103 FERC ¶ 61,354

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Public Utilities Commission of the State of California	
v.	Docket Nos. EL02-60-000 and EL02-60-003
Sellers of Long Term Contracts to the California Department of Water Resources	
California Electricity Oversight Board	
v.	Docket Nos. EL02-62-000 and EL02-62-003
Sellers of Energy and Capacity Under Long-Term Contracts with the California Department of Water Resources	(Consolidated)

ORDER ON PARTIAL INITIAL DECISION, REMAINING SUBSTANTIVE ISSUES AND MOTIONS

(Issued June 26, 2003)

1. This proceeding involves complaints by which customers under certain long-term contracts sought to modify those contracts with more than twenty-four (24) sellers. As a result of withdrawals, only seven sellers remain in this proceeding. The Public Utilities Commission of the State of California (CPUC) and the California Electricity Oversight Board (CEOB) (collectively, "Complainants") allege that the prices, terms and conditions of long-term contracts entered into between the California Department of Water Resources (CDWR) and a group of sellers of energy are unjust and unreasonable and, to

the extent applicable, not in the public interest. Complainants seek that the contracts be voidable, at the option of the State of California, or be abrogated.

2. In the order issued on April 25, 2002,[1] the Commission set the instant complaints for hearing. On January 16, 2003,[2] after an evidentiary hearing, the Administrative Law Judge (ALJ) concluded that the applicable standard of review intended by the parties for the contracts at issue here is the "public interest" standard.[3]

3. In this order, we affirm the ALJ's finding that the "public interest" standard of review applies to all the contracts at issue which did not contain explicit Mobile-Sierra[4] language. We also find that Complainants have not met their burden of proof under the "public interest" standard to justify the modification or abrogation of the contracts at issue in this proceeding. Thus, we deny the complaints. In denying the instant complaints, we have considered the evidentiary record developed in this proceeding, findings of the Commission Staff's Final Report on Price Manipulation in Western Markets in Docket No. PA02-2-000 (Staff Report), and evidence submitted in the 100-Day Discovery Proceeding in Docket No. EL00-95, et al.[5]

4. Specifically, we affirm the ALJ's finding that the applicable standard of review for the contracts at issue here is the "public interest" standard. Before discussing the specific facts of the case before us, it is important to understand the historical context in which the "public interest" standard has been applied by the courts, and the legal parameters within which the Commission must address requests for contract reformation. The "public interest" standard of review was first introduced by the U.S. Supreme Court in

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[1] Public Utilities Commission of California v. Sellers of Long Term Contracts, 99 FERC ¶ 61,087 (2002) (April 25 Order).

[2] Public Utilities Commission of California v. Sellers of Long Term Contracts, 102 FERC ¶ 63,013 (2003) (Partial Initial Decision).

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

[4] Mobile, 350 U.S. 332; Sierra, 350 U.S. 348.

[5] San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Serv., 101 FERC ¶ 61,186 (2002) (November 20 Order), order on clarification and reh'g, 102 FERC ¶ 61,164 (2003) (February 10 Order).

the 1956 Mobile case[6] and the concurrently decided Sierra case.[7] The U.S. Supreme Court held that, in order to justify modification of its contract, the seller in that case had to show that the contract rate was so low that it was contrary to the public interest. In the Mobile and Sierra decisions, the Court sought to mesh the respect for the sanctity of contracts under the Federal Power Act (FPA)[8] and Natural Gas Act[9] with the traditional scheme of regulation under these statutes. The Court held that, where the public utility (or natural gas company) and its customer contracted for a particular rate and did not reserve for the seller the right to unilaterally propose a rate change, the utility cannot unilaterally (i.e., without the customer's consent) file a new rate under Section 205 of the FPA[10] to supersede the agreed-upon rate. The Court also ruled that the Commission's power under Section 206 of the FPA[11] to alter the existing contract rate, after its acceptance by the Commission, is limited.[12]

5. In the Sierra decision, the Court gave examples of factors that would meet the "public interest" standard and allow the selling utility to modify its contract. The selling utility was required to demonstrate, for example, that "the rate is so low as to adversely affect the public interest -- as where it might impair the financial ability of a public utility to continue service, cast upon other consumers an excessive burden, or be unduly discriminatory."[13]

6. Both Mobile and Sierra addressed seller challenges to contract rates alleged to be too low. In later cases, the Mobile-Sierra doctrine was applied to contracts containing

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[6] Mobile, 350 U.S. 332.

[7] See Sierra, 350 U.S. 348.

[8] 16 U.S.C. §§ 796 et seq. (2000).

[9] 15 U.S.C. §§ 717 et seq. (2000).

[10] 16 U.S.C. § 824d (2000).

[11] 16 U.S.C. § 824e (2000).

[12] Boston Edison Co. v. FERC, 233 F.3d 60, 64-65 (1st. Cir. 2000) (Boston Edison) (citing Sierra, 350 U.S. at 352-55; accord Mobile, 350 U.S. at 347).

[13] See Sierra at 355.

rates that allegedly were too high.[14] The Mobile and Sierra cases were decided in a cost-based rate regime and consequently dealt with changes proposed to contracts that were already on file with the Commission. The application of the Mobile-Sierra doctrine was later extended to contracts that were not on file with the Commission.[15]

7. In a more recent case involving a long-term, fixed-rate contract, the court held that a showing of "a mere rate disparity or a benefit to the purchasing utility or its customers for a rate modification does not suffice, without more, to satisfy [the 'public interest'] standard."[16] In PEPCO, the court also noted that the purchaser seeking a lower rate failed to "offer any evidence (beyond speculation) that the only potential non-parties here, its ratepayers, were adversely affected by the existing rates; it did not, for example, even attempt to show how much if any of the rate disparity was passed on to PEPCO ratepayers rather than borne by the utility itself."[17] While PEPCO claimed an excessive burden on its customers and discriminatory impact from the disparity between the contract rates and the OATT rate charged by the same transmission provider, the court said that "other than pointing out that the contract rate is twice [Allegheny's] OATT rate, [PEPCO] has presented no evidence regarding how the contract rates are unduly discriminatory or excessively burdensome on PEPCO ratepayers."[18] The court noted the Commission's precedent which holds that "the fact that a contract has become uneconomic to one of the parties does not necessarily render the contract contrary to the public interest."[19]

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

[15]See, e.g., Richmond Power & Light v. FPC, 481 F.2d 490, 493 (D.C. Cir. 1973) (holding that "the contract between the parties governs the legality of the filing. Rate filings consistent with contractual obligations are valid; rate filings inconsistent with contractual obligations are invalid."). Borough of Lansdale, Pennsylvania v. FPC, 494 F.2d 1104, 1112 (D.C. Cir. 1974).

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

[17]Id. at 408.

[18]Id. at 409.

[19]See, e.g., Gulf States Utilities Company v. Southern Company Services, Inc., et

(continued...)

8. Based upon our review of the evidence and the totality of circumstances, we conclude that the Complainants have failed to meet their burden of proof under the "public interest" standard, as defined in past cases. We find that the challenged contracts are not contrary to the public interest because the Complainants have failed to demonstrate that the contracts in question caused financial distress for the Complainants, threatening their ability to continue service, that the contracts cast an excessive burden on 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 are contrary to the public interest. At the time of contract execution, other alternatives were available to the Complainants; however, they chose to enter into the contracts in question, accepting market risks. Complainants benefitted from resales of the energy purchased under these contracts during the relevant period; however, after the drop in prices, Complainants became dissatisfied with their bargains and sought contract modification. The law is quite clear on that point. The fact that a contract becomes uneconomic over time does not render it contrary to the public interest. We, therefore, deny the instant complaints.

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

I. Background

10. On February 25, 2002, Complainants filed separate, but virtually identical, complaints seeking to modify thirty (30) contracts.[20] The contracts at issue are long-term contracts between the California Department of Water Resources (CDWR) and more

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

[20]The contracts which were set for hearing were listed in April 25 Order, 99 FERC at Appendix A and are provided herein in Appendix A.

than twenty-four (24) sellers[21] of energy. Complainants claimed that the prices, terms and conditions of these contracts are unjust and unreasonable and, to the extent applicable, not in the public interest. Complainants also alleged that these sellers obtained the prices, terms and conditions in the contracts through the exercise of market power in violation of the Federal Power Act (FPA) and that the sellers' actions were causing injury to the citizens and ratepayers of California.

[21]The complaints were filed against the following Respondents: Allegheny Energy Supply Company, LLC (Allegheny); Calpeak Project Companies; Calpine Energy Services, L.P. (Calpine); Clearwood Electric Company, LLC (Clearwood); Colton Power, L.P. (Colton), successor in interest to Alliance Colton, L.L.C. (Alliance); Constellation Power Source, Inc. (Constellation); Coral Power, L.L.C. (Coral); Dynegy Power Marketing, Inc. (Dynegy); El Paso Merchant Energy, L.P. (El Paso); Fresno Cogeneration Partners, LP (Fresno); GWF Energy LLC (GWF Energy); High Desert Power Project, LLC (High Desert); Imperial Valley Resource Recovery Company, L.L.C. (Imperial Valley) and Primary Power International (Primary Power), agents for Imperial Valley (collectively, IVRRC); Mirant America Energy Marketing, LP (Mirant); Morgan Stanley Capital Group, Inc. (Morgan Stanley); Pacificorp Power Marketing, Inc. (PPM); PG&E Energy Trading-Power, LP (PG&E Energy); Sempra Energy Resources (Sempra); Soledad Energy, LLC (Soledad); Sunrise Power Company, LLC (Sunrise); Wellhead Power Gates LLC and Wellhead Power Panoche LLC (Wellhead Companies); Williams Energy Marketing & Trading Company (Williams); and Whitewater Energy Corporation (Whitewater).

Complainants have withdrawn their complaints with the majority of the Respondents. Notices of withdrawal of complaints with prejudice were filed as to: (1) Whitewater on May 1, 2002; (2) Calpine on May 1, 2002 and May 2, 2002; (3) Constellation and High Desert on May 2, 2002 and May 6, 2002; (4) CalPeak Power – Midway LLC, CalPeak Power – Mission, LLC, CalPeak Power – Panoche LLC, CalPeak Power - Border LLC, CalPeak Power – Vaca Division LLC, CalPeak Power – El Cajon LLC and CalPeak Power – Enterprise LLC on May 20, 2002 and May 21, 2002; (5) Soledad on July 12, 2002; (5) GWF Energy on September 4, 2002 and September 5, 2002; (6) Alliance and Colton on September 30, 2002 and October 1, 2002; (7) PG&E Energy on October 3, 2002; (8) Sunrise on January 13, 2003. No motions in opposition to the notices of the withdrawal were filed, and the Commission took no action to disallow the withdrawal. Accordingly, pursuant to Rule 216 of the Commission's Rules of Practice and Procedure, 18 CFR § 385.216(b) (2003), the withdrawals became effective at the end of 15 days from the date of the filing of the notices. The notice of withdrawal of the complaints as to Williams is granted, as discussed below.

11. On April 25, 2002, the Commission dismissed the complaints regarding the contracts that were entered into after June 20, 2001, "the date on which the Commission's West-wide mitigation went into effect, . . . since the effect of the West-wide mitigation was to stabilize prices."[22] The Commission set for hearing the complaints regarding the contracts entered into before June 20, 2001. The Commission limited the evidentiary hearing to determining:

> whether the dysfunctional California spot markets[23] adversely affected the long-term bilateral markets, and, if so, whether modification of any individual contract at issue is warranted. The hearing will not address issues concerning the Commission's policies on granting market-based rate authority or on regulation of sellers with such authority. Further, if the judge concludes that modification of one or more of the contracts is warranted, the judge should not attempt at this stage to determine how those contracts should be modified.[24]

12. The Commission differentiated this evidentiary hearing from the staff investigation of potential manipulation of electric and natural gas prices in the West. The Commission stated that:

> By order issued on February 13, 2002 [in Docket No. PA02-2-000], the Commission directed a staff investigation of potential manipulation of electric and natural gas prices in the West. We are setting the instant contracts for hearing under Section 206 of the FPA based on the arguments that the dysfunctional spot markets in California caused long-term contracts not to be reasonable, whereas the investigation is looking at whether there

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[22] April 25 Order, 99 FERC ¶ 61,087.

[23] In this context, spot markets or spot market sales are sales that are 24 hours or less and that are entered into the day of or day prior to delivery. See San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services, 96 FERC ¶ 61,120 at 61,515 (2001); San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services, 95 FERC ¶ 61,418 at 62,545 n.3 (2001).

[24] April 25 Order, 99 FERC at 61,384.

was improper behavior by sellers that may have caused prices not to be reasonable.[25]

13. In addressing the standard of review to be applied to the contracts at issue, the Commission reiterated its long-standing policy of upholding the sanctity of contracts and stated that it would not modify market-based contracts absent extraordinary circumstances.[26] The Commission determined that the contracts that contained explicit Mobile-Sierra language would have to satisfy the Mobile-Sierra "public interest" standard of review to justify modification of the contracts. The parties whose contracts contained explicit Mobile-Sierra language include: Allegheny; Mirant; and Coral. The Commission ruled that it needed additional information in order to determine the applicable standard of review for the contracts that did not contain an explicit Mobile-Sierra provision. The parties whose contracts did not contain explicit Mobile-Sierra language include: El Paso; Dynegy; Morgan Stanley; and Sempra. In its January 23, 2002 Order on Rehearing, the Commission stated that "[t]he evidentiary hearing was established to, among other things, interpret the terms of [the contracts at issue] and to ascertain the intent of the parties at the time these contracts were signed."[27]

14. In the July 23 Order, the Commission affirmed its dismissal of the complaints related to the contracts entered into after June 20, 2001, granted rehearing and dismissing complaints related to two qualifying facilities, and denied all other requests for rehearing and clarification.[28] By order dated November 27, 2002, the Chief Administrative Law Judge suspended the proceeding as to Williams pending finalization of the parties' settlement agreement. Therefore, Complainants continue to pursue complaints against only seven sellers: Allegheny, Mirant, Coral, El Paso, Dynegy, Morgan Stanley, and Sempra.

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[25] April 25 Order, 99 FERC at 61,383, n.28.

[26] April 25 Order, 99 FERC at 61,383.

[27] Public Utilities Commission of California v. Sellers of Long Term Contracts, 100 FERC ¶ 61,098 at P 12 (2002) (July 23 Order).

[28] July 23 Order, 100 FERC ¶ 61,098. The Commission clarified that the complaints against Clearwood; Fresno; Wellhead Companies; PPM; and Sunrise were dismissed and that the complaints against Clearwood, Wellhead Companies, PPM and Sunrise were dismissed with prejudice. Id. at P 28. The Commission also dismissed the complaints against IVRRC and Soledad. Id. at P 19.

15. Additional background on this proceeding is provided in Appendix B.

II. Discussion

A. Procedural Matters

1. Notice of Withdrawal of Complaints as to Williams

16. On January 13, 2003, Complainants filed a joint notice of withdrawal of their complaints with prejudice as to Williams and a joint motion requesting an order to approve such withdrawal. Rule 216 of the Commission's Rules of Practice and Procedure, 18 CFR § 385.216(b)(1) (2003), provides that the withdrawal of any pleading, such as a complaint, is effective at the end of 15 days from the date of filing of a notice of withdrawal, if no motion in opposition to the notice of withdrawal is filed within that period and the decisional authority does not issue an order disallowing the withdrawal within that period. If a motion in opposition to a notice of withdrawal is filed within the 15-day period, the withdrawal is not effective until the decisional authority issues an order accepting the withdrawal.[29]

17. PG&E filed a timely response to the notice of withdrawal requesting that the Commission clarify: (1) that Williams' settlement with Complainants and any other litigant does not compromise the claims of PG&E and other non-settling parties in Docket No. EL00-95, et al., or elsewhere for energy and related products procured by and paid for by PG&E or that PG&E is found liable to pay for; and (2) that permitting this withdrawal would not constitute a ruling upon, or approval of, any provisions of the Williams' settlement with Complainants.

18. Rule 216 does not require the party seeking withdrawal of a pleading to show good cause; on the contrary, it requires good cause for disallowing the withdrawal. We find no such good cause here. Complainants and Williams have agreed to the withdrawal, and we find no reason to force Complainants and Williams to continue to litigate when they do not wish to do so. Therefore, we grant the withdrawal at issue. We clarify that our action with respect to the withdrawal of the complaints as to Williams will not affect in any way the amount of refunds that Williams may owe in Docket No. EL00-95, et al., or elsewhere. We further clarify that we only address here the withdrawal of the complaints as to Williams and do not rule substantively on the proposed settlement agreement between Complainants and Williams.

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[29] 18 CFR § 385.216(b)(2) (2003).

2. Allegheny Settlement Agreement

19. On June 11, 2003, Complainants, Allegheny and Allegheny Trading Finance Company (collectively, the Settling Parties) filed a settlement agreement (Allegheny Settlement Agreement).[30] The Settling Parties requested that the Commission stay this complaint proceeding against Allegheny pending Commission action on the filing.

20. Without accepting the Settling Parties' characterization of their request as seeking a "stay," we will defer action as to Allegheny at this point pending our review of, and decision on, the proposed settlement.

3. ALJ's Ruling Prohibiting Discovery on Market Power/Market Manipulation

21. Complainants claim that the ALJ erred in prohibiting discovery on market power/market manipulation and in admitting evidence of alleged losses while preventing Complainants from conducting meaningful cross-examination. They assert that they sought this information to counter Respondents' market fundamentals' arguments. Complainants state that, if the Commission concludes that Complainants have sufficiently proven their case without evidence of market abuse, then this issue is moot. Complainants argue that, if the Commission concludes otherwise, then the Commission should either: (1) remand for discovery and hearing on the issue of market abuse, or (2) presume that each Respondent (a) committed market abuse in a manner that contributed to the meltdown of the spot market and (b) had a basis for expecting that abuse of that type would enhance future spot market prices, the benefits of which they would not forego by signing forward contracts based upon expectations of lower prices.

