

FEDERAL ENERGY REGULATORY COMMISSION
Washington, D.C. 20426

October 26, 2005

In Reply Refer To:
Lehman Brothers Commodity Services Inc.
Docket No. ER05-1420-000

McDermott Will & Emery LLP
Attn: Catherine M. Krupka, Esq.
Attorney for Lehman Brothers Commodity Services Inc.
600 13th Street, N.W.
Washington, D.C. 20005-3096

Dear Ms. Krupka:

1. On August 31, 2005, Lehman Brothers Commodity Services Inc. (Lehman Brothers) filed an application for market-based rate authority with an accompanying tariff. The proposed market-based rate tariff provides for the sale of capacity, energy, and ancillary services at market-based rates and for the reassignment of transmission capacity, and the resale of firm transmission rights (FTRs).¹ Lehman Brothers' submittal includes the Commission's market behavior rules² and the change in status reporting

¹ Lehman Brothers plans to sell certain ancillary services in the markets administered by PJM Interconnection, LLC (PJM), the New York Independent System Operator, Inc. (NYISO), ISO New England (ISO-NE), and the California Independent System Operator Corporation, Inc. (CAISO).

² *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 105 FERC ¶ 61,218 (2003), *order on reh'g*, 107 FERC ¶ 61,175 (2004).

requirement adopted by the Commission in Order No. 652.³ Lehman Brothers' submittal satisfies the Commission's standards for market-based rate authority and its tariff is accepted for filing effective October 31, 2005.

2. Lehman Brothers states that it is a Delaware corporation with its principal place of business in New York, New York. Lehman Brothers states that it is a wholly-owned subsidiary of Lehman Brothers Special Financing Inc. and an indirect subsidiary of Lehman Brothers Holdings Inc.

3. Lehman Brothers Special Financing Inc. deals in a range of derivative products including interest rate, currency, credit and mortgage derivatives. Lehman Brothers Holdings Inc. is a financial services institution which conducts business in equity and fixed income sales, trading and research investment banking, private investment management, asset management and private equity.

4. Lehman Brothers Inc. is a wholly-owned subsidiary of Lehman Brothers Holding Inc. Lehman Brothers Inc.'s primary activities include securities trading, underwriting, investment and merchant banking and financial advisory services. Lehman Brothers states that neither Lehman Brothers Holding Inc. nor Lehman Brothers Inc. owns or controls any energy assets located in the United States; however, in the course of providing financial services Lehman Brothers Holding Inc. and Lehman Brothers Inc. may invest in entities which own energy-related assets such as generation units, transmission facilities, pipelines, oil exploration and production facilities and coal supply facilities. Lehman Brothers states that Lehman Brothers Holding Inc. and Lehman Brothers Inc. are passive or non-controlling investors in these entities, generally holding less than 5 percent ownership and holding no position that would give Lehman Brothers Holding Inc. or Lehman Brothers Inc. control over the day-to-day operations of power-related assets.

5. Lehman Brothers states that it is also affiliated with other entities that trade distressed debt and similar financial products; however, all of these entities are separate legal entities from Lehman Brothers and all are passive or non-controlling investors or lenders to unaffiliated companies that directly or indirectly own electric generation or transmission.

³ *Reporting Requirement for Changes in Status For Public Utilities With Market-Based Rate Authority*, Order No. 652, 70 Fed Reg. 8,253 (Feb. 18, 2005), FERC Stats. & Regs. ¶ 31,175, *order on reh'g*, 111 FERC ¶ 61,413 (2005) (Order No. 652).

6. Lehman Brothers states that it intends to sell, market and trade wholesale power, capacity, ancillary services and related services in various markets in the United States.

Procedural Matters

7. Notice of the Lehman Brothers' August 31, 2005 filing was published in the *Federal Register*, 70 Fed. Reg. 54,041 (2005), with interventions and protests due on or before September 21, 2005. None was filed.

Discussion

Market-Based Rate Authorization

8. The Commission allows power sales at market-based rates if the seller and its affiliates do not have, or have adequately mitigated, market power in generation and transmission and cannot erect other barriers to entry. The Commission also considers whether there is evidence of affiliate abuse or reciprocal dealing.⁴ As discussed below, the Commission concludes that Lehman Brothers satisfies the Commission's standards for market-based rate authority.

9. In its order issued in *AEP Power Marketing, Inc.*, 107 FERC ¶ 61,018 (April 14 Order), *order on reh'g*, 108 FERC ¶ 61,026 (2004), the Commission adopted two indicative screens for assessing generation market power, the pivotal supplier screen and the wholesale market share screen. However, under section 35.27 of the Commission's regulations, applicants need not demonstrate any lack of market power in generation with respect to sales from capacity constructed after July 9, 1996.⁵ Further, if an applicant sites generation in an area where it or its affiliates own or control other generation assets, the applicant must study whether its new capacity, when added to existing capacity, raises generation market power concerns.⁶ The Commission clarified that in circumstances where construction on all of an applicant's generation commenced after

⁴ See, e.g., *Progress Power Marketing, Inc.*, 76 FERC ¶ 61,155 at 61,919 (1996); *Northwest Power Marketing Co., L.L.C.*, 75 FERC ¶ 61,281 at 61,899 (1996); *accord Heartland Energy Services, Inc.*, 68 FERC ¶ 61,223 at 62,062-63 (1994).

