70 documents related to the call.

⁹⁰ This request is untimely as a request for rehearing of the April 23 Order, and the movants have failed to preserve the issue for judicial review. See 16 U.S.C. § 8251 (a) and (b). Nevertheless, the Commission will address the allegations.

Act applies only to a “meeting of an agency.”⁹¹ Section 552b(a)(2) defines a Sunshine Act “meeting” as “the deliberations of at least the number of individualized agency members required to take action on behalf of the agency where such deliberations determine or result in the joint conduct or disposition of official agency business.”⁹² Consistent with this, the Commission’s Sunshine Act regulations specify that “the deliberations of at least a quorum of the Commission” are required in order for the Sunshine Act to apply. See 18 C.F.R. § 375.202(a)(1). Under the governing statute and regulations, at least three members of the Commission are required to be present for a quorum to exist. Specifically, the Department of Energy Organization Act, 42 U.S.C. §§ 7101-7352, which established the Commission provides that for the Commission “a quorum for the transaction of business shall consist of at least three members present.”⁹³ Because only two Commissioners (Chairman Wood and Commissioner Brownell) participated in the call, there was no quorum to constitute a Commission “meeting” subject to the Sunshine Act.

96. Moreover, as discussed above, the conference call did not involve any “deliberations” that “determine or result in the joint conduct or disposition of official agency business.” See 5 U.S.C. 552b(a)(2). The summary of the March 26 conference call confirms that the two commissioners merely expressed viewpoints that had already been discussed at the March 26 open meeting. Even if the Commissioners did express their views regarding this proceeding, no “official agency business” was disposed of or conducted during the conference call. Therefore, the Commission rejects Snohomish’s allegation that the conference call violated the Sunshine Act.

The Commission orders:

(A) The Complainants’ requests for rehearing of the June 26 Order are hereby denied for the reasons stated in the body of this order.

⁹¹ See 5 U.S.C. § 552(b); 5 U.S.C. § 552 b(a)(2), FCC v. ITT World Communications, Inc., 466 U.S. 463, 469 (1984) (“None of the Sunshine Act’s requirements is triggered, however, “unless the gathering in question is a ‘meeting’ of that agency.”).

⁹² Natural Resources Defense Council, Inc. v. NRC, 216 F.3d 1180, 1182 (D.C. Cir. 2000).

⁹³ 42 U.S.C. § 7171(e); see also 18 C.F.R. § 375.101(e)(defining a quorum of the Commission as consisting of “at least three members present”).

(B) The Respondents' request for clarification of the June 26 Order is hereby granted in part and denied in part for the reasons stated in the body of this order.

(C) SCWC and Snohomish's rehearing request of the April 23, 2003 Order is hereby denied for the reasons stated in the body of this order.

By the Commission. Commissioner Massey dissenting with a separate statement attached.

(S E A L) Commissioner Brownell concurring with separate statement attached.

Linda Mitry,
Acting Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Nevada Power Company and
Sierra Pacific Power Company

v.

Docket Nos. EL02-28-004
EL02-28-005
EL02-33-004
EL02-33-005
EL02-38-004
EL02-38-005

Enron Power Marketing, Inc.
El Paso Merchant Energy
American Electric Power Services, Corp.

Nevada Power Company

v.

Docket Nos. EL02-29-004
EL02-29-005
EL02-30-004
EL02-30-005
EL02-31-004
EL02-31-005
EL02-32-004
EL02-32-005
EL02-34-004
EL02-34-005
EL02-39-004
EL02-39-005

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.

Southern California Water Company

v.

Docket Nos. EL02-43-004
EL02-43-005

Mirant Americas Energy Marketing, L.P.

Public Utility District No. 1
Snohomish County, Washington

v.

Morgan Stanley Capital Group, Inc.

Docket Nos. EL02-56-004
EL02-56-005

(Consolidated)

(Issued November 10, 2003)

MASSEY, Commissioner, dissenting:

I dissented from the underlying order and nothing in today's order persuades me to change my mind. The public interest requires that the contracts at issue be reformed.

For the reasons stated in my dissent in the underlying order, I dissent from today's order.

William L. Massey
Commissioner

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(Issued November 10, 2003)

Nora Mead BROWNELL, Commissioner concurring:

1. I am writing separately to reiterate a concern I raised about the June 26 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' failure to explicitly reserve the buyers' 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

2. 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

¹Nevada 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)).

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

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