22. Sellers argue that the ALJ properly excluded from the proceeding inquiry into market power and costs. Sellers claim that Complainants' argument that they should have been allowed to submit evidence regarding alleged market manipulation constitutes a collateral attack on the April 25 Order in this case, which limited the scope of the proceeding to the exclusion of market power issues and was an improper attempt to seek interlocutory appeal. Sellers dispute Complainants' assertion that they were prejudiced by the inability to present evidence of market power. Sellers further state that, in any case, there is no basis in the record for the presumption that the expectation of the alleged

[30] On that same date, in Docket No. ER01-1847-001, Complainants and Allegheny filed an Amended and Restated Master Power Purchase and Sale Agreement between Allegheny Trading and CDWR (Amended and Restated Agreement).

continued existence of market power when market conditions were tight substantially inflated prices in the long-term bilateral markets.

23. Allegheny avers that Complainants' request to conduct discovery on allegations of market power are improper and irrelevant because Complainants have failed to show any connection between the dysfunctional Independent System Operator (ISO) and Power Exchange (PX) markets and the long-term bilateral market.

24. We find that the ALJ properly interpreted the Commission's orders in this proceeding on the exclusion of market power/market manipulation information and properly prohibited discovery on this issue. Therefore, we affirm the ALJ's ruling. We also address the issue of market manipulation in more detail below.

4. ALJ's Ruling Admitting Rebuttal Testimony of Mr. Koenig

25. Complainants claim that the ALJ erred in admitting the Rebuttal Testimony of David Koenig to the extent it purported to quantify Allegheny's losses under its contract with CDWR. Complainants assert that they were prejudiced by the late production of the purported backup data to this testimony. Complainants contest the ALJ's decision to permit Allegheny to submit testimony without backup data, refuse to strike the testimony when Allegheny had not provided any backup data by the date of the hearing and require Complainants to cross-examine Mr. Koenig using backup data that could not be read in the allotted time or used meaningfully in cross-examination. Complainants request that the Commission strike Mr. Koenig's Rebuttal Testimony on costs but allow it to be refiled in the remedy phase of these proceedings after appropriate discovery.

26. Allegheny argues that the ALJ judge properly admitted Mr. Koenig's testimony on Allegheny's up-front losses because the ALJ found that Complainants were not prejudiced in any way.

27. We defer to the ALJ's finding that Complainants were not prejudiced in any way by the admission of Mr. Koenig's Rebuttal Testimony and, therefore, deny Complainants' request to strike. However, our ruling on the merits does not rely on this testimony, as discussed below.

5. Request to Include in Record Market Manipulation/Abuse Evidence Submitted in Docket Nos. EL00-95, et al., and Motion to Reopen the Record or Take Official Notice of Evidence of Market Abuse.

28. On April 22, 2003, Complainants filed a Motion to Reopen the Record or Take Official Notice of Evidence of Market Abuse. Complainants have submitted a supplemental filing asserting the relevance of certain evidence adduced in Docket No. EL00-95, et al., (100-Day Discovery Proceeding) to this proceeding. Complainants acknowledge that, at the time of their supplemental filing, the record of this proceeding had been closed, post-trial briefing had been completed and the entire record had been certified to the Commission. They state, however, that the Commission's February 10 Order in EL00-95, et al.,[31] raised the question of whether the Commission intended to effectively grant Complainants' request for remand for discovery and hearing on the issue of market abuse in this proceeding.

29. The Commission did not intend to grant Complainants' request for remand indirectly through the February 10 Order.[32] The additional discovery and adducement of evidence granted in the Commission's November 20, 2002 Order[33] and subsequently clarified in the February 10 Order were limited to Docket No. EL00-95, et al.[34] The February 10 Order did direct parties to file an index for each other pending or proposed proceeding for which the filer claims its submission is relevant;[35] however, this directive was not an authorization for further discovery in the instant case or a finding that such information is relevant or admissible herein.

30. Complainants also request that the Commission reopen the record to admit or take official notice of: (1) FERC Staff's Final Report on Price Manipulation in Western Markets, Docket No. PA02-2-000 (March 2003) (Staff Report) and the evidence upon which the Staff Report is based, and (2) the evidence of market manipulation/abuse

[31] February 10 Order, 102 FERC ¶ 61,164.

[32] Id.

[33] November 20 Order, 101 FERC ¶ 61,186.

[34] February 10 Order, 102 FERC ¶ 61,164.

[35] Id. at 61,446.

introduced in Docket Nos. EL01-10, IN01-3, EL02-113-000, EL02-114-000, EL02-115-000, EL02-80, EL02-81, EL02-82 and EL02-83.

31. At Oral Argument, Complainants argued that the evidence of market manipulation is relevant to the application of the "public interest" test. In Complainants' opinion, a contract with a seller who is found by the Commission to have participated in market manipulation should be abrogated because sellers that abuse market rules and standards of behavior should not be allowed to derive windfall profits from a traumatized market at the expense of customers. Complainants also suggested that a remand to the ALJ may be necessary to adduce additional evidence on market manipulation.

32. Coral responds that market power and manipulation are assumed and are not an issue in this proceeding because when the Commission set these complaints for hearing it assumed that the spot market was dysfunctional. Coral argues that the Staff Report is not evidence upon which the Commission could base its decision because it has not been subject to discovery, cross-examination or rebuttal. Coral asserts that it is pointless to reopen the record to admit the statistical analysis in the Staff Report because, according to Complainants' evidence in this proceeding, the analysis documented in the Staff Report is not sufficiently powerful to detect the linkage, let alone "significant" linkage, between contemporaneous spot and forward prices. Coral contends that, even if the simple regression analysis in the Staff Report were powerful enough to detect the linkage between contemporaneous spot and forward prices, the results show low coefficients which do not establish an adverse effect of sufficient magnitude to warrant contract abrogation. Coral also disputes the interpretation of the slight correlation which is provided in the Staff Report.

33. Sellers argue that Complainants have not demonstrated that extraordinary circumstances exist to reopen the record to bring in "evidence" that is not related to one of the issues at the heart of this proceeding. They note that the Commission did not require Complainants either to prove that the ISO and PX spot markets were dysfunctional or to demonstrate the causes of that dysfunction, but rather were allowed to presume conclusively that those spot markets were dysfunctional. Sellers contend that it would be inappropriate for the Commission to take official notice pursuant to Rule 508, as requested, because the "evidence" of market manipulation in several other dockets and the Staff Report are contested facts. Sellers assert that, even if the correlation analysis in the Staff Report were allowed into the record, it would not support or compel a conclusion that dysfunctions in ISO spot markets adversely and materially affected forward markets. Sellers argue that Complainants made a tactical decision not to submit a statistical correlation analysis at hearing and must live with the consequences of that decision. They point out that Complainants have not distinguished the correlation

analysis in the Staff Report from any other expert evidence that Complainants might have submitted at hearing or shown that it enjoys any special evidentiary status by virtue of having been performed by members of the Commission's Staff that would reward them with the opportunity to revisit their own tactical missteps. Sellers also note that the Staff Report only recommends remand to the presiding ALJ for contracts subject to the "just and reasonable" standard of review. Sellers contend that the "evidence" of market power and manipulation for other proceedings fall outside the scope of issues set for hearing in the April 25 Order and, even if considered, would not add substantive support to Complainants' case.

34. We find that Complainants' request that we take official notice of the Staff Report findings and evidence submitted in the 100-Day Discovery Proceeding is moot because we have considered these findings and evidence as part of the record of this proceeding. As discussed below, we conclude that, even if we assume that the allegations and findings contained in the Staff Report and the 100-Day Discovery Proceeding were true, they would not be determinative of the issues in this proceeding. We deny Complainants' request to take official notice of or reopen the record to admit evidence submitted in other proceedings. The records of those proceedings contain thousands of submittals, most of which are case-specific and not relevant to the issues in the instant proceeding; the documents that could be relevant have been submitted in the 100-Day Discovery Proceeding.

6. Motion to Lodge

35. On January 29, 2003, CDWR filed a complaint against Allegheny Energy Supply Company, L.L.C. (Allegheny Energy Supply) and Allegheny Trading Finance Company (Allegheny Trading) in the Superior Court of California, County of Sacramento. In its complaint, CDWR seeks to terminate its master sales contract and two confirmation letters that were assigned by Allegheny Energy Supply to Allegheny Trading based upon issues allegedly related to the assignment. Complainants request that the Commission consider this complaint within the context of this proceeding.

36. On December 4, 2002, the Commission authorized the assignment as consistent with the public interest and rejected CEOB's arguments against the assignment.[36] Given the Commission's approval of the assignment and prior decision not to stay the approval of the assignment pending the resolution of the issues in this proceeding, we deny Complainants' motion to lodge this complaint in this proceeding.

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[36] Allegheny Energy Supply Company, et al., 101 FERC ¶ 61,278 (2002).

B. Commission Determination Regarding Substantive Issues

Findings of Fact and Conclusions of Law

37. In deciding whether the Complainants have met their burden of proof under the "public interest" standard of review to justify contract modification in these cases, we rely on the evidentiary record developed in this proceeding and also consider the findings of the Staff Report and evidence submitted in the 100-Day Discovery Proceeding. The Staff Report found that spot market distortions flowed through to forward power prices, particularly those for contracts of a short-term nature, i.e., one to two years time to delivery. In addition, the Staff Report and the 100-Day Discovery Proceeding suggest that the California ISO and PX markets were subjected to market manipulation and gaming. The Staff Report conclusions and the 100-Day Discovery Proceeding documents are being contested in "show cause" proceedings involving allegations and/or findings of manipulation in the spot markets. However, even if we were to assume that these allegations and/or findings were true, they would not be determinative of the issues in the instant proceeding. The Commission has already concluded that the California ISO and PX spot markets were dysfunctional during the relevant period and that rates in those markets were unjust and unreasonable.[37] Evidence of market manipulation merely suggests yet another cause of the spot market dysfunctions and the unjust and unreasonable rates in the spot markets. However, a finding that the unjust and unreasonable spot market prices caused forward bilateral prices to be unjust and unreasonable would be relevant to contract modification only where there is a "just and reasonable" standard of review.[38] As we have concluded, the contracts at issue in this proceeding do not provide for such a standard but rather evidence an intent that the contracts may be changed only pursuant to the "public interest" standard of review. Under the "public interest" standard, to justify contract modification it is not enough to show that forward prices became unjust and unreasonable due to the impact of spot market dysfunctions; it must be shown that the rates, terms, and conditions are contrary

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[37] See, e.g., San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services, 93 FERC ¶ 61,121 at 61,359-60 and 61,372 (2000) (November 1 Order); order on reh'g and clarification, 97 FERC ¶ 61,275, at 62,225 (2001).

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

to the public interest.[39] As fully discussed below, we conclude that the Complainants failed to make such a showing.

38. As determined by the Presiding ALJ and affirmed in this order, Complainants in this proceeding must meet the "public interest" standard in order to justify the requested contract modification. The ALJ concluded that Complainants failed to meet their burden of demonstrating that the contracting parties intended another standard of review to apply.[40]

39. The parties have failed to distinguish evidence required to demonstrate that a contract is not just and reasonable and that needed to demonstrate that the Mobile-Sierra "public interest" test has been met. The parties spent most of the trial and their briefs attempting to demonstrate whether the contract rates were just and reasonable. A summary of the parties' arguments and rebuttals are provided in Appendix C. The arguments which are relevant have been addressed herein. They presented very little evidence relevant to the Mobile-Sierra standard of review. Based on the record, we conclude that Complainants have failed to demonstrate that any of the three prongs announced in the Sierra case has been met or that any other factor introduced into evidence warrants a finding that any of the contracts is contrary to the public interest and should be modified.

40. Based on the record, we conclude that there is no credible record evidence that the contracts at issue are placing Complainants in financial distress or that other customers will bear an excessive burden as a result of upholding the challenged contracts. In fact, one of CDWR's central objectives was to achieve a portfolio that yielded a weighted average price no higher than $70/MWh, the average cost of energy supply reflected in the IOUs' retail rates, as of January 2001.[41] In securing its contracts, CDWR achieved an overall portfolio that is diversified both in terms of energy products and durations[42] and

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[39] See, e.g., Sierra, 350 U.S. at 354-355.

[40] See Partial Initial Decision, 102 FERC at P 43 and 45.

[41] Exh. CAL-51 at 10:24-11:3; Exh. AYE/SER-7 at 70:22-71:4 (Hart deposition); Exh. AYE/SER-11 at 64:11-66:2 (Nichols deposition); Tr. at 1258:14-1260:9; Exh. S-8 at 16:2-23.

[42] Exh. DYN-38 at 1.

reflects an average price of $70/Mwh.[43] The average price for the first 5 years (May 2001 to December 2005) was estimated at $84/Mwh and for the last 5 years (January 2006 to December 2010) was estimated at $60/Mwh.[44] Complainants were unable to demonstrate that the contracts were priced above long-run competitive prices.[45]

41. Furthermore, Complainants have failed to present evidence showing that the challenged contracts are unduly discriminatory. In the past, the Mobile-Sierra doctrine has been applied to allegations of discriminatory or preferential treatment to the detriment of other purchasers who are not parties to the contract.[46] No such showing has been made by Complainants.

42. In addition to the evidence on the effects of the challenged contracts on the parties and customers, the ALJ has developed an extensive evidentiary record on the totality of circumstances preceding and following the execution of the contracts at issue.

43. Specifically, the record shows that CDWR had options and at least some bargaining power when it entered into this portfolio of contracts after often protracted negotiations. During late January and early February 2001, Governor Davis signed legislation that authorized CDWR to purchase, mostly through long-term contracts, the "net-short" requirement of California's IOUs, approximating 10,000 MW.[47] The "net short" requirement is the difference between the amount of power that could be supplied by the California IOUs from their resources and the total demand for power at any given

[43]Exh. CAL-70 at 13 of Update of California Department of Water Resources Power Purchase Contract Efforts dated May 31, 2001 (May 31, 2001 CDWR Update); Exh. CAL-51 at 31:16-19; Exh. DYN-1 at 16:25-27.

[44]Exh. CAL-70 at 13 of May 31, 2001 CDWR Update.

[45]Exh. MAEM-25 at 6:20-9:22; Exh. COR-48; Exh. COR-50; Exh. CAL-163 at 1:22-2:7.

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

[47]Exh. COR-1 at 8:1-7; Exh. COR-25 at 16:22-24; Exh. CAL-13; Exh. EPME-1 at 30:7-11; Exh. CAL-15.

time.[48] Originally, to cover the net short positions, CDWR obtained almost all of the power it needed from either the spot market or "out of market."[49]

44. On January 22, 2001, Governor Davis' office announced that CDWR would issue a Request for Bids for Energy Purchase (RFB) and explained that the Governor "expect[s] these bids on long term energy contracts should stabilize the market and drive the price of electricity down. . . . This is a key step in our efforts [to] keep the lights on in California at a reasonable price."[50]

45. On January 23, 2001, CDWR issued its first RFB.[51] CDWR sought bids at fixed prices for 69,000 to 100,000 GWH of on-peak energy annually and another 26,000 to 40,000 GWH of off-peak energy annually.[52] CDWR received 99 bids in response.[53]

46. CDWR assembled a highly sophisticated procurement team to assist in CDWR's purchasing efforts.[54]

47. On February 1, 2001, the California Legislature passed Assembly Bill 1 of the 2001-2002 First Extraordinary Session ("AB1X"), which authorized CDWR "to enter

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[48]Exh. CAL-78 at 6:9-12; Exh. DYN-1 at 8:10-12.

[49]Exh. S-4 at 16:19-17:1.

[50]Exh. COR-1 at 8:7-13; Exh. COR-6; accord Exh. DYN-12 at 50:3-16.

[51]Exh. CAL-66; Exh. COR-25 at 9:21-22; Exh. EPME-28 at 2:11-12, 3:15-16.

[52]Exh. CAL-66; Exh. S-4 at 18:14-16.

[53]Exh. AYE-57.

[54]Exh. AYE-56 at 1; Exh. AYE-49 at 11:2-10; Exh. COR-1 at 10:16-11:20; Exh. COR-8; Exh. CAL-78 at 1:7-2:18; Exh. CAL-79; Exh. CAL-12 at 3:18-21; Exh. CAL-51 at 4:5-5:14, 1:3-19, 5:15-7:3; Exh. DYN-41 at 8:4-19; Exh. COR-67 at 222:22-223:6; Tr. at 1588:10-12, 1589:23-24, 1590:18-20; Exh. S-4 at 16:5-9; Exh. COR-41 at 5:12-6:7, 12:8-15; Exh. MAEM-1 at 16:4-8; Exh. EPME-56 at 4:18-5:1; Exh. EPME-28 at 5:7-9; Exh. EPME-35 at 1; Exh. COR-67 at 49:7-50:9; Exh. DYN-48 at 39:7-40:7; Exh. DYN-40 at 8:1-12; Exh. DYN-45 at 20:12-18, 21:13-22:6; accord, Exh. DYN-53 at 17:17-21.

into contracts for the purchase of electric power."[55] AB1X authorized, but did not require, CDWR to make power purchases to cover the California IOUs' net short position.[56] Under AB1X, CDWR could enter into long-term power purchase contracts but could not provide any sovereign guaranty (i.e., its obligations were expressly not backed by the full faith and credit or taxing power of the State of California).[57]

48. On February 2, 2001, CDWR issued a second RFB requesting a mix of products and indicating that it was willing to buy from supply portfolios.[58] Like CDWR's first RFB, this RFB also emphasized that bidders, and not CDWR, would be responsible for ensuring delivery to the specific congestion zone and that CDWR would assume neither transmission nor congestion risk and continued to require fixed pricing only.[59] The RFB did not indicate a preference for 1 to 3-year contracts or any other specific duration.[60] CDWR's RFB solicited opportunities for different products to be offered up by prospective bidders.[61] CDWR received 114 bids in response.[62]

49. CDWR received a total of 213 offers to its first and second RFBs.[63] Within a few weeks, CDWR was able to assemble a portfolio of approximately 41 commitments, totaling approximately $43 billion.[64] This portfolio covered about 12,000 MW during

[55]Exh. CAL-15; accord, Exh. S-4 at 15:21-16:2.