⁵ 18 C.F.R. § 35.27(a) (2005). We note that the Commission intends to address as part of the generic rulemaking proceeding in Docket No. RM04-7-000 whether to retain or modify section 35.27(a) of our regulations.

⁶ See *AEP Power Marketing, Inc.*, 107 FERC ¶ 61,018 at P 69 (2004).

July 9, 1996, no generation market power analysis need be performed.⁷ Lehman Brothers states that it does not own or control any generation. However, affiliates of Lehman Brothers own generation in the ISO-NE, NYISO, Arizona Public Service (APS), Entergy, Michigan Electric Coordinated Systems (MECS), and Salt River Project (SRP) markets. Lehman Brothers states that all of its affiliated generation located in the NYISO, MECS, APS, Entergy, and SRP markets is post-July 1996 capacity.

10. Lehman Brothers affiliates own 151 MWs of capacity in the ISO-NE market. Lehman Brothers has prepared both the pivotal supplier and the wholesale market share screen analyses for the ISO-NE market. Lehman Brothers states that it passes the screens in ISO-NE. The Commission has reviewed Lehman Brothers' generation market power analyses for ISO-NE and has determined that Lehman Brothers passes both the pivotal supplier and the wholesale market share screens in ISO-NE. Based on Lehman Brothers' representations, the Commission finds that Lehman Brothers satisfies the Commission's generation market power standard for market-based rate authority.

11. Lehman Brothers states that neither it nor any of its affiliates owns or controls any transmission facilities in the United States. Based on these representations, the Commission finds that Lehman Brothers satisfies the Commission's transmission market power standard for the grant of market-based rate authority.

12. Lehman Brothers states that it does not have the ability to erect barriers to entry because neither it nor its affiliates owns or controls any sites for the construction of new generation capacity, construction or engineering firms, or natural gas facilities that would allow them to inhibit competition. Based on this representation, the Commission is satisfied that Lehman Brothers cannot erect barriers to entry.

13. Lehman Brothers states that neither Lehman Brothers nor any of its affiliates has a franchise or service territory for the transmission, distribution or sale of electric power in the United States. Additionally, the proposed tariff prohibits transactions with any public utilities with franchised service territories that are controlled by, under common control with, or control Lehman Brothers, without first receiving Commission approval under a separate filing under section 205 of the Federal Power Act. Based on this representation, the Commission finds that Lehman Brothers satisfies the Commission's concerns with regard to affiliate abuse.

⁷ See *AEP Power Marketing, Inc.*, 108 FERC ¶ 61,026 at P 110 (2004).

14. Lehman Brothers requests authority to engage in the sale of certain ancillary services (listed in the proposed tariff) at market-based rates into the markets administered by PJM, NYISO, ISO-NE, and the CAISO. Consistent with Commission precedent granting authority to sellers to engage in such transactions in those markets, the Commission will grant Lehman Brothers' request.⁸

15. Lehman Brothers also requests authority to sell additional ancillary services as the Commission may specify and authorize from time to time in orders that extend such authority to all sellers previously authorized to sell energy and capacity at market-based rates. The Commission will grant Lehman Brothers' request; however, this grant does not relieve Lehman Brothers of the requirement to have current and complete tariffs on file with the Commission, pursuant to 18 C.F.R. § 35.1 (2005).⁹

16. Lehman Brothers also requests authority to reassign transmission capacity and to resell FTRs or their equivalent. The Commission finds Lehman Brothers' proposed provisions consistent with the Commission's requirements.¹⁰ Accordingly, the Commission will grant this request.

Other Waivers, Authorizations and Reporting Requirements

17. Lehman Brothers requests the following waivers and authorizations: (1) waiver of Subparts B and C of Part 35 of the Commission's regulations requiring the filing of cost-of-service information, except as to sections 35.12(a), 35.13(b), 35.15, and 35.16; (2) waiver of Parts 41, 101, and 141 of the Commission's accounting and periodic reporting requirements; (3) abbreviated filings with respect to interlocking directorates under Part 45 of the Commission's regulations; and (4) blanket authorization under Part 34 of the Commission's regulations for all future issuances of securities and assumptions of liability.

⁸ See, e.g., *New England Power Pool*, 85 FERC ¶ 61,379 (1998), *reh'g denied*, 95 ¶ 61,074 (2001); *PJM Interconnection, LLC*, 86 FERC ¶ 61,247 (1999), *California Independent System Operator*, 100 FERC ¶ 61,060 (2002), *order on reh'g*, 101 FERC ¶ 61,061 (2002); and *New York Independent System Operator, Inc.*, 89 FERC ¶ 61,196 (1999), *New York Independent System Operator, Inc.*, 90 FERC ¶ 61,317 (2000).