[56]Exh. CAL-15; Exh. DYN-1 at 9:11-16.

[57]Exh. CAL-15; Exh. CAL-66; Exh. CAL-67; Exh. EPME-56 at 3:14-15.

[58]Exh. CAL-67; Exh. S-4 at 18:18-19:3; Exh. COR-1 at 8:20-10:5; Exh. EPME-28 at 4:16.

[59]Exh. CAL-67; Exh. COR-1 at 8:20-10:5; Exh. EPME-28 at 4:17-18.

[60]Exh. CAL-67; Exh. S-4 at 18:18-19:2; Exh. COR-1 at 8:20-10:5; Exh. COR-41 at 20:13-21:2.

[61]Tr. at 1253:10-11.

[62]Exh. AYE-58; Exh. CAL-67.

[63]Exh. AYE-57; Exh. AYE-58; Exh. DYN-40 at 6:17-18.

[64]Exh. S-4 at 19:18-19.

the peak year.[65] In addition to the responses to the RFBs, CDWR negotiated with suppliers outside the RFB process.[66] There was competition among sellers to make offers to CDWR and, as a result, CDWR had choices and rejected numerous seller proposals.[67]

50. CDWR negotiated with the sellers on an individual basis and controlled what information they had regarding the success of CDWR's procurement strategies.[68] CDWR gained negotiating leverage with each agreement that it reached with the sellers.[69] Contemporaneous statements made by CDWR and the Governor of California indicate that they fully supported the price, terms and conditions in the contracts at the time they were executed.[70] On May 24, 2001, counsel and a negotiator for CDWR, prepared a memorandum to a CDWR representative, at the latter's request, in which he stated that "[e]ach power purchase agreement was the subject of often protracted negotiations. Frequently, sellers had to concede numerous points to obtain the terms and provisions they ultimately ended up with in the agreements."[71] CDWR's lead negotiator stated that

> I can't get terribly upset by these critics who say oh, by gosh, this is higher than what the price might be. Well, hell, they don't know. We didn't just

[65]Exh. S-4 at 19:19-20.

[66]Tr. at 1563:2-4; Tr. at 1564:16-25.

[67]Exh. AYE-80 at 196:15-25; Exh. AYE-61; Exh. EPME-28 at 11:1-3; Exh. COR-48 at 15:4-9.

[68]Exh. COR-63 at 2; Exh. AYE-51; Tr. 1561:14-1562:9; Exh. AYE/SER-1 at 37:18-21.

[69]Exh. AYE-80 at 271:23-272:8; Exh. J-2 at 170:14-21; Exh. COR-48 at 15:4-7; Exh. AYE-52.

[70]Exh. DYN-37 at 1; Exh. COR-61 at 1; Tr. at 1496:7-15; Exh. COR-62; Exh. DYN-38; Exh. DYN-26 at 152:16-153:8; Exh. DYN-27 at 210:24-211:19; 215:15-217:2; 221:23-222:12.

[71]Exh. AYE-51 at NAV08-016238; Tr. at 1561:14-1562:18.

> fall off a turnip truck. I am not saying we took the shirt off their back. But I am saying that these were fair, negotiated, hard-fought deals.[72]

51. The rates, terms and conditions of the contracts and concessions made by the various parties during negotiations indicate that the contracts were not the product of unequal bargaining power.[73]

52. CDWR had options and did not lack bargaining power, given the number of parties who were interested in selling power to the State of California on a long-term basis.[74] CDWR was "essentially a single purchaser," and CDWR knew its actions would affect market prices.[75]

53. Although CDWR was viewed as more creditworthy than the California IOUs, its creditworthiness was still a concern to the marketplace.[76] Thus, the distribution of risks in CDWR's contracts was not symmetric between CDWR and the sellers under many contracts.[77] CDWR was, however, in a favorable bargaining position as a buyer of forward bilateral contracts because it was the largest, creditworthy bulk buyer in the State of California.[78] This fact gave CDWR a great deal of bargaining power over sellers of long-term contracts.[79] Negotiators on behalf of CDWR pressured sellers into doing deals

[72]Exh. DYN-26 at 152:16-153:8.

[73]Exh. DYN-1 at 41:4-15; Exh. DYN-1 at 19:9-14, 22:21-23:11; Exh. EPME-28 at 4:4-5, 8:7-9:13; Exh. SER-1 at 3:25-5:6.

[74]Exh. COR-7 at 1; Exh. AYE-57; Exh. AYE-58; Exh. AYE-49 at 8:8-9; Exh. CAL-90 at 3:21-4:1; Exh. AYE-80 at 271:23-272:8;Exh. CAL-51 at 36:12-16; Exh. J-2 at 170:14-21; Exh. MAEM-1 at 17:1-3.

[75]Exh. CAL-90 at 3:21-4:1; Tr. at 1856:21-1857:16.

[76]Exh. EPME-1 at 53:5-54:2.

[77]Id.

[78]Exh. DYN-24 at 20:6-14; Exh. MAEM-1 at 15:26-16:4; Tr. at 2389:21-2390:4; Exh. SER-1 at 28:9-11.

[79]Exh. DYN-40 at 5:18-20; Exh. MAEM-1 at 16:14-17:3; Exh. AYE/SER-1 at 37:17-38:3.

with the State by indicating that "the Governor's office would use the media against companies that failed to deal with California."[80]

54. CDWR was able to demand and obtain many concessions from the Sellers, including obligating many, if not all, of the sellers to: (1) make immediate and/or near-term sales to CDWR at below-market prices, (2) assume transmission and congestion risk and provide high supply availability guarantees, (3) allow CDWR to dispatch the supplier's generation, (4) assume the risk of changes in fuel prices, and (5) provide CDWR the option of choosing seller-supply and/or CDWR-supply of natural gas.[81] In certain of the contracts under review, even though the sellers proposed a fuel price indexing formula, CDWR insisted on a fixed price, thereby leaving sellers to bear the risk that fuel prices would increase in the future.[82]

55. CDWR rejected a number of contract offers for many reasons, including pricing, transmission constraints, credit issues and terms (e.g., length of contract, type of product).[83] CDWR rejected contracts with a large number of suppliers offering, in the aggregate, more than 10,000 megawatts for sale to CDWR.[84] There was give and take involved in the negotiations: CDWR would sometimes reject certain proposals and sellers would come back to CDWR with new proposals.[85]

56. CDWR articulated the State's purchasing objectives in a report titled "Summary of California Department of Water Resources Power Purchase Contract Efforts."[86] Its objectives included: (1) creating a power purchase portfolio to reduce dependence on the spot market, (2) providing price stability and certainty, and (3) expediting construction of

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[80] Exh. DYN-1 at 23:4-5; accord, Exh. MAEM-1 at 16:19-23, 16:25-17:3.

[81] Exh. COR-1 at 46:3-47:5; Exh. AYE-14 at 3:1-4:20; Exh. EPME-28 at 10:4-14; Exh. MAEM-1 at 13:5-18; Exh. MSC-1 at 6:16-7:2; Exh. SER-1 at 25:8-26:21; Exh. DYN-1 at 26:15-27:3.

[82] Exh. S-1 at 25:8-11.

[83] Exh. AYE-61 at DW-0015-0794; accord, Exh. AYE-80 at 227:12-14; Exh. AYE-59 at 90:11-13, 93:6-20; Exh. EPME-1 at 63:8-14; Exh. EPME-47 at 36:10-11.

[84] Exh. AYE-1 at 4:14-16.

[85] Exh. AYE-80 at 227:12-20.

[86] Exh. CAL-70.

new power plants, peaking facilities and distributed generation.[87] CDWR also sought to secure delivery of power in calendar year 2001.[88]

57. CDWR took a deliberate and systematic approach to building its portfolio of power supply resources needed to cover the net-short requirements of the IOUs.[89] It began by negotiating commitments to buy around-the-clock power (7x24) and then began to shift its focus toward meeting on-peak requirements, which was followed with an effort to secure supply reductions in shoulder months.[90] Initially, CDWR wanted as much firm power under contract as it could obtain as soon as possible so it could immediately publicize these lower prices and reduce price volatility.[91] CDWR was looking for baseload, dispatchable, peaking, unit firm, and unit contingent products.[92] CDWR sought to obtain a portfolio of contracts, some with fixed prices and some with tolling provisions so that it could hedge its risk.[93]

58. CDWR sought products of 90 days, three years, five years, and 10 years in duration.[94] CDWR sought contracts for a 10-year period because California "needed new energy in addition to getting existing energy in the [S]tate under contract," and CDWR "recognize[d] that financing of new plants would require a longer period of time from which to get a reasonable price. [CDWR] did not want to be paying for a new plant in two, [or] three years. [CDWR] expected to see some contracts come in a 10-year period

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[87]Exh. CAL-70 at 1; see also Exh. COR-67 at 141:14-142:2.

[88]Exh. CAL-51 at 29:3-30:6.

[89]Exh. COR-1 at 44:19-45:13; accord, Exh. MAEM-1 at 15:23-26.

[90]Exh. COR-1 at 44:19-45:13; Exh. COR-41 at 13:19-14:1.

[91]Exh. DYN-1 at 17:19-22.

[92]Tr. at 1559:23-1560:7; accord, Exh. COR-67 at 94:7-95:20; Exh. EPME-28 at 3:16-20.

[93]Exh. AYE-80 at 132:13-133:5.

[94]Tr. at 1559:18-22; accord, Exh. CAL-78 at 8:12-18; Exh. EPME-28 at 3:18-19; Exh. S-4 at 18:16-19:2; Exh. CAL-66; Exh. CAL-67.

for that reason."[95] Most of the contracts entered into by CDWR to remedy its dependence on the spot market were for terms of ten years or more.[96] CDWR understood that long-term contracts were "one building block . . . in solving the energy crisis."[97]

59. CDWR expected that supplies during summer 2001 could be scarce and, therefore, placed greater value on supply certainty, and sellers were offered incentives to bring supplies to the market.[98] CDWR was able to reduce its exposure to the spot market, stabilize prices and obtain a certainty of supply and portfolio of contracts.[99]

60. Based on the above, we conclude that Complainants have failed to demonstrate the financial impairment, excessive burden or undue discrimination described in Sierra or any other factor sufficient to meet the "public interest" standard of review. Moreover, the contracts at issue were the result of choices voluntarily made by CDWR. The record also establishes that CDWR had better alternatives[100] and was not compelled to enter into the contracts at issue here.

61. Finally, there is nothing in the record, in the Staff Report, or in the 100-Day Discovery Proceeding evidence to support a finding that there was market manipulation specific to the long-term contract negotiations resulting in prices and terms being challenged here.

62. Therefore, based on the record, it appears that Complainants' only basis for contract modification is their dissatisfaction with the bargain. Commission and court precedent clearly establish that allegations that contracts have become uneconomic by the passage of time do not render them contrary to the public interest under the FPA.[101] The record clearly indicates that the challenged transactions were the result of CDWR's

[95]Tr. at 1719:2-13.

[96]Exh. COR-25 at 4:1-6.

[97]Exh. DYN-12 at 49:17-23.

[98]Exh. EPME-47 at 26:15-27:19.

[99]Exh. CAL-78 at 5:6-13, 17:9-15.

[100]See Exh. AYE-57 and Exh. AYE-58.

[101]See PEPCO, 210 F.3d at 409 (citing Soyland, 51 FERC at 61,013). See also Papago, 723 F.2d at 953; Sierra, 350 U.S. at 354-355.

voluntary choices. Therefore, because there is no evidence of unfairness, bad faith, or duress in the original negotiations, Complainants are not entitled to change CDWR's bargains.[102]

63. For these reasons, we find that Complainants have failed to meet their burden of proof under the "public interest" standard and contract modification in this case is thus not warranted.

C. Partial Initial Decision

64. The ALJ concluded that the case law is clear that where a contract fails to specifically provide that the contract may be unilaterally altered, Mobile-Sierra requires that proposed changes meet the "public interest" standard.[103] Under the Mobile-Sierra doctrine, the U.S. Supreme Court had held that a contract with a "public interest" standard of review may be modified only if the contract is shown to be contrary to the public interest (e.g., where the contract rate impairs the financial ability of the public utility to continue service, casts upon other customers an excessive burden, or is unduly discriminatory).[104] The ALJ noted that while the Mobile-Sierra doctrine arose in the context of a completely regulated environment, where, as here, the contracts were entered into under the parties' market-based rate authority, the Commission has stated that "[p]reservation of the contracts has, if anything, become even more critical."[105]

65. The ALJ reviewed the evidence in the record proffered by the contracting parties regarding the intent of the parties as to unilateral filing rights under the subject contracts aside from the express language of the contracts themselves.[106] The ALJ found that the

[102]See PEPCO, 210 F.3d at 410.

[103]Partial Initial Decision, 102 FERC at P 28.

[104]Sierra, 350 U.S. at 355.

[105]Partial Initial Decision, 102 FERC at P 31 (quoting April 25 Order, 99 FERC at 61,383).

[106]See Partial Initial Decision, 102 FERC at P 36-42. The evidence of the contracting parties' intent on this issue is as follows: Exh. SER-1 at 34:6-36:14 (Niggli); SER-2; Exh. SER-32 at 6:17-7:5 (Niggli); Exh. SER-34; Exh. SER-35; Exh. SER-55; Exh. SER-56; Exh. DYN-1 at 12:10-12, 26:15-18, 31:23-32:24, 33:6-9, 33:10-34:5

(continued...)

"evidence demonstrates that the contracting parties did not intend to preserve their rights to make unilateral application to the Commission for changes in rates, terms or conditions" of the Dynegy, El Paso, Morgan Stanley or Sempra contracts.[107] Rather, the ALJ found that "the extrinsic evidence of record indicates that the State had very little confidence in the Commission as an avenue for relief at the time these contracts were negotiated, that CDWR negotiated the subject contracts in a 'crisis' environment, and that for various reasons CDWR's negotiating team focused almost exclusively on the pricing terms of the subject contracts."[108] The ALJ notes that, in fact, Sempra's witness testified that precluding unilateral application to the Commission for changes in rates, terms and conditions was an issue of importance to CDWR and that the parties agreed to language precluding the Commission from changing the contract rates, terms and conditions.[109] The ALJ concluded that "[a] review of each of the four remaining contracts and of the evidentiary record in this proceeding supports a finding that the parties did not retain the right to unilaterally seek changes to their contracts, nor did the parties intend to do so."[110]

66. The ALJ also noted that, on January 14, 2003, after the close of the evidentiary record in this proceeding, after the filing of Initial Briefs, and after issuance of the

[106](...continued)
(Lednicky); Exh. DYN-2 at EOB-DYN-1-0005286; Exh. DYN-40 at 16:3-6 (Lednicky); Exh. MSC-1 at 9:12-18 (Hamdan); Exh. S-1 at 6:15-8:17, 11:1-11, 15:10-19:2 (Forman); Exh. S-4 at 6:11-15:14 (Tingle-Stewart); Exh. CAL-181 at 308:12-25 (Freeman); Tr. at 1633:8-1637:6 (Hart); Tr. at 2292:16-2293:6 (Smith); Tr. at 2476:5-2482:6 (Forman); Tr. at 2486:8-21 (Forman); Exh. US-1 at 13:3-14:16 (Thomas); Tr. at 2143:13-2149:11 (Lednicky); Tr. at 2293:8-15 (Smith); Tr. at 2458:4-7 (Forman). See id. at P 35-42.

[107]Id. at P 43 (citing see, e.g., Exh. SER-1 at 34:10-26 (Niggli); Exh. DYN-1 at 33:10-34:5 (Lednicky)).

[108]Id. at P 43.

[109]Id. (citing Exh. SER-1 at 34:6-26 (Niggli); Exh. SER-32 at 6:17-28 (Niggli)). For example, the ALJ found that, "with regard to the [Sempra] Agreement, [the President of Sempra] testified that, at CDWR's insistence, language was inserted into the [Sempra] Agreement to ensure that the Commission would not have the ability to review the rates, terms and conditions of the [Sempra] Agreement." Partial Initial Decision, 102 FERC at n.22 (citing Exh. SER-1 at 34:10-26 (Niggli)).

[110]Id. at P 45.

Commission's January 10, 2003 Order,[111] Complainants "acknowledged that '[they] have not argued, or submitted evidence, to the effect that the absence of an explicit Mobile-Sierra provision in the remaining four contracts is itself a basis for not applying the Mobile-Sierra standard to those contracts. Accordingly, to the extent the Mobile-Sierra standard applies to the contracts with explicit Mobile-Sierra provisions, it applies to the contracts without such provisions.'"[112] The ALJ concluded that:

> while the Complainants maintain their objection to the Commission's rulings on the applicability of the Mobile-Sierra standard to any of the contracts at issue, Complainants concede that there is no basis in the record, under the Commission's rulings to date in these proceedings, for not applying the Mobile-Sierra standard to the Dynegy, El Paso, Morgan Stanley and Sempra contracts[, contracts at issue which did not contain explicit Mobile-Sierra language,] to the same extent it applies to the other contracts [with explicit Mobile-Sierra provisions] already before the Commission for determination.[113]

D. Exceptions to Partial Initial Decision

1. Evidence of Market Manipulation and the Exercise of Market Power

a. Argument

67. Complainants argue that the ALJ erroneously concluded that the Commission limited the scope of the evidentiary hearing to matters other than market manipulation and the exercise of market power. They state that the Commission correctly ruled that proof of the exercise of market power would not be required for Complainants to prevail; however, they contend that the Commission never ruled that such proof should not be

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[111] Public Utilities Commission of California v. Sellers of Long Term Contracts, 102 FERC ¶ 61,025 (2003) (January 10 Order).

[112] Id. at P 44 (citing Answer of the California Public Utilities Commission and California Electricity Oversight Board to Motion to Hold Briefing in Abeyance, Jan. 14, 2003 (January 14 Answer)).

[113] Partial Initial Decision, 102 FERC at P 52. See also January 14 Answer at P 7. However, as noted below, Complainants argue that here the "just and reasonable" standard and the Mobile-Sierra "public interest" standard effectively merge because it is contrary to the public interest to charge unlawful rates to the public.

allowed. Complainants contend that it would not have been appropriate for the Commission to restrict Complainants' Section 206 rights by prohibiting discovery and precluding evidence of sellers' exercise of market power. They assert that such proof would (1) provide direct evidence that sellers who were actively inflating spot market prices would expect to continue to do so and thus inflate forward prices, (2) rebut Respondents' argument that economic fundamentals alone explain the spot prices and forward prices during the California crisis, and (3) undercut Respondents' argument that the "sanctity" of contracts should be upheld.

68. Complainants argue that Reliant's alleged misconduct[114] stipulated to in Docket No. PA02-2-001 offers direct proof on the central issue that was set for hearing in this proceeding: the dysfunctional exercise of market power in the California PX spot market adversely affecting the long-term bilateral market by artificially inflating forward prices. They contend that such evidence disproves Respondents' experts' claims that market fundamentals during May-June 2000 explain the price inflations that began in May-June 2000 and persisted through June 2001. They conclude that excluding such direct proof on the threshold issue was erroneous.

b. Responses

69. Trial Staff argues that this exception is merely an attempt to bolster Complainant's contention that the ALJ should have allowed discovery and presentation of evidence of market power and market manipulation at the hearing. It contends that the exception is misplaced since it is not pertinent to the subject matter of the Partial Initial Decision and Complainants have properly briefed this issue directly to the Commission in the second portion of this proceeding. Trial Staff states that Complainants have improperly presented evidence on the merits of an issue ruled outside the scope of the hearing and that the Commission should not countenance Complainant's reliance on extra-record evidence through their citation to the Reliant trader transcripts.

70. Allegheny, Coral, Dynegy, El Paso, Mirant, Morgan Stanley and Sempra (collectively, Sellers)[115] argue that the Partial Initial Decision did not open the door for

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[114]Complainants refer to Reliant's alleged withholding of approximately 2,000 MW of capacity from the market and falsely reporting to brokers that it needed to buy electricity for the third quarter of 2000 because it foresaw insufficient capacity in its own generation due to emissions (NOx) constraints and/or other capacity factor limitations.

[115]Allegheny, Coral and Mirant joined in Sellers' Brief Opposing Exceptions for

(continued...)

Complainants to restate objections to prior rulings or to submit irrelevant and prejudicial evidence into the record that closed on December 12, 2002. Sellers note that this issue is not a legitimate exception because it falls outside the scope of issues to be addressed by the ALJ as set forth not only in the Commission's April 25, 2002 order but also the January 10, 2003 order. Sellers request that the challenge to rulings on the scope of the hearing in any of Complainants' briefs be rejected as an impermissible collateral attack on the Commission's April 25, 2002 order which limited the scope of the evidentiary hearing to matters other than market manipulation and the exercise of market power. They argue that objections to the limitation on the scope of the hearing should have been sought through rehearing of the April 25, 2002 order. Sellers also contend that Complainants' challenge to the prior rulings of the Chief Judge and ALJ regarding the scope of the proceeding is an untimely, improper attempt to seek interlocutory appeal of such rulings.[116]

c. Commission Determination

71. This exception is not pertinent to the subject matter of the Partial Initial Decision which only addressed the applicable standard of review. However, our consideration of market manipulation and market power evidence is discussed above. Therefore, we dismiss this exception.

2. Application of Mobile-Sierra to Buyers and Sellers

a. Argument

72. Complainants reassert their contention that Mobile-Sierra should not apply to any of the contracts at issue because Complainants were not the contracting parties. However, even if Complainants were actual parties to the contracts, they argue that different factors apply when the Mobile-Sierra "public interest" test is applied to a buyer, rather than a seller. They contend that, when it is alleged that rates are too high and the buyer has agreed to pay too much, the "public interest" inquiry asks whether the buyer's customers will bear the burden. They conclude that in a case such as this one, where the

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[115](...continued) the purpose of responding to assertions concerning the content and/or applicability of the Mobile-Sierra standard of review, market power and market manipulation.

[116]Citing Pacific Gas Transmission Company, 56 FERC ¶ 61,430 at 62,537 (1991); McDowell County Consumers Council, Inc. v. American Elec. Power Company, 26 FERC ¶ 61,042 at 61,140 (1984).

rates are directly borne by the public because the buyer was a state agency purchasing power solely for the benefit of the public, the "just and reasonable" standard and the Mobile-Sierra "public interest" standard effectively merge because it is contrary to the public interest to charge unlawful rates to the public.

b. Response

73. Trial Staff and Sellers state that Complainants do not take issue with the application of the "public interest" standard to the contracts at issue, but rather with the test to be applied when dealing with a buyer, not a seller, under the Mobile-Sierra doctrine. They also note that the ALJ properly cited to San Diego Gas & Electric Company v. Public Service Company of New Mexico[117] for the holding that a buyer is subject to the "public interest" standard, notwithstanding that the contract was silent as to the buyer's Section 206 rights. Sellers also cite to other cases in which the "public interest" standard was applied to buyers without collapsing that standard into a lower "just and reasonable" analysis,[118] emphasizing two cases in which a buyer's request to modify a contract was rejected.[119]

74. Sellers argue that Complainants' conclusion that they should be subject to a less strict standard of review does not comport with judicial precedent which dictates that the strict "public interest" standard of review applies.[120] Sellers also respond that Complainants' allegation that the "public interest" standard does not consider the effect

[117]San Diego Gas & Electric Company v. PSC of New Mexico, 91 FERC ¶ 61,233 at 61,852-53 (2000) (June 1 Order).

[118]San Diego, 904 F.2d at 730-32; April 25 Order, 99 FERC at 61,383, App. A; July 23 Order, 100 FERC at 61,394; Public Utilities Commission of California v. Sellers of Long Term Contracts, 101 FERC ¶ 61,293 at 62,175 (2002) (December 17 Order); Nevada Power Co., et al. v. Enron Power Marketing, Inc., et al., 101 FERC ¶ 63,031, 65,277 (2002); PEPCO, 210 F.3d at 412.

[119]San Diego, 904 F.2d at 730-32; PEPCO, 210 F.3d at 412.

[120]Sellers note that there have been cases in which the Commission has applied a more flexible public interest standard; however, those circumstances involved cases in which the Commission had never had an opportunity to review the disputed contracts and the Commission sought to apply a more flexible public interest standard to protect non-parties. See Northeast Utilities Serv. Co., 66 FERC ¶ 61,332 (1994) (Northeast Utilities); Florida Power & Light Co., 67 FERC ¶ 61,141 (1994) (FP&L).

on ratepayers is unsupportable since this effect is considered in the first and second prong of the test.

c. Commission Determination

75. Complainants appear to argue that, because they are not parties to the contracts at issue and they filed these complaints on behalf of California customers, the Commission should apply the more flexible "public interest" standard developed in the Northeast Utilities[121] line of cases.

76. In the April 25 Order[122] and the July 23 Order,[123] the Commission rejected this assertion that a lower "public interest" standard applies. In those orders, the Commission stated that the State of California entered into the contracts at issue through one of its many agents, CDWR.[124] The Commission does not believe that a different standard of review should apply because these contracts are being challenged by other agents of the State of California, namely CEOB and CPUC.[125] The Commission stated that, in performance of its duty of administering the FPA, it views the State of California, CDWR, CPUC, and CEOB as one and the same entity that, in this case, acted as a buyer in the energy markets.[126] Accordingly, we deny this exception.

3. Countervailing Policy Goals and Appropriateness of Modification

a. Argument

77. Complainants assert that the Partial Initial Decision ignores an overriding policy: the public's interest in just and reasonable rates. They also contend that the Mobile-Sierra principles would not be compromised if the instant contracts are modified because (1) the contracts were signed during an extraordinary market meltdown, (2) the contracts were signed after the Commission gave notice in its December 15 Order that it was

[121] Northeast Utilities, 66 FERC ¶ 61,332.

[122] April 25 Order, 99 FERC at 61,382-383.

[123] July 23 Order, 100 FERC at 61,396.

[124] April 25 Order, 99 FERC at 61,382-383; July 23 Order, 100 FERC at 61,396.

[125] Id.

[126] July 23 Order, 100 FERC at 61,396.

concerned about forward prices and would entertain after-the-fact challenges, and (3) the requested remedy would allow every seller to recover all its legitimate costs, plus a reasonable rate of return. They conclude that the remedy requested in these extraordinary circumstances would not create precedent that would impede contract formation in the normal course.

b. Response

78. Trial Staff notes that the ALJ did not determine whether the contracts should be modified. It states that the ALJ merely noted that, if the parties have not preserved their rights to seek unilateral modifications, then the Mobile-Sierra standard of review serves to protect the expectations of the contracting parties that their negotiated agreement will not be modified unless in the public interest.

79. Sellers argue that Complainants' criticism of the policy considerations cited by the ALJ are unjustified because they flow directly from judicial and Commission precedent.[127]

c. Commission Determination

80. The policy considerations raised here by Complainants were beyond the scope of the Partial Initial Decision. The ALJ was not directed by the Commission to address whether specific contracts should be modified and therefore did not do so. We addressed these policy considerations above, however.

4. Application of the Mobile-Sierra Standard to Market-Based Rate Contracts

a. Initial Contract Review Under "Just and Reasonable" Standard

i. Argument

81. Snohomish argues that, because in the market-based rate context there is no initial review and approval of contract provisions such as price and term, the protections guaranteed by the FPA which ensure that all rates, terms and conditions of service are

[127] Citing Partial Initial Decision at P 45 n.25 (citing Texaco Inc. v. FERC, 148 F.3d 1091, 1095 (D.C. Cir. 1998) (Texaco); Town of Norwood v. FERC, 202 F.3d 392, 400 (1st Cir. 2000); Papago, 723 F.2d at 953)); November 1 Order, 93 FERC at 61,359.

just and reasonable[128] are circumvented if the "public interest" standard is applied to market-based rate contracts.[129]

ii. Response

82. Trial Staff points out that, after determining that none of the Respondents possessed the ability to exercise market power, the Commission granted all of the Respondents in this proceeding market-based rate authority. Trial Staff argues that, therefore, by definition the rates, terms and conditions of the actual contracts that Respondents negotiated in the market place are deemed just and reasonable. Trial Staff concludes that the need for prior Commission approval of these contracts has been met because the rates, terms and conditions included within these agreements are presumed just and reasonable. Trial Staff claims that Snohomish is taking issue not only with the determination that the Mobile-Sierra "public interest" standard applies but also with the validity of market-based rates generally.

83. Sellers argue that Snohomish misapprehends and/or seeks to collaterally attack the Commission's established notice and filing requirements and how they apply to market-based rates. They state that the application of the Mobile-Sierra doctrine cannot depend on the filing and approval of a contract if no such approval is available from, much less required by, the Commission. Sellers contend that Snohomish fails to recognize the Commission's discretion to authorize and implement its own filing requirements[130] and the sound policy decision behind the Commission's decision not to require individual market-based rate contracts to undergo additional review before they can become effective.[131]

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[128]Citing 16 U.S.C. §§ 824d, 824e (2000).

[129]It asserts that, in FP&L, 67 FERC at 61,398, the Commission rejected the notion that it is or should be bound by the "public interest" standard when it initially reviews a contract. See also Northeast Utilities, 66 FERC at 62,082; Pennsylvania Electric Co. v. FERC, 11 F.3d 207, 210 (D.C. Cir. 1993).

[130]Citing 16 U.S.C. § 824d(c) (2000).

[131]Citing GWF Energy LLC and Southern Co. Servs. Inc., 97 FERC ¶ 61,297 at 62,391 (2001), reh'g denied, GWF Energy LLC, 98 FERC ¶ 61,330 (2002) (GWF), appeal docketed sub nom. Public Utilities Commission of California v. FERC, No. 02-1108 (D.C. Cir. filed Apr. 12, 2002), dismissed June 18, 2002.

iii. Commission Determination

84. As noted in GWF,[132] 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. A new determination concerning the justness and reasonableness of a long-term service agreement is therefore unnecessary because such a determination has, in effect, already been made in the acceptance, and continuing effectiveness, of the market-based rate tariff pursuant to which a long-term service agreement is filed. The required mechanisms for ensuring that market-based rates are just and reasonable are in place: (1) prior to selling at market-based rates, sellers are required to file their proposed market-based rate tariffs for Commission review and demonstrate that they lack generation and transmission market power and control no other barriers to entry and that there is no affiliate abuse or reciprocal dealing; and (2) sellers file triennial updates thereafter. If Snohomish were correct, no contract made under market-based authority would protect the parties' contractual expectations as envisioned by the U.S. Supreme Court in Mobile-Sierra. Moreover, the Commission has expressly rejected this proposition[133] and expressly excluded from the subjects set for hearing issues concerning the Commission's policies on granting market-based rate authority or on regulation of sellers with such authority.[134] Accordingly, we reject this exception.

b. Authority to Approve Market-Based Rates

i. Argument

85. Snohomish claims that the Partial Initial Decision exceeds the Commission's authority to approve market-based rates by allowing rates that are unreasonable, imposing on customers the burden of proving that markets were not competitive, and presuming that market-based rates alone produce competition which results in virtually any price falling within the zone of reasonableness.

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[132] GWF, 98 FERC at 62,390-91.

[133] See GWF, 98 FERC at 62,390-91; State of California ex rel. Lockyer v. British Columbia Power Exchange Corp., 99 FERC ¶ 61,247 at 62,063 (2002), reh'g denied, 100 FERC ¶ 61,295 (2002), appeal filed sub nom. State of California v. FERC, No. 02-73093, 9th Cir.

[134] April 25 Order, 99 FERC at 61,384.

ii. Response

86. Trial Staff notes that the ALJ recognized that valid, market-based rates are just and reasonable rates unless the public interest requires that they be changed. Trial Staff also points out that the FPA and Natural Gas Act (NGA) place the burden of proof on those advocating a change in the status quo. Trial Staff argues that, because Complainants seek to abrogate or modify the instant contracts, they bear the burden of proof which the Commission has stated is a "heavy burden" given the request to modify contracts which were entered into voluntarily in a market-based rate environment.[135]

iii. Commission Determination

87. Market-based rates are authorized based upon a finding that a seller lacks market power and that, therefore, the seller's rates will be just and reasonable. Over time, the rates in a specific contract may become unjust and unreasonable. If the contract rates become unjust and unreasonable (i.e., not what a competitive market would produce) and the contract does not permit a "just and reasonable" review, the contract rates over the life of the contract may be changed only if found to be contrary to the public interest pursuant to the Mobile-Sierra doctrine.[136]

88. In this proceeding, CDWR adopted a contractual arrangement under which the Commission maintains the ability under Section 206 of the FPA to replace rates only if they are contrary to the public interest. As stated in the April 25 Order, the burden of proof in this case is a “heavy burden” given that the contracts were entered into voluntarily in a market-based rate environment.[137] Complainants have not met their "heavy burden" because they have not shown that the rates in the instant contracts are contrary to the public interest. Therefore, we dismiss this exception.

c. Legislative History of the FPA

i. Argument

89. Snohomish argues that the legislative history of the FPA indicates that Congress did not intend to grant private contracts, including independently negotiated bilateral contracts, immunity from the Commission's oversight responsibilities. Snohomish also

[135] April 25 Order, 99 FERC at 61,383.

[136] Sierra, 350 U.S. at 355.

[137] April 25 Order, 99 FERC at 61,383.

contends that the Commission's prior rulings and the legislative history of the Energy Policy Act of 1992 (Energy Policy Act) indicate that, even though Congress intended to promote competition in the industry and the electricity markets have become more competitive than when the FPA was first enacted, Congress did not intend to alter the Commission's Section 205 and 206 authority to modify or terminate jurisdictional contracts and/or rate schedules.[138]

ii. Response

90. Trial Staff states that private contracts are not immune from Commission oversight. It argues that the Commission would order an appropriate remedy if the contracts were not in the public interest because they imposed an excessive burden on customers, were unduly discriminatory or were entered into as a result of market power or market manipulation. Trial Staff contends that the issue is not whether the Commission will perform its regulatory duties but whether Complainants have carried their burden of proof to warrant contract reformation.

ii. Commission Determination

91. We agree that private contracts are not subject to immunity from the Commission's oversight responsibilities. Indeed, the Mobile-Sierra doctrine recognizes that, even if parties agree to limit their unilateral rights to amend contracts, they cannot eliminate the Commission's indefeasible right to replace rates that are contrary to the public interest.[139] However, under long-standing court precedent, the fact that a contract rate may no longer be just and reasonable does not equate to a demonstration that the contract is contrary to the public interest. We also agree that nothing in the Energy Policy Act altered the Commission's Section 205 and 206 authority to amend contracts. The Commission is following the requirements of Sections 205 and 206, as interpreted by the Mobile-Sierra line of cases, in analyzing the evidence before us. The fact is that Complainants have failed, based upon this record, to show that the contracts at issue are contrary to the public interest. Therefore, we deny this exception.