⁹ See *Calhoun Power Co.*, 96 FERC ¶ 61,056 (2001).

¹⁰ See *Calif. Indep. Sys. Operator, Inc.*, 89 FERC ¶ 61,153 (1999); *Southwestern Public Service Co.*, 80 FERC ¶ 61,245 (1997).

18. The Commission will deny Lehman Brothers' request for waiver of the full requirements of Part 45 of the Commission's regulations. The Commission has stated that it will no longer grant waivers of the full requirements of Part 45 in orders granting market based rate authority.¹¹

19. With regard to the other waivers and authorizations requested by Lehman Brothers, the Commission will grant those waivers and authorizations consistent with those granted other entities with market-based rate authorizations.¹² Notwithstanding the waiver of the accounting and reporting requirements here, the Commission expects Lehman Brothers to keep its accounting records in accordance with generally accepted accounting principles.

20. Within 30 days of the date of the issuance of this order, any person desiring to be heard or to protest the Commission's blanket approval of issuances of securities or assumptions of liabilities by Lehman Brothers should file a motion to intervene or protest with the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426, in accordance with Rules 211 and 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.211 and 385.214 (2005).

21. Absent a request to be heard within the period set forth above, Lehman Brothers is hereby authorized to issue securities and assume obligations or liabilities as guarantor, indorser, surety, or otherwise in respect of any security of another person; provided that such issue or assumption is for some lawful object within the corporate purposes of Lehman Brothers, compatible with the public interest, and reasonably necessary or appropriate for such purposes.

¹¹ See *Commission Authorization to Hold Interlocking Positions*, Order No. 664, 70 Fed. Reg. 55,717 (September 23, 2005), 112 FERC ¶ 61,298 at P 34 (2005) ("[W]e intend to no longer grant waivers of the full requirements of Part 45 in our orders granting market based rate authority. Rather, persons seeking to hold interlocking positions will be required henceforth to comply with the full requirements of Part 45").

¹² It should be noted that the Commission is examining the issue of continued applicability of the waivers of its accounting and reporting requirements (18 C.F.R. Parts 41, 101, and 141), as well as continued applicability of the blanket authorization for the issuance of securities and the assumption of obligations and liabilities (18 C.F.R. Part 34). See *Accounting and Reporting of Financial Instruments, Comprehensive Income, Derivatives and Hedging Activities*, Order No. 627, 67 Fed. Reg. 67,691 (Oct. 10, 2002), FERC Stats. & Regs. ¶ 32,558 at P 23-24 (2002).

22. The Commission reserves the right to modify this order to require a further showing that neither the public nor private interests will be adversely affected by continued Commission approval of Lehman Brothers' issuances of securities or assumptions of liabilities.
23. Consistent with the procedures the Commission adopted in Order No. 2001, an entity with market-based rates must file electronically with the Commission an Electric Quarterly Report containing: (1) a summary of the contractual terms and conditions in every effective service agreement for market-based power sales; and (2) transaction information for effective short-term (less than one year) and long-term (one year or greater) market-based power sales during the most recent calendar quarter.¹³ Electric Quarterly Reports must be filed quarterly no later than 30 days after the end of the reporting quarter.¹⁴ Accordingly, Lehman Brothers must file its first Electric Quarterly Report no later than 30 days after the first quarter Lehman Brothers' rate schedule is in effect.
24. Lehman Brothers must timely report to the Commission any change in status that would reflect a departure from the characteristics the Commission relied upon in granting market-based rate authority.¹⁵

¹³ *Revised Public Utility Filing Requirements*, Order No. 2001, 67 Fed. Reg. 31,043 (May 8, 2002), FERC Stats. & Regs. ¶ 31,127 (2002). Required data sets for contractual and transaction information are described in Attachments B and C of Order No. 2001. The Electric Quarterly Report must be submitted to the Commission using the EQR Submission System Software, which may be downloaded from the Commission's website at <http://www.ferc.gov/docs-filing/eqr.asp>.

¹⁴ The exact filing dates for these reports are prescribed in 18 C.F.R. § 35.10b (2004). Failure to file an Electric Quarterly Report (without an appropriate request for extension), or failure to report an agreement in an Electric Quarterly Report, may result in forfeiture of market-based rate authority, requiring filing of a new application for market-based rate authority if the applicant wishes to resume making sales at market-based rates.

¹⁵ *Reporting Requirement for Changes in Status For Public Utilities With Market-Based Rate Authority*, Order No. 652, 70 Fed Reg. 8,253 (Feb. 18, 2005), FERC Stats. & Regs. ¶ 31,175, *order on reh'g*, 111 FERC ¶ 61,413 (2005) (Order No. 652).

25. Lehman Brothers' next updated market power analysis is due within three years of the date of this order. The Commission also reserves the right to require such an analysis at any intervening time.

By direction of the Commission.

Magalie R. Salas,
Secretary.