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[138]Citing City of Bedford, Virginia, et al. v. Appalachian Power Company, 87 FERC ¶ 61,037 at 61,139 (1999).

[139]See Papago, 723 F.2d at 953. See also id. at 954 ("The Commission's obligation to insure that rates do not violate that prescription [that they are in the public interest] is imposed for the direct benefit of the public at large rather than (like the prescription of just and reasonable rates) for the direct benefit of the seller and purchaser; and it therefore cannot be waived or eliminated by agreement of the latter.")

5. Implied Waiver of Section 206 Rights

a. Argument

92. Snohomish claims that the ALJ's conclusion that parties can waive Section 206 rights by implication is contrary to established precedent.[140] It also argues that the ALJ's reliance on San Diego Gas & Electric Co. v. Public Service Co. of New Mexico[141] is misplaced because: (1) the Commission there concluded that the parties had contemplated the possibility of a rate decrease but prohibited the filing for such a decrease as an express and integral part of the bargain struck by the contracting parties; and (2) the contract there had been approved by the Commission as just and reasonable, and the Commission found that contractual language could not restrict the Commission's review of a contract upon initial filing.

b. Response

93. Trial Staff and Sellers responds that the case law is unambiguous that, when contracts are negotiated in the absence of clear contractual language allowing unilateral contract modification under Section 206, the party seeking change must meet the "public interest" standard.

c. Commission Determination

94. The Complainants in this case were given an opportunity to provide evidence demonstrating the parties' intent to apply the "just and reasonable" standard to the contracts at issue. Instead, they argued at hearing as well as in their post-hearing briefs that the "just and reasonable" standard and the "public interest" standard merge because it is contrary to the public interest to charge unlawful rates to the public. The Commission and court precedent establish that the "public interest" standard and the "just and reasonable" standard of review are two separate standards and thus cannot be collapsed into one standard of review.[142] The weight of the record evidence on the circumstances surrounding execution of the challenged contracts demonstrates that the parties intended

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[140] Citing Sithe/Independent Power Partners v. Niagara Mohawk Power Corp., 76 FERC ¶ 61,285 at 62,458 (1996); Boston Edison, 233 F.3d at 67.

[141] June 1 Order, 91 FERC ¶ 61,233.

[142] See, e.g., Sierra at 354-5 (1956) and Southern California Water Co. v. Southern California Edison Co., 90 FERC ¶ 61,287 (2000).

the "public interest" standard of review to apply to the contracts at issue. On this basis, we therefore affirm the Initial Decision's conclusion that the "public interest" standard of review applies to these particular contracts and deny exceptions on this issue.

6. Satisfaction of the Mobile-Sierra Standard

a. Argument

95. Snohomish contends that the "public interest" standard is met here because of the devastation inflicted on electric customers across the West by the rates, terms and conditions contained in the long-term contracts that grew out of the crisis. It claims that evidence presented by Complainants establishes that the expectation that the California spot markets would continue to spiral out of control indefinitely forced CDWR to accept long-term contracts at prices and with terms and conditions far less favorable than would have resulted from a dysfunctional market. Snohomish concludes, therefore, that customers will be forced to bear excessive burdens arising from the market dysfunction into the future unless the Commission modifies these contracts.

b. Response

96. Trial Staff points out that the determination of whether the "public interest" standard has been met was beyond the scope of the Partial Initial Decision.

c. Commission Determination

97. In its January 10 Order, the Commission limited the scope of the Partial Initial Decision to a determination of which standard of review to apply to contracts without explicit Mobile-Sierra language and stated that the Commission would determine whether the appropriate standard had been met based upon the evidence presented. We discuss above whether the "public interest" standard has been met and conclude that Complainants have not met their burden of proof.

7. Alleged Unlawful Deregulation of Electricity Sales

a. Argument

98. Universal contends that the imposition of the "public interest" standard on a contract that is silent as to the parties' Section 205 and 206 rights to unilaterally modify the contract constitutes the unlawful deregulation of electricity sales because it allows

sellers of electricity to collect rates and charges that are not just and reasonable, in contradiction with the express words of the FPA.

b. Response

99. Trial Staff counters that, while Sections 205 and 206 require that all rates be just and reasonable, that requirement cannot be read in isolation when a freely-negotiated contract prohibits or limits changes to that contract. It contends that the only interpretation of "just and reasonable" that affords meaning to the language of such a contract, the established Mobile-Sierra doctrine and the intent of the parties is that the contract price is the just and reasonable rate. Trial Staff argues that a contract price based upon market-based rates would be just and reasonable if it is consistent with the seller's market-based rate authority. It claims that such a just and reasonable rate may become unjust and unreasonable only if one of the three prongs of the "public interest" test is met. It concludes that other measures of justness and reasonableness, such as traditional cost-of-service calculations, do not apply, unless the "public interest" test is met first.

100. Sellers contend that collapsing the "public interest" standard into the "just and reasonable" standard would be an arbitrary and capricious abandonment of years of decisions upholding contract sanctity and applying the "public interest" standard when buyers seek to abrogate fixed-rate contracts.

c. Commission Determination

101. As discussed above, if rates become unjust and unreasonable (i.e., not what a competitive market would produce over the life of the contract) and the contract does not permit a "just and reasonable" review, they may be changed only if found to be contrary to the public interest pursuant to the Mobile-Sierra doctrine.[143] Under the contracts at issue, the Commission maintains the ability under Section 206 to replace rates that are contrary to the public interest; however, it does not have the power to replace rates that are unjust, unreasonable, or unduly discriminatory or preferential to the detriment of the contracting purchaser.[144] Complainants have not shown that the rates in the instant contracts are contrary to the public interest. Therefore, we deny this exception.

The Commission orders:

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[143] Sierra, 350 U.S. at 355.

[144] See Papago, 723 F.2d at 953.

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

(B) The complaints are hereby denied.

(C) Complainants' motion requesting order to approve withdrawal of complaints with prejudice as to Williams is granted, as discussed in the body of this order.

(D) Complainants' motion to reopen the record is hereby granted in part and denied in part, as discussed in the body of this order.

(E) Complainants' motion to take official notice is hereby denied, as discussed in the body of this order.

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

By the Commission. Chairman Wood concurred in part with a separate statement attached.
(S E A L) Commission Massey dissented with a separate statement attached.
Commission Brownell concurred with a separate statement attached.

Magalie R. Salas,
Secretary.

Appendix A

LIST OF CONTRACTS SET FOR HEARING

Public Utilities Commission of the State of California v.
Sellers of Long Term Contracts to the California Department of Water Resources
Docket Nos. EL02-60-000 and EL02-62-000

I. Contracts for which the issue of the applicable standard of review was summarily decided:

Seller's Name	Contract Date
Williams Energy Marketing & Trading Company	2/21/2001
Allegheny Energy Supply Company, LLC	3/23/2001
Allegheny Energy Supply Company, LLC	4/20/2001
Soledad Energy, LLC	4/28/2001
GWF Energy, LLC	5/11/2001
Mirant Americas Energy Marketing, LP	5/22/2001
Coral Power, L.L.C.	5/24/2001

II. Contracts for which the issue of the applicable standard of review was set for hearing:

Seller's Name	Contract Date
El Paso Merchant, L.P.	2/13/2001
Morgan Stanley Capital Group, Inc.	2/14/2001
Dynegy Power Marketing, Inc.	3/2/2001
Imperial Valley Resource Recovery Company, L.L.C.	3/13/2001
Alliance Colton, LLC	4/23/2001
Sempra Energy Resources	5/4/2001
PG&E Energy Trading-Power, L.P.	5/31/2001

Appendix B

The evidentiary hearing began on December 2, 2002 and concluded on December 12, 2002.

On December 17, 2002, the Commission denied Allegheny's emergency motion for summary dismissal of the complaints regarding its contracts which had been filed on October 29, 2002.[145] To expedite resolution of the proceeding as to Allegheny and other parties whose contracts contained explicit Mobile-Sierra provisions, the Commission directed the ALJ to omit the initial decision on this issue and certify the record directly to the Commission. On December 24, 2002, the ALJ certified the record of this portion of the proceeding directly to the Commission, as directed, and proceeded to evaluate the record for the purpose of preparing an initial decision on the contracts of the remaining sellers.[146]

On January 10, 2003, in response to motions for partial summary disposition on the applicable standard of review for Dynegy's, El Paso's, Sempra's and Morgan Stanley's long-term contracts with CDWR, the Commission directed the ALJ to determine the applicable standard of review for the contracts which did not contain explicit Mobile-Sierra language and, if the ALJ found the "public interest" standard applied, to certify the record of those contracts directly to the Commission for consideration of all remaining issues in the case.[147] On that same date, initial post-trial briefs were filed by Complainants, Allegheny, Coral, Dynegy, El Paso, Mirant, Morgan Stanley, Sempra, Respondents jointly, Trial Staff and Universal.

On January 13, 2003, Complainants filed a joint notice of withdrawal of their complaints with prejudice as to Williams and a joint motion requesting an order to approve such withdrawal. On January 28, 2003, Pacific Gas and Electric Company (PG&E) filed an answer to the notice of withdrawal.

On January 16, 2003, the ALJ issued a partial initial decision finding that the "public interest" standard applies to all the contracts which did not contain explicit

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[145] December 17 Order, 101 FERC ¶ 61,293.

[146] Public Utilities Commission of California v. Sellers of Long Term Contracts, 101 FERC ¶ 63,034 (2002). See also Errata Notices dates 12/31/02 and 1/10/03.

[147] January 10 Order, 102 FERC ¶ 61,025.

Mobile-Sierra language.[148] On January 17, 2003, the ALJ certified the record to the Commission. On January 24, 2003, the Secretary clarified that the parties were directed to submit their reply briefs directly to the Commission no later than January 27, 2003 and that the Commission would accept the initial briefs filed with the ALJ on January 10, 2003. On January 27, 2003, reply briefs were filed by Complainants, Allegheny, Coral, Dynegy, El Paso, Mirant, Morgan Stanley, Sempra, Respondents jointly, Trial Staff and Universal.

Briefs on exceptions to the Partial Initial Decision were filed by the CPUC and the CEOB. Briefs opposing exceptions were filed jointly by Allegheny, Coral, Dynegy, El Paso, Mirant, Morgan Stanley and Sempra and by Trial Staff.

On February 24, 2003, Complainants filed a motion to lodge a complaint which they filed in the Superior Court of California.

On March 3, 2003, Complainants sought to supplement the record in this proceeding with the market manipulation/abuse evidence submitted in Docket No. EL00-95, et al. On March 11, 2003, Respondents jointly filed a motion to strike this submission or, in the alternative, a motion for leave to respond to the supplemental submission.[149] Respondents also individually opposed and filed evidence, including new testimony, in response to Complainants' supplemental submission.[150] On March 20, 2003, Complainants filed reply comments. On March 25, 2003, Complainants filed an answer in response to the motion to strike and Allegheny's and Reliant's response to their supplemental submission. On March 26, 2003, Complainants filed a motion to strike submissions filed by Mirant and Sempra. On April 2, 2003, Allegheny, Coral, Dynegy, El Paso, Mirant and Sempra filed a motion to strike or, in the alternative, a motion for leave to respond to Complainants' reply comments. On April 9, 2003, Mirant and Sempra filed a response to Complainants' motion to strike their submissions. On April 10, 2003, Complainants filed a response to the motion to strike their reply comments.

[148] Partial Initial Decision, 102 FERC ¶ 63,013.

[149] On March 18, 2003, Reliant Energy Services, Inc. and Reliant Energy Power Generation, Inc. (collectively, Reliant), an intervenor in this proceeding, responded to Complainants' supplemental submission.

[150] Complainants and Respondents also submitted indexes that had been requested to be filed in Docket Nos. EL00-95, et al., pursuant to a Commission order. See February 10 Order, 102 FERC ¶ 61,164.

On April 16, 2003, Complainants filed a Motion for Disclosure of Alleged Off-The-Record Communications and Request for Oral Argument. On April 18, 2003, Respondents filed a Motion for Leave to File an Answer and Answer to the Request for Oral Argument. On April 18, 2003, a notice was issued scheduling oral argument for May 15, 2003. On April 22, 2003, the Commission filed a summary of the events relating to the alleged off-the-record communications, and, on April 23, 2003, the Commission issued an order finding that these were not inappropriate communications;[151] therefore, Complainants' motion for disclosure is now moot.

On April 22, 2003, Complainants filed a Motion to Reopen the Record or Take Official Notice of Evidence of Market Abuse. Coral and Sellers filed answers in opposition to this motion.

On May 15, 2003, the Commission held oral argument in this proceeding (Oral Argument).

On June 11, 2003, in Docket Nos. EL02-60-000 and EL02-62-000, Complainants, Allegheny and Allegheny Trading Finance Company (collectively, the Settling Parties) filed a settlement agreement (Allegheny Settlement Agreement).[152] On June 13, 2003, a notice was issued shortening the comment period on the Allegheny Settlement Agreement.[153]

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[151]Nevada Power Company, et al., v. Enron Power Marketing, Inc., et al., 103 FERC ¶ 61,080 (2003).

[152]On that same date, in Docket No. ER01-1847-001, Complainants and Allegheny filed an Amended and RestatedAgreement.

[153]The comment period on the Amended and Restated Agreement was shortened also.

Appendix C

Summary of Parties' Arguments Regarding Remaining Substantive Issues

1. Impact of the Spot Market on the Forward Market

a. Initial Briefs

i. Complainants

Complainants allege that the prices CDWR agreed to pay in the first five months of 2001 for electricity to be delivered in the remainder of 2001, all of 2002, and into 2003 were enhanced by the expectation that the price-inflating effects of the flaws in the spot markets would not fully attenuate until 2004. Complainants assert that prices were high in the spot market because supply was tight relative to demand and that tightness of supply, in the absence of firm regulatory safeguards, created conditions in which the withholding of even small amounts of supply would substantially raise prices. They contend that tight supply in the electricity markets is the condition that activates and can be exacerbated by market flaws.

Complainants state that forward prices are based upon expected future spot prices, and forward markets are necessarily affected by expected dysfunction in the spot market. They argue that the forward prices that prevailed prior to June 2001 for delivery of electricity prior to 2004 reflected a premium above the price that would have been expected based upon the interaction of supply and demand in a functioning and competitive market as a result of the expected continued effects of spot market dysfunction. They contend that the risk premium analysis provided does not explain the gap between the fundamentals forecast and the actual forward prices. They claim that their expert confirmed that the gap can only be explained by the market's expectation of continued dysfunction in the spot market. They assert that changes in NOx regulations cannot explain the drop in forward prices. They state that new generation would not have an effect on forward prices. They argue that expectations of economic performance remained the same during the relevant two week period or that there was no unexpected news about nuclear or hydro conditions announced in late May that would have affected forward prices. They claim that the exercise of market power and changes in regulatory approach and CDWR's long-term contracting also affected forward prices.

Complainants contend that the credit concerns with the IOUs that caused QFs to go offline were a dysfunction, not a market fundamental, and adversely affected CDWR's negotiations.

Complainants claim that the structure and pricing of the long-term contracts reflect the impact of the dysfunctional spot market. They contend that over time the back-end loaded contracts will provide total revenues that match or exceed the expected spot prices, including the high 2001 and 2002 expected prices, over the life of the contract. They assert that sellers also spread out high prices for 2001 and 2002 by increasing the number of megawatt hours delivered in the back-end years. They state that contract negotiations were driven by crisis conditions that were a direct result of the dysfunctional spot market. They argue that the forward price curves established the floor for the negotiation of the instant contracts, and the contracts are overall priced higher than the expected spot prices would otherwise suggest.

ii. Trial Staff

Trial Staff asserts that the high prices in California's long-term, bilateral energy markets may be attributable to three factors: (1) flaws in the spot markets; (2) competitive market fundamentals; or (3) the exercise of market power or market manipulation. Trial Staff notes that the Commission placed the third outside the scope of the hearing due to the investigation in Docket No. PA02-2-000. Trial Staff's witness testified that: (1) the Commission issued orders addressing most of the flaws it identified in the California spot markets prior to the execution of the contracts at bar; (2) market fundamentals do not improperly affect forward contract prices, but rather produce price signals that such contracts should reflect; and (3) the Complainants failed to meet their burden because they did not distinguish adequately between the adverse effects of any flaws that may have remained in the spot markets and the effects of market fundamentals on the long-term, bilateral markets.

Trial Staff argues that Complainants did not show that expected future prices in the dysfunctional ISO and PX spot markets adversely affected the prices of the forward contracts entered into by CDWR, as the Commission required. Trial Staff asserts that the parties executed the contracts at issue between February 13, 2001 and May 24, 2001, after the PX spot market suspended operation at the end of January 2001. Trial Staff contends that Complainants' witness recognized that PX spot market prices played no role in determining the forward price curves upon which the long-term contracts were based. Trial Staff concludes, therefore, that market participants could have no expectations of future PX spot market prices in determining the prices of the long-term contracts signed between February and May 2001.

Trial Staff claims that Complainants did not produce any evidence explicitly linking the ISO spots markets with the contested contracts, only providing testimony about spot market prices in general.

Trial Staff asserts that the Commission took actions to correct most of the flaws in the California spot markets that gave rise to dysfunctions prior to the execution of the contested contracts, thus eliminating any effects of the flaws on these forward contracts. Therefore, Trial Staff concludes that, even if Complainants had offered evidence on the specific effects of the ISO and PX spot markets on the contracts at issue, as required by the hearing order, they would not have been able to demonstrate any substantial adverse effect from spot market dysfunctions because the Commission took preemptive action to eliminate the dysfunctions prior to the time the instant contracts were executed. Trial Staff argues that, once the Commission acted, market participants were (or should have been) aware that this critical dysfunction that created over reliance on spot markets would be less of a factor affecting prices.

Trial Staff contends that the remaining reasons for prices to continue to be relatively high are: (1) competitive market forces (i.e., market fundamentals); (2) inadequate retail demand responsiveness; (3) possibly the exercise of market power; and (4) market participants may have expected the spot market flaws identified by the Commission to continue, despite Commission action to remedy them, thus affecting their calculation of forward prices. Trial Staff asserts that forward contracts are supposed to reflect competitive market forces on prices (i.e., prices are expected to and must rise to induce the investment in new capacity that is needed to serve customers adequately). Trial Staff claims that, after December 15, 2000, prices in the spot market were becoming less and less reflective of a dysfunctional market design and thus more reflective of competitive market conditions. Therefore, Trial Staff concludes that Complainants must identify and segregate the portion of the forward contract rates at issue which was due to the effect of competitive factors and the portion which was due to other effects. Trial Staff contends that if these distinctions are not made Complainants risk overestimating the effect of any residual spot market flaws or exercise of market power on the long-term contracts.

Trial Staff argues that the position of Complainants' witness that the high contract prices must either be explained totally by a market fundamentals "hypothesis" or a market dysfunction "hypothesis" is not tenable. Trial Staff asserts that the simple correlation between spot and forward prices and a synchronous decline does not prove or even suggest that high spot prices caused forward prices to be high.

Trial Staff asserts that to demonstrate the magnitude of the dysfunction on the contracts at issue Complainants mistakenly rely on their expert's testimony which erroneously estimated "the level of overcharge[s]" in the contracts at issue "by comparing the expected contract costs with the costs of an alternative source of generation." Trial Staff notes that, after acknowledging that he made computational errors, the expert which provided this testimony filed supplemental testimony which conceded that, when corrected, his analysis would not show "that the contracts are priced above long-run competitive prices."

Trial Staff concludes that a review of Complainants' evidence shows that they failed to meet their heavy burden to demonstrate that dysfunctional California spot markets adversely affected the long-term bilateral markets, and, even if they had, they failed to show the extent of any such effect that would warrant the modification of the instant contracts.

iii. Sellers

Sellers[154] argue that Complainants have failed to show that the dysfunctional spot markets adversely affected the long-term bilateral markets. Sellers claim that Complainants did not present any empirical or statistical analysis attempting to prove that the dysfunctional ISO spot markets in any way affected the long-term bilateral markets.

Sellers contend that Complainants' primary expert did not present any analysis of ISO spot markets, looking instead at bilateral spot markets. Sellers state that the expert failed, therefore, to provide substantive evidence concerning the relevant spot markets.

Sellers note that the only empirical analysis that Complainants offered in their direct case when corrected for numerous and admitted errors showed that the rates in the challenged contracts do not exceed long-term competitive prices.

Sellers contest Complainants' expert's emphasis on the supposedly sudden and dramatic two-week decline in bilateral spot and forward prices during late May and early June 2001 relied upon to demonstrate that spot market dysfunction adversely affected forward power prices. Sellers respond that the "two-week" price collapse theory is factually incorrect when viewed in the context of overall price trends throughout the spring of 2001 and, therefore, is not dispositive.

Sellers argue that none of the external factors cited by Complainants' expert support his theory that sudden changes in certain "external factors," such as political

[154]On January 10, 2003, Dynegy, El Paso, Morgan Stanley and Sempra filed a joint initial hearing brief which was virtually identical, expect for its discussion of the applicable standard of review, to a joint initial hearing brief filed by Allegheny, Coral and Mirant on that same date. Therefore, the following discussion of their initial hearing briefs will refer to these Respondents collectively as "Sellers."

developments, explained the supposedly sudden and dramatic collapse in spot and forward prices better than market fundamentals.

Sellers challenge Complainants' experts' broad definition of "dysfunction" which included any market flaw combined with scarcity and a related notion of a "dysfunction magnifier." Sellers argue that this definition of dysfunction contradicts Commission precedent and well-established economic principles as noted in Sellers' economists testimony. Sellers also argue that the expert's "dysfunction magnifier" was unsupported by any empirical analysis actually proving that dysfunctions in ISO spot market affected forward markets.

Sellers contend that Complainants ignored the price forecasts that CDWR's own consultants at Navigant Consulting (Navigant) developed while the challenged contracts were being negotiated and executed. Sellers note that a version of these price forecasts, one which never contained any "dysfunction premium," substantially exceeded the market-based forward price curves for electricity that were publicly available at the time for all periods other than summer 2001 and that even the difference for the summer 2001 period was small in all but one month.

Sellers also claim that, although the expert admitted that forward natural gas prices, emission allowance costs and other market fundamentals are critical to understanding forward electric prices, he never comprehensively analyzed these market fundamentals in preparing his pre-filed testimony and, thus, had little or no basis for opining that anything other than fundamentals drove forward electric prices.

Sellers also assert that, even if Complainants had shown that dysfunctional ISO spot markets had some adverse effect on the long-term bilateral markets, they did not show that the effect was of sufficient magnitude to warrant modification of the instant contracts.

Sellers argue that their witness demonstrated that the primary drivers of forward prices were market fundamentals, not dysfunctions in the ISO spot markets. Sellers also argue that forward contracts were not symptomatic of dysfunctions in the ISO spot markets, rather they helped cure any dysfunctions that existed in those markets.

iv. Dynegy

Dynegy asserts that Complainants did not offer direct analysis of underlying market fundamentals to support their assertions that dysfunction in the forward markets affected Dynegy's contract price, did not present evidence that evaluated the contract price and did not address Dynegy's witness' contention that the price terms associated with the fixed and system contingent capacity and energy were not controversial or objected to during the contract negotiations.

v. Mirant

Mirant contends that the expert testimony presented by Complainants crumbles when applied to the Mirant Agreement and, in fact, supports a finding that the assumed dysfunctional California ISO spot markets has no adverse effect on the forward markets at the time the Mirant Agreement was negotiated and executed.

vi. Sempra

Sempra argues that it does not consider current spot prices in pricing electricity products and that alleged dysfunctions in the ISO spot markets did not influence Sempra's bids to CDWR. It asserts that forward price curves obtained from brokers and traders for electricity and natural gas played a significant role in Sempra's offer prices to CDWR. Sempra also took into consideration (1) construction and operational costs associated with developing its generation assets, (2) statements by California representatives suggesting that CDWR was looking for prices in the $50-$60 per megawatt-hour price range, (3) losses that Sempra would incur by making sales at below-market rates for the summer of 2001, and (4) the unique credit risks entailed in entering into a transaction with CDWR without credit assurances typically required by Sempra.

Sempra argues that Complainants have conceded that they cannot show that the dysfunctional ISO spot markets had any discernible effect on long-term bilateral contract prices for delivery beyond some unspecified point "into 2003." Sempra contends that, even setting aside Complainants' witness' unsubstantiated estimates of his dysfunction premium for 2001 through 2003, the magnitude of his dysfunction premium as applied to the Sempra Agreement falls short of that which would be required for Complainants to meet their heavy burden in this regard. It claims that an alleged "overcharge" of 2.8 to 3.6 percent above a purported ideal rate cannot justify the extraordinary remedy of contract modification under any standard of review.

vii. Universal

Universal argues that there are two conditions that must be met for market-based rates to be just and reasonable: (1) there must be a competitive market and (2) the resulting prices must fall within the same zone of reasonableness as cost-based rates. It argues that the long-term bilateral market was not competitive because it was dysfunctional due to the market structure and the pattern of prices is in a range which indicated that market forces were not driving the prices to a “market clearing,” marginal cost level. It contends that the dysfunction in the spot market did affect the long-term markets.

Universal challenges the evidence tendered by Trial Staff because it claims that: (1) its witness admitted that he did not perform any study to determine why prices were so high in the California market in 2001; (2) its witness admitted that the long-term market might have been affected by the dysfunction in the spot market, but he decided not to investigate the subject; (3) its witness admitted that he considered only a few and selective portions of the evidence offered by Complainants and Sellers; and (4) its witness did not examine the evidence on the California market that was accumulated by Commission Staff and made available not only to the Commission but also to other agencies such as the U.S. Securities and Exchange Commission, U.S. Department of Justice and Federal Trade Commission. It criticizes other testimony which relied on this witness.

b. Reply Briefs

i. Complainants

Complainants charge that the lack of installed plants in California was a direct result of market flaws. They contend that these market flaws were also evidenced by a lack of incentives for new construction, changes which would affect the forward markets. They state that the combination of existing market flaws and tight supply led to sellers exercising market power through withholding supply and driving up prices. Complainants argue that the fact that they were precluded from investigating or offering evidence of market abuse created a "catch-22" situation.

Complainants allege that the Commission's November and December 2000 orders did nothing to relieve prices, but rather, caused the spot and forward markets prices to rise. They assert that the result was contracts priced at or above the forward curves, suggesting that there was an expectation of continued dysfunction driving forward prices until 2004.

Complainants assert that Respondents mischaracterize Navigant's proxy price model and its purpose. They argue that the proxy price model does not, as Respondents state, represent a forecast of competitive prices. They claim that Navigant's model is neither a forecast of market fundamentals nor an estimate of future competitive prices, but rather a conservative proxy with which CDWR could estimate revenue requirements for electricity purchases.

ii. Trial Staff

Trial Staff argues that Complainants have revealed the weakness of their case by switching their primary reliance from their own witnesses' flawed analyses to a graph created by a witness for Dynegy to support their claim that a "dysfunctionality premium" existed in 2001 in the forward markets. Trial Staff explains that the graph displays a gap between the average forward prices and the model's forecasts for 2001 and 2002 and that Complainants contend that the gap between the two curves on the graph, which Complainants modified and included in their Initial Brief, shows that forward prices were "infected" by spot market dysfunctions. Trial Staff states that the graph, modified or unmodified, shows no such thing. Trial Staff argues that, simply recognizing that a gap exists between a curve depicting forward on-peak prices at a particular California delivery point and a curve depicting prices forecasted by a commercial software model, does not conclusively establish the existence of a "dysfunctionality premium" in forward markets.

Trial Staff asserts that Complainants' analysis of spot and forward prices for a particular two-week period in 2001 failed to produce any proof that spot market dysfunction actually affected the forward market. It notes that Complainants assert that their witness independently confirmed that the gap displayed in Exhibit DYN-31 can only be explained by expectations of continued dysfunction in the spot market. Trial Staff argues that the problem with this approach is that it does not demonstrate that the dysfunctional ISO and PX spot markets affected the forward markets and, at best, merely shows that spot and forward prices moved together during those two weeks. Trial Staff also argues that Complainants do not demonstrate the extent to which these price levels were the result of competitive market forces and the extent to which they were the result of other causes, such as market flaws.

Trial Staff argues that the fact that some QFs did not sell generation to California utilities because of credit concerns fails to establish a causal relationship between spot market dysfunction and the forward contracts at issue. Trial Staff states that, by characterizing the credit concerns as a dysfunction, Complainants contend such withholding of power by QFs pushed forward prices up, thus proving their witness' conclusion that spot market dysfunction affected forward prices. Trial Staff asserts that Complainants' argument makes little sense because QFs did not sell their output into the ISO and PX spot markets; instead, pursuant to Section 210 of the Public Utility Regulatory Policies Act, they sold power directly to electric utilities. Thus, Trial Staff concludes that QFs did not have a direct relationship to the spot markets. Trial Staff points out that, as explained in the testimony submitted on behalf of Respondents Morgan Stanley, Sempra, Mirant and Allegheny, beginning in December 2000, the Commission relaxed its restrictions on QFs, allowing them to sell excess output through bilateral contracts.

Trial Staff claims that Complainants were unable to prove their assertion that the pricing structure of the forward contracts, some of which contain levelized prices, was driven by the dysfunctional spot markets operated by the ISO and PX. Trial Staff asserts that the fact that the contracts at issue may have been priced at or above the forward price curves does not support Complainants' contention that the prices in the contracts incorporated the dysfunctions in the spot market and therefore must be modified to achieve just and reasonable rates.

Trial Staff states that now Complainants contend that a measure of the excessive burden on ratepayers can be found in Appendix C to their Initial Brief, which they admit is a "rough" quantification of the "dysfunctionality premium." Trial Staff argues that, not only is it too late for Complainants to attempt to quantify (for the first time) this measurement of the alleged "overcharges," but also the theory upon which they rely is flawed because there has been no showing that the forward price curves where the product of the dysfunctional spot market.

iii. Sellers

Sellers argue that Complainants did not and cannot demonstrate that the dysfunctional spot markets had an adverse effect on the long-term bilateral markets in California. Sellers contend that Complainants' analysis on this point is flawed because it is based upon misguided assumptions and incorrect price comparisons, including a misuse of the GE MAPS results presented by one of Sellers' witnesses. Sellers assert that Complainants constructed a faulty analysis of expected prices for 2002 (as of March 1, 2001) and then worked backwards to fill this evidentiary void by purporting to derive a dysfunction premium for 2001 forward prices. Sellers dismiss as mere theory Complainants' argument that changes in bilateral spot and forward prices during a two-week period in late May and early June 2001 demonstrated the existence of a dysfunction premium in the forward market prices. Sellers claim that Complainants' analysis regarding this two-week period fails to take into account critical changes in market fundamentals.

Sellers maintain that the evidence shows that the dysfunctional spot markets did not adversely affect the long-term contracts at issue in any material manner. Sellers assert that, contrary to Complainants' contention, scarcity alone is not a market dysfunction that affected the long-term bilateral markets during 2001. Seller's state that prior Commission orders make clear that scarcity contributed to dysfunction in the ISO and PX spot markets only to the extent that it was combined with State-imposed restrictions on the IOUs that forced them to buy power exclusively in the PX spot markets. Sellers state that the Commission eliminated these State-imposed restrictions in January 2001, thereby eliminating this contributing factor to dysfunction in the residual ISO spot markets. Moreover, Sellers argue that even if market participants could exercise market power in the ISO spot markets during conditions of scarcity, it is virtually impossible to leverage such market power into the bilateral forward markets. Sellers state that doing so is especially difficult in the long-term bilateral markets because the market for forward contracts is not the final market available to either a buyer or seller (meaning that the buyer or seller can wait to buy or sell later in the forward or spot markets).

Sellers contend that Complainants failed to prove, under any relevant standard, that the effect of the dysfunctional ISO spot markets on long-term bilateral markets in California was of a magnitude warranting abrogation or modification of the challenged contracts. Sellers argue that Complainants have taken the position that they are entitled to relief if they show that the dysfunctional ISO spot markets had any effect on the contracts at issue and that such a position constitutes a collateral attack on the April 25 Order in this case, which requires Complainants to show an adverse effect of sufficient magnitude to warrant abrogation or modification. Sellers claim that, instead of making the required showing, Complainants rely upon a flawed benchmark analysis and unsupported dysfunction premiums. In any case, Sellers assert that the contract costs are below the ten-year $70/MWH target sought and achieved by the CDWR and that CDWR's payments under the contracts did not exceed the level that the retail market was accustomed to paying.

iv. Allegheny

Allegheny claims that Complainants' contention that the Allegheny Agreement was priced above its forward curves is patently wrong. Allegheny states that CDWR obtained a just and reasonable price from Allegheny and agreed to compensate Allegheny for the substantial risks it assumed under the contract. Allegheny argues that, contrary to Complainants' misrepresentation, at the time of the negotiations, Allegheny's

11-year, $61MWh contract was priced at virtually the same level as its forward price curves and carried a de minimis $10 million dollar projected "cushion" over the entire life of the long-term fixed price contract. Allegheny argues that Complainants fail to mention that, based upon Navigant's then-current forward curves at the time of contracting and the swap-price methodology used by Mr. Koenig, the price of the Allegheny Agreement would have been $70/MWH. It concludes that, based upon CDWR's own forward curves, the Allegheny Agreement price of $61/MWH was substantially cheaper and priced far below expected spot prices, as projected in CDWR's own forward curves. Allegheny asserts that whether or not the contract was priced at or above the forward price curves at the time of Complainants' analysis does not take into account the fact that Allegheny, like CDWR, was a price taker in the volatile electricity markets and therefore was taking on substantial risks for which compensation was appropriate.

Allegheny notes that Dynegy's witness' review of CDWR's contracts, to demonstrate that their forward price curves formed the floor for negotiations, analyzed only contracts entered on or before March 1, 2001 and therefore his study did not include the Allegheny Agreement which was signed on March 23,2001 and April 20,2001, respectively.

Allegheny states that the record shows the absurdity of Complainants contention that the Commission should "presume" that the Allegheny Agreement, on the day it was signed, was hugely profitable. First, it states that the record demonstrates that the Allegheny Agreement was not "hugely profitable" because it shows that the expected mark-to-market value, based upon the forward curves from which the price was derived, was a mere $10 million. Second, it points out that Mr. Koenig testified that Allegheny undertook numerous actions to perform under the CDWR contract which resulted in realized cash losses in the hundreds of millions of dollars.

Allegheny alleges that Complainants have not demonstrated that the harm, if any, to California from these contracts is of a magnitude warranting modification. Allegheny argues that Complainants' analysis of contract overcharges, as well as their conclusion that these overcharges harmed the State economy, are so flawed as to invalidate their conclusions. Allegheny claims the corrected analysis of Complainants' evidence shows that the Allegheny contracts produce savings to the State of $67.4 million or $92.5 million per year.

Allegheny asks the Commission to reject Complainants' arguments that the contracts should be reformed based on Respondents' legitimate performance costs because they are not the appropriate measure of the just and reasonable rates of the

Allegheny Agreement. It claims that a seller's costs are not a relevant test for market-based rate authority or market-based transactions.

v. Dynegy

Dynegy argues that Complainants has not submitted any evidence that Dynegy's price was affected by spot market dysfunction. Dynegy submits that although the State argues that Dynegy's prices were developed based on forward price curves that were affected by spot market dysfunction, it has not submitted testimony analyzing Dynegy's prices and in fact declined to do so. Dynegy contends that allowing Complainants to now argue that they have a new approach to quantifying a dysfunction premium in Dynegy's prices is "unacceptable". Furthermore, Dynegy argues that Complainants' analysis is incorrect in that prices under the Dynegy contract are 10 to 25 percent less than the forward price curves at the time the contract was signed. Dynegy points out that under the contract Complainants have the benefit of falling gas prices and that this reduction in gas prices through October 2002 caused lower contract prices. To support its position, Dynegy states that its witness concluded that Dynegy's prices were driven by market fundamentals and exhibited no material influence of spot market dysfunction.

Dynegy also alleges that Complainants misconstrue several facts to cast Dynegy in a bad light. Among the facts misconstrued is the amount of capacity CDWR must buy under the Dynegy Agreement. Dynegy claims CDWR is only obligated to take 200-500 MWs and is not obligated for anything above that. Dynegy argues that Complainants' assertion that the tolling requirements of the Dynegy Agreement "places all gas risk on Dynegy" is false since gas prices have fallen providing the State with significant benefits. Dynegy also disputes the accuracy of Complainants' recalculation of its witness' estimation of Dynegy's contract price and attributing 2001 dysfunctionality premiums calculations to that witness. Dynegy alleges that Complainants fail to address forward price curves developed by its own consultant. Dynegy argues that the price forecasts were higher than the market-based forward price curves that existed at the time Dynegy negotiated its contract with CDWR.

Dynegy asserts that Complainants grossly overstate Dynegy's profit expectations. It notes that Complainants did not file any testimony, thus depriving Dynegy of an opportunity to engage in cross-examination or file rebuttal testimony. Dynegy argues that Complainants' figures of $635-$812 million in profits do not take into account taxes or other offsets, which would result in $387-$495 (accounting for taxes only). According to Dynegy, this amount is below its investment in its California units. Despite this result, Dynegy explains that it is "sound policy for generators to earn profits when the market is tight, enabling them to ride out the lean periods when capacity is plentiful."

vi. El Paso

El Paso argues that Complainants failed to show any evidence that supports their contention that El Paso's prices were above market. El Paso states that its evidence proves that contract prices with CDWR reflect market prices with no indication of market dysfunction.

El Paso contends that the fact that agreed upon price was below current spot market prices and near-term forward prices but above long-term prices predicted at the time does not indicate that El Paso's price included expectations of continued dysfunction, as suggested by Complainants. El Paso argues that what Complainants describe as market dysfunction is nothing more than evidence of arbitrage in a competitive market.

According to El Paso there is no evidence in the record that supports Complainants' claim that El Paso's forward curves were above market. Rather than prove the point, El Paso charges that Complainants improperly assume that a dysfunctionality premium is imbedded in market and contract prices.

vii. Morgan Stanley

Morgan Stanley argues that Complainants have failed to meet their heavy burden to demonstrate generally that the bilateral forward contracts between the sellers and the CDWR were adversely affected by dysfunctions in the California spot markets. Specifically, Morgan Stanley states that Complainants have not and can not demonstrate that the Morgan Stanley Agreement contains a dysfunction premium. Morgan Stanley points out that the record fails to demonstrate that dysfunctions in the California spot markets, when exacerbated by conditions of true supply scarcity, necessarily created conditions conducive to the withholding of power that pumped up the prices in the California spot markets. They state that such an assumption ignores the Commission's December 15, 2000 Order which specifically addressed the dysfunctions it believed were affecting the California organized spot markets (e.g., the buy-sell requirement). Morgan Stanley avers that, regardless of whether power was withheld from California, Complainants have failed to demonstrate, and their expert witnesses did not provide any analysis of, a nexus between the California spot markets and the bilateral power markets in the West.

Morgan Stanley notes that its expert witnesses did analyze the relationship between these markets and testified that the pattern of prices in the bilateral spot markets at NP 15 and SP 15 was significantly different than the pattern of prices in the California spot markets. They also testified that the dysfunctions that the Commission identified in its December 15, 2000 Order as extant in the California spot markets were not present in the bilateral spot markets. Further, Morgan Stanley argue that the "evidence" that Complainants do cite, the two-week price collapse theory and the GE MAPS model results disprove, rather than prove the existence of a dysfunction premium. Morgan Stanley argues the two-week price collapse theory demonstrates that: (1) changes in market fundamentals do account for the decline in the forward power price during the period between May 24, 2001 and June 6, 2001; and (2) the PJM market either was adversely affected by the same dysfunctions extant in the California spot markets or the PJM market suffered from the same type of dysfunctions. Morgan Stanley claims that Complainants confused, misconstrued, and misused GE MAPS model results so that they would support their theory of the case. However, it notes that when viewed appropriately the GE MAPS model results serve as an extremely conservative estimate of the absolute floor for what prices would have been.

Morgan Stanley states that the factual and empirical record evidence that Morgan Stanley and the other Respondents presented in this proceeding demonstrates that market fundamentals affecting supply and demand were the primary driver of forward prices rather than dysfunctions in the California organized spot markets and that on this basis alone the Commission should find that the Morgan Stanley contract meets the "public interest" standard.

Morgan Stanley contends that Complainants' summation of the evidence against Morgan Stanley in Appendix A6 demonstrates that the Morgan Stanley Agreement price was consistent with the forward market price when the contract was executed. Morgan Stanley states that the entire point of Complainants’ exercise in Appendix A6 was to show that the "dysfunctionality premium" was embedded in the Morgan Stanley forward curve. It argues, however, that the “dysfunctionality premium” is not supported by the evidence. Morgan Stanley asserts that Complainants’ allegation that Morgan Stanley received a $60 million dysfunctionality premium completely ignores the record evidence. For example, Morgan Stanley points to the Morgan Stanley Trader who derived Morgan Stanley’s forward curve and priced the contract and testified that Morgan Stanley did not include any premium for the alleged dysfunctional market. Morgan Stanley notes that it also offered evidence that it had no generation capacity to serve the contract and purchased power in the same markets as CDWR, and, as a result, Morgan Stanley was subject to the same prices and price risk as CDWR. Thus, Morgan Stanley concludes that Appendix A6 shows only that Morgan Stanley seeks to operate its business in a profitable manner and does so by offering power at market prices, neither of which is contrary to the public interest.

Morgan Stanley also argues that Complainants attempt to lump Morgan Stanley's contract along with other Respondents' contracts through unsupported assumptions, general conjecture and improperly attempting to shift the burden of proof onto Morgan Stanley. Morgan Stanley states that Complainants attempt to shift the burden of proof onto Respondents on two central issues: (1) Complainants "ask the Commission to presume that each contract, on the date it was signed, were [sic] hugely profitable . . . far exceeding any legitimate costs;" and (2) Complainants argue that "[t]he Respondents have not explained, nor can they, why a purchaser with superior leverage would (1) pay more, not less, than the sellers' forward price curves, (2) enter into contracts for 10 years, when it really wanted 1-3 year deals, and (3) agree to purchase large amounts of energy in the out years of the contract with relatively small amounts delivered in the early years when the purchaser desperately needed the power."

viii. Mirant

Mirant argues that Complainants did not demonstrate that the Mirant Agreement price was above Mirant's internal forward curve. Mirant states that, although Complainants purport to rely on Mirant witness' calculation of a levelized price from Mirant's forward price curves, it fails to mention some explicit caveats noted by the witness in presenting his calculations. First, Mirant notes that the witness explained that his calculation of a levelized price was based upon Mirant's historical forward curves for "mid" prices while Mirant's actual offer price for the CDWR (or any other) sale would have been developed using the ask price curve, which is by definition higher than the mid curve. Second, Mirant notes that the witness explained that the forward price curve he used reflected prices for trades of relatively small blocks of power, usually 25 to 50 MW, while Mirant committed to sell CDWR a 500 MW block of power. Mirant argues that the sale of such a large block would tend to command a higher price because as the witness testified "larger sales would be expected to move the market." Thus, Mirant notes that both of these factors tend to depress the forward curve-based price calculation.

Mirant also argues that Complainants failed to mention that forward prices climbed considerably between May 17, 2001, when Mirant and CDWR reached agreement as to basic terms of the Mirant Agreement, and May 22, 2001, when the parties executed the contract. Further, Mirant notes that, according to Complainants' expert witness, the May 22 date is the more appropriate date for purposes of comparison since "either party could walk away from a contract until the contract was finalized."

Mirant states that the only analysis in the record of expected competitive prices as of mid- May 2001 demonstrates that the Mirant Agreement was not adversely affected by spot market dysfunction. It contends that Complainants failed to acknowledge that the GE MAPS modeling analysis relies on market information as of March 1, 2001 only, more than two months before the Mirant Agreement was negotiated.

ix. Sempra

Sempra contends that Complainants provided little, if any, record evidence directly addressing the Sempra Agreement. Sempra argues that the State provides no probative evidence demonstrating that the dysfunctional ISO spot markets adversely affected the rates, terms or conditions in the Sempra Agreement. Sempra argues that the State mischaracterized and misused the GE MAPS price forecast model, which did not and cannot model all relevant market fundament in particular, scarcity rents. Sempra contends that, in its initial brief, it demonstrated that this March 1, 2001 price forecast provides no probative evidence concerning the existence or magnitude of a dysfunction premium after March 1, 2001, when the Sempra Agreement was largely negotiated and finally executed. Sempra argues that this analysis was based on information regarding market fundamentals and forward price curves available more than two months prior to the execution of the Sempra Agreement and the expert nor Complainants ever attempted to calculate a dysfunction premium in a similar manner for any period after March 1,2001. Sempra concludes that it is clear that Complainants failed to demonstrate the existence of a dysfunction premium in forward prices at any point after March l, 2001, much less on May 4, 2001 (the day on which the Sempra Agreement was executed).

Sempra claims that Sellers' witnesses testified that a version of this unadjusted fundamental price forecast for on-peak prices prepared by Navigant in May 2001 (the month during which the Sempra Agreement was executed) showed that forecasted prices were significantly above forward prices for October 2001 through the 2005 calendar year, while they were below forward prices only during the summer of 2001. Sempra asserts that compared to the Navigant price forecast, which is more probative of CDWR's market expectations in the spring of 2001 than the interpretation of the after-the-fact GE MAPS results, the prices in the Sempra Agreement did not contain a dysfunction premium.

Sempra states that it did not rely on publicly available forward price curves in developing offer prices for the vast majority of its deliveries. Sempra asserts that Sempra considered a variety of factors other than forward price curves for electricity when pricing its bid to CDWR. Sempra also points to statements by California representatives indicating that CDWR was looking for prices in the $50-$60 per MWH range which became the starting point for Sempra's calculations of its offer prices. Sempra claims that it was hoping to develop a fleet of generation facilities in and around California that would be supported by the Sempra Agreement and that could be used to hedge Sempra's sales to CDWR. Accordingly, Sempra asserts that its offer price took into account the substantial costs and risks associated with its generation development, while also factoring into its offer price certain costs and risks associated with contractual terms demanded by CDWR. Sempra argues that it only looked to forward price curves for electricity for the first two years of the term of the Sempra Agreement (during which time only 3 percent of the total power provided to CDWR under the Agreement would be delivered); however, Sempra had to look at forward price curves for power for these first two years because Sempra was aware that it would be acting as a purchaser during that time. Sempra argues that Complainants acknowledge that Sempra only looked at forward price curves to price "near term forward energy."

Sempra argues that, even assuming arguendo, that the Commission had found market power to be an issue relevant to this proceeding, the evidence shows that Sempra did not possess market power at the time of the negotiation and execution of the Sempra Agreement. Sempra contends that there is no procedural or substantive basis for applying the presumptions on market power issues that Complainants request. Sempra states that Sempra did not obtain authority from the Commission to make sales at market-based rates until April 10, 2001 and that Sempra did not have any power available for sale in 2001. Thus, Sempra argues that it was not "on the spot market" until CDWR made it clear that summer 2001 sales at below-market rates were a precondition to Sempra obtaining a long-term deal with CDWR and Sempra was forced to go out into the spot market as a purchaser to procure power to resell to CDWR. Sempra states that it could not have played any part in the "meltdown of the spot market" which occurred in 2000 and early 2001. Second, Sempra states that the record also shows that there is simply no reason to presume that Sempra expected market power (or any other factor) to keep spot prices high because Sempra expected that spot prices would fall as a result of market fundamentals by 2002. Finally, Sempra contends that the record evidence demonstrates that there is no basis to presume that the rates under the Sempra Agreement reflect the expected future exercise of market power by Sempra or anyone else because, as a general matter, Complainants' own evidence demonstrates that the prices under the Sellers' contracts do not exceed long-run competitive prices.

x. Universal

Universal argues it has shown that the dysfunctions in the California spot market affected long term pricing and that market forces were not acting as a regulatory constraint. It argues that market-based rates must be in the same "zone of reasonableness" as cost-based rates. Universal argues that almost $600,000,000 a year in overcharges is evidence of unjust and unreasonable rates that should be investigated.

Universal questions what constitutes the "zone of reasonableness" as well as how this zone is to be derived in a market-based environment. Universal claims that Sellers did not provide data to show that Sellers' rates fell within a zone of reasonableness. Therefore, Universal avers that failure to provide this data is conclusive that the rates were unjust and unreasonable. Universal also argues that it has shown that prices under Sellers contracts were so scattered and so great "that no claim could be made that market forces were keeping prices within the zone of reasonableness." Universal concludes that it has successfully shown that the rates in question are unjust and unreasonable and that the Commission must act on this showing or violate the FPA.

2. Benchmark Analyses

a. Initial Briefs

i. Complainants

Complainants allege that the Commission's $74/MWh benchmark requires adjustments to be useful in evaluating the contracts. They contend that the prices in the Allegheny, Coral, El Paso and Morgan Stanley contracts significantly exceed the benchmark even when $74/MWh is used as the benchmark for the first five years.

Complainants claim that the fact that the contracts incorporate the expected results of the dysfunctional spot markets is enough to satisfy the "public interest" standard and move to the remedy phase of these proceedings. They argue that in the absence of the presumptive protection of workably competitive markets, the only other logical method to determine just and reasonable rates for these contracts, while ensuring that all legitimate costs and a reasonable return are recouped by Sellers, is to resort to the traditional cost-of-service approach. Complainants note that, due to the ALJ's ruling that precluded discovery of Respondents' costs, Complainants were unable to demonstrate the excesses embodied in the rates in question in comparison to the Respondents' costs. They state that notwithstanding the limiting effects of this ruling, they developed two surrogate measures of the overcharges that demonstrate that the magnitude of the adverse effect of the spot market dysfunctions on the instant contracts is substantial. First, they assert that evidence establishes that the price in each of the contracts contain the dysfunctionality premiums embedded in the forward price curves for 2001 and 2002. Second, they restate that the Commission's benchmark provides additional corroboration of the magnitude of the adverse effect embedded in each of the contracts.

ii. Trial Staff

Trial Staff argues that the Commission's $74/MWH benchmark should not be adjusted as Complainants' witnesses suggest. Trial Staff discredits Complainants' witness who challenged the accuracy of the benchmark because he did not know precisely what was contained in the benchmark because the Western Power Trading Forum did not provide the actual derivation of the $67.45/MWh rate that was adopted by the Commission and, therefore, could not say with any degree of certainty that the rate did not incorporate a 10 percent rate reduction from pre-restructuring levels, as the Commission stated in its December 15, 2001 order, or that the rate did not account for the value of ancillary costs included in pre-restructuring retail rates.

Trial Staff contends that to the extent a contract price fell below $74/MWh it should be considered just and reasonable. Trial Staff notes that the Governor had requested that the CPUC develop a benchmark and that Complainants' witness could not explain why it would not be reasonable to assume that the $70/MWh target sought and achieved in the CDWR's portfolio was the benchmark. Trial Staff points out that the $70/MWh price target which CDWR achieved for its entire portfolio of long-term contracts was approved for pass-through by the CPUC. Additionally, Trial Staff asserts that the witness' valuation of the costs of ancillary services is overstated and based upon erroneous assumptions. Trial Staff claims that the witness' contention that the level of the benchmark was influenced by natural gas prices tainted by market abuse is without merit because no evidence was presented that market abuse occurred prior to the restructuring of the electric industry in California and it is unclear how historic embedded costs could be influenced by natural gas prices tainted by market abuse. Trial Staff points out that, under the witness' assertion that the benchmark reflects the historic costs of a portfolio of assets and therefore can only be meaningfully compared to a whole portfolio of contracts that serve an entire load profile, CDWR's portfolio of long-term contracts which is below the $74/MWh benchmark would be found just and reasonable. Trial Staff claims that, in arguing that the benchmark had to be translated into product-specific benchmarks to be a meaningful standard for comparison with contracts at issue, Complainants' witness erroneously assumed that the $74/MWh price was not comparable to the price for a 24-by-7 contract that offers power at a flat level throughout the day and year. Trial Staff also asserts that, in deriving their product specific benchmarks, Complainants' witness also erroneously used a cost ratio based on 1997 embedded costs, notwithstanding the fact that the $74/MWh benchmark was based upon 1996 costs. Trial Staff concludes that based upon these erroneous assumptions Complainants' witness concluded that the prices in the Allegheny, Coral, El Paso, Morgan Stanley were above what they would have been if it had not been for the dysfunctional spot market.

Trial Staff does not believe that it is necessary to make any adjustment to the $74/MWh benchmark for the difference in the duration of the contracts and contract prices below the benchmark should be deemed just and reasonable. Trial Staff argues that the three methods of adjustment proposed by Complainants' witnesses are flawed and should not be used. Trial Staff asserts that the Sempra contract is below the benchmark because it provides an average rate below $70/MWh, with power provided during the summer of 2001 at below-market rates. Trial Staff states that the other contracts are more difficult to compare because they are above the $74/MWh benchmark and sets forth the difficulties in the comparison for the Dynegy, El Paso and Morgan Stanley contract.

Trial Staff argues that CDWR was unable to demonstrate any significant adverse affects that these contracts would have on either the California economy or the wholesale and/or retail customers. Trial Staff emphasizes that Complainants' witness' conclusion that the instant contracts had macroeconomic impact on the California economy because of overcharges associated with the contracts was discredited when the Respondents' witnesses pointed out errors in the analysis and Complainants' witness concluded that, after correction, his analysis would not show that the contracts were priced above long-run competitive prices.

iii. Sellers

Sellers argue that Complainants have failed to show any viable quantification of the magnitude of the alleged impact of the dysfunctional ISO spot markets on the contracts at issue. Sellers note that Complainants only attempt to quantify this alleged impact was through the direct testimony of an expert which was flawed and when corrected suggested that the contracts were not adversely affected by the dysfunction because they did not exceed long-run competitive prices derived from estimates of long-run marginal costs. Sellers also argue that Complainants' downward adjustment version of the Commission's $74/MWh benchmark ignores the plain meaning of the Commission's order establishing that benchmark and has no credible justification. Finally, Sellers contest Complainants' experts misuse of the GE MAPS Modeling Data developed by Sellers' witness.

iv. Allegheny

Allegheny points out that its contract price of $61/MWh and $76/MWh (for peaking power) are well below the Commission's benchmark price of $74/MWh for round-the-clock power. Allegheny states that it relied upon the Commission's benchmark in its negotiations with CDWR. It notes that its agreement is below numerous other benchmarks as well, including CDWR's target price of $70/MWh for long-term contracts. It contends that because the Allegheny contract was priced at $61/MWh it gave the State the leeway to enter into higher priced contracts while not causing the average price to exceed the $70/MWh target. It states that its Offer of Proof demonstrates that Allegheny's March 23, 2001, 11-year, long-term power contract was comparably priced to post-June 19, 2001 contracts and that its April 2001 short-term peaking power contract for power in 2003 was similarly priced even below post-June 19, 2001 contracts that contained similar terms and conditions.

v. Coral

Coral argues that the price of energy in the Coral Agreement when levelized over the life of the contract falls below the Commission's just and reasonable benchmark of $74/MWH. Coral contends that in formulating an adjusted benchmark Complainants' witnesses ignored most of the distinguishing characteristics of the Coral Agreement: its substantial seasonal shaping, the value to CDWR of 500 hours per year of dispatch control over the Wildflower Units, and the agreement becomes a tolling structure in 2006 through 2011. Coral claims that segmentation of the eleven-year contract term into two periods, a five-year term and a six-year term, in the adjusted formula does not produce a valid economic benchmark. It contends that the composite benchmark is equally illogical and produces a "heads-I-win-tails-you-lose" result for CDWR.

Coral claims that the prices in the Coral Agreement when levelized over the term of the contract fall below the long-run marginal cost of generation in California as measured by Complainants' own witness.

vi. Dynegy

Dynegy states that quantitative evidence demonstrates that the price in the Dynegy Agreement was driven by market fundamentals and did not exhibit any material influence of spot market dysfunction. Dynegy claims that its price is below Complainants' forward curves used by Navigant Consulting during the negotiation of the long-term contracts as well as the average forward prices reflected in contemporaneous broker sheets.

Dynegy responds to Complainants' arguments regarding the analysis of GE Maps by noting that Complainants' witness testified that a $6/MWh capacity charge would fully compensate generators fo their fixed costs, thus, withdrawing criticism of a capacity adder and advocating a higher charge than that used by one of Sellers' experts. It also counters that Complainants' witnesses provide the elements needed to disprove Complainants unfounded reliance on Sellers' expert's GE MAPS results.

vii. Morgan Stanley

Morgan Stanley contends that the long-run marginal cost of new generation is not relevant to the Morgan Stanley Agreement because, as a power marketer and price taker, Morgan Stanley's marginal cost of supplying power to CDWR is the offer side of Morgan Stanley's forward electricity price curve when the CDWR transaction was executed, not the long-run marginal cost of new generation. It asserts that the forward price curves produced by Navigant for CDWR are equal to, or higher than, the forward price curves that Morgan Stanley used to price its contract with CDWR.

Morgan Stanley claims that the Commission's $74/MWh benchmark does not apply to the Morgan Stanley Agreement because: (1) CDWR did not consider the benchmark when pricing the contract, (2) Morgan Stanley relied on forward market prices, not the benchmark, to determine a reasonable contract price, (3) the Commission did not intend for the benchmark to apply to a single contract, and (4) the Commission did not intend to establish a cost-based standard for market-based prices for long-term contracts. It adds that the adjustments to this benchmark appear to be an impermissible collateral attack on the Commission's December 15, 2001 Order.

viii. Sempra

Sempra argues that Complainants have failed to provide any evidence specifically addressing the Sempra Agreement. It claims that the rates, terms and conditions of its contract are, and were acknowledge by CDWR and California officials to be, just and reasonable. It points out that the rates under the Sempra Agreement are just and reasonable when compared to the benchmarks used by Complainants, including an analysis of long-run competitive prices prepared by Complainants' witness.

b. Reply Briefs

i. Complainants

Complainants charge that Respondents have failed to explain the disparity between the forward prices and Dynegy's witness' fundamentals forecast. They state that Dynegy's witness did not claim, as Respondents state, that the disparity was due to scarcity rent, but rather could be explained by risk premium. They argue that their witness' testimony supports Dynegy's witness' analysis and use of capacity adders and Respondents' attempt to change the record should be unsuccessful.

Complainants argue that Dynegy's revised fundamentals forecast prices are false due to misleading ranges and use of a weighted average calculation. Complainants contend that even using Dynegy's adjustments, the 2003 fundamentals forecast is below the forward prices for almost every month. Complainants assert that, despite the inaccuracies of the recalculation by Dynegy, there is still a significant price gap that can only be explained as a dysfunction premium, not a scarcity rent.

Complainants aver that due to the huge disparities between the benchmark contract of $74/MWH and Respondents' prices, which are substantially higher, they have made a compelling showing that a Phase II proceeding is warranted. The benchmark evidence raises a strong presumption that some sellers were exercising market power, thereby raising a similar presumption that the markets were not competitive. Furthermore, Complainants argue that the benchmark was ambiguous and subject to refinement therefore Respondents have no "reliance interest" in their interpretation of the benchmark. Additionally Complainants argue that any contracts exceeding five years should be compared to a benchmark that is extended on the basis of the Respondents' forward curves to ensure competitive prices. For any years beyond the first five, a benchmark of $74/MWH is not competitive, and should not be considered just and reasonable as Trial Staff argues.

Complainants assert that the benchmark applies to all sellers including power marketers based on underlying policy and prior Commission statements. While Morgan Stanley argues that the Commission did not intend for the benchmark to apply to power marketers, Complainants argue that at no point did the Commission imply that the benchmark only applied to suppliers owning existing generation equipment, nor did it exempt the contracts of power marketers when these issues were set for hearing. Additionally, applying the benchmark to power marketers is consistent with Commission policy objectives to contain prices. If the benchmark did not apply to power marketers in addition to other suppliers, generation owners would instead be insulated from the effects of the benchmark.

ii. Trial Staff

Trial Staff argues that Complainants presented flawed arguments concerning the application of the Commission's $74/MWH benchmark to the contested contracts. Trial Staff asserts that, with respect to the contract-specific benchmark analyses presented by Complainants, Trial Staff does not believe that reference to the Commission's benchmark demonstrates that the rates in these contracts were adversely affected by the spot market dysfunctions. Trial Staff argues that the rates in these contracts merely reflect the parties' expectations regarding future spot market prices, and, as discussed in Trial Staff's Initial

Brief, there has been no showing that those expected future spot market prices were driven by anything other than market fundamentals. Moreover, Trial Staff states that a number of the contracts fully satisfy the Commission's benchmark. For example, Trial Staff points to one of Allegheny's contracts, an 11-year contract priced at $61/MWh providing both around-the-clock (7-by-24) and peaking power, that is well below the $74/MWH benchmark and should on that basis alone be deemed just and reasonable.

Trial Staff contest Complainants' contention that, notwithstanding the fact that no benchmark analysis was done on the Dynegy, Mirant and Sempra contracts, "it is fair to conclude that the prices in these contracts also exceed the benchmark." Trial Staff argues that such a conclusion must be rejected not only because it is completely unsupported and speculative but also because it erroneously places the ultimate burden of persuasion on the Respondents, contrary to law.

iii. Allegheny

Allegheny contests Complainants' contention that the Commission should use the Dynegy Agreement to "help put in perspective just how extraordinary these agreements are." Allegheny states that there is no basis for the Commission to adopt this one-size-fits-all approach to characterizing the contracts at issue in this proceeding because the Allegheny Agreement and circumstances in which it was negotiated were distinct from the Dynegy Agreement. For example, it notes that the Dynegy Agreement involves sales from a group of generating facilities that Dynegy purchased while Allegheny owns no plants. It points out that Complainants allege that they entered into the Dynegy Agreement because they "desperately needed the energy Dynegy was offering for the summer of 200l" while, because Allegheny owned or controlled no generation in the market, its entry into the market did not impact the quantity of supply available to the CDWR. It asserts that CDWR wanted to shift to Allegheny the costs and risks of purchasing at high prices and "borrow" money by using Allegheny effectively as a bank. Allegheny states that other differences with the Dynegy Agreement include the fact that (1) Allegheny's long-term contract with CDWR exceeds ten years, while the Dynegy contract is much shorter with a duration of three years, and (2) unlike Dynegy which structured a portion of its contract as a tolling arrangement with CDWR taking fuel risk, Allegheny assumed the full risk of fluctuating prices of natural gas in its contract.

Allegheny argues that the comparison to the Commission's $74/MWH benchmark shows that the Allegheny Agreement is per se just and reasonable, rather than that the Allegheny Agreement was affected by dysfunction. Allegheny challenges Complainants' contention that Allegheny's $61/MWh Agreement exceeds the benchmark even when

$74/MWh is used for the first five years. Allegheny asserts that Complainants neglect to mention that the benchmark upon which these results are based is the "use the seller's forward curves" method for the period beyond five years which Trial Staff and Sellers' expert witnesses thoroughly discredited. Allegheny states that the figures cited by Complainants as the amounts by which the Allegheny Agreement "exceed the benchmark" are therefore meaningless and incorrect and that Complainants claim that these figures evidence effects of the dysfunctional spot market on forward markets is meritless. Further, Allegheny claims that Complainants' contention is surprising since their own pre-filed testimony shows, as confirmed by Dr. Pechman on cross-examination, that the first five years of the Allegheny $61/MWH rate is not only substantially lower than the Commission's $74/MWH benchmark but also lower than the lowest version of Complainants' "retooled" price adjusted and product-specific adjusted benchmark of $61.50. It notes that Trial Staff agrees that the Allegheny Agreement satisfies the Commission's $74/MWH benchmark. Thus, Allegheny believes that the comparison of the primary Allegheny Agreement, at $61/MWH, to Complainants' own projections of non-dysfunctional prices shows that the Allegheny Agreements produce significant savings, as opposed to overcharges or "dysfunction premiums," as compared to the Commission's benchmark.

iv. El Paso

102. El Paso asserts that Complainants cannot adequately compare the El Paso Agreement with the $74/MWh benchmark. It contends that comparing the two ignores the extrinsic factors that justify the terms of the contract. El Paso argues that Complainants ignored the specific guidance of the Commission as to the legal effect of the benchmark: anything below the benchmark is just and reasonable. El Paso also argues that, in San Diego Gas & Elec.,[155] the Commission stated that buyers may elect to enter into contracts above the level of the benchmark provided the contract suits their needs. Based on this holding, El Paso avers that there is no justification for using the $74 benchmark. Even if the benchmark was a starting point used to measure the reasonableness of the El Paso Agreement, El Paso argues that it provided values other than price to CDWR, such as bearing additional default risk than is standard in order to assist California during its power crisis. El Paso contends that these additional non-price values should be taken into consideration as well.

[155] San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services, 93 FERC ¶ 61,294 at 61,995 (2000).

v. Mirant

103. Mirant asserts that Complainants' request for an affirmative finding that the challenged contracts were adversely affected by dysfunction in the ISO spot markets by comparing four of those contracts to the Commission's $74/MWH advisory benchmark should be rejected. Mirant contests Complainants' argument that "margins by which these four contracts exceed the relevant benchmarks are so wide that it is only proper to conclude that the remaining contracts, Dynegy, Mirant and Sempra.. . must also exceed the benchmark by some margin," noting that Complainants ask the Commission to presume that the Mirant Agreement would not compare favorably with the Commission's benchmark, if such an analysis were (or could be) done, and that contract modification is warranted as a result. Mirant notes that Complainants' expert witnesses never applied the benchmark to the Mirant Agreement. Mirant states that Complainants' expert conceded at hearing that the Commission's $74 MWH benchmark was developed as a guideline for contracts with a five-year term and could not readily be applied to the nineteen-month Mirant Agreement. Mirant asserts that the burden is on Complainants to show that the challenged contracts were adversely affected by spot market dysfunction and that, if Complainants believed that a benchmark comparison could establish that link, they should have provided that comparison as part of their affirmative case.

Mirant notes that it undertook its own benchmark analysis as part of its direct case. Mirant's expert witness compared the Mirant Agreement to three other CDWR power purchase agreements and found that the price in the Mirant Agreement was comparable to the prices in those contracts. Although Mirant's expert's testimony was stricken, Mirant points out that the ALJ allowed Mirant to submit the stricken testimony as an offer of proof. Mirant argues that, if the Commission agrees with Mirant that its expert's benchmark comparison should be taken into account, the case against modification of Mirant's Agreement becomes clearer because the analysis further demonstrates that the Mirant Agreement was not adversely affected in any manner by dysfunctions in the ISO spot markets. Mirant states that regardless of whether the Commission considers its expert's alternative benchmark analysis, it must disregard Complainants' assertion that the Commission should assume that the Mirant Agreement would fail any such benchmark comparison because Complainants' tactic is improper and is a request for a presumption based upon analyses that were never done.

vi. Morgan Stanley

Morgan Stanley states that the difference between the $74/MWH benchmark and the Morgan Stanley contract price does not prove that Morgan Stanley included a dysfunctionality premium in the contract price.

vii. Sempra

Sempra states that the Sempra Agreement compare favorably to a variety of benchmarks. Sempra points out that while Complainants' witnesses decided against conducting an analysis of the Sempra Agreement, Sempra submitted a different kind of "benchmark" analysis in Sempra's direct case. Sempra states that its witness compared the rates in the Sempra Agreement against 14 long-term contracts that CDWR entered into after June l9, 2001 (when no party alleges that ISO spot markets were dysfunctional) and found the prices in the Sempra Agreement to be comparable, or in a number of instances, superior to prices in these 14 long-term contracts executed after June 19, 2001. As a result, its witness concluded that the Sempra Agreement was free from spot market dysfunctions. Sempra contends that, to the extent the Commission agrees to accept Sempra's Offer of Proof, it provides another piece of evidence showing that the Sempra Agreement should not be subject to abrogation or modification.

3. Relative Bargaining Power

a. Initial Briefs

i. Complainants

Complainants assert that the number of bids received in response to the RFBs is insignificant because all of the negotiations occurred above the inflated forward price curves. They claim that Respondents' contention that CDWR had options is further undercut because (1) many of the bids were for less than 100 Mws when CDWR needed 12,000-15,000 Mws, (2) many of the offers started delivery after the summer of 2001, and (3) many of the sellers were unknown entities without experience in the power industry.

Complainants argue that, under the extraordinary circumstances in which CDWR was purchasing power, CDWR had essentially no bargaining power. They assert that Respondents have not explained and cannot explain why a purchaser with superior leverage would (1) pay more, not less, than the sellers' forward price curves, (2) enter into contracts for 10 years when it needed 1-3 year contracts, and (3) agree to purchase large amounts of energy in the out years of the contracts with relatively small amounts delivered in the early years when the purchaser desperately needed the power.

ii. Trial Staff

Trial Staff argues that the totality of purchases and the conditions present at the time the contracts were entered into do not justify contract modification. Trial Staff contends that CDWR, through the California Energy Resources Scheduling Division (CERS), procured a diversified portfolio of contracts which varied in terms of the products provided and length of the contract with a variety of suppliers and power companies at an average contract price over the May 2001 through December 2010 period below the $74/MWh benchmark established by the Commission. Trial Staff claims that the terms and conditions of the proposals made by CDWR and the processes and procedures CDWR used to evaluate the contracts were the result of decisions freely made by CDWR. Trial Staff asserts that CDWR's purchasing strategy was intended to, and did, shift considerable risk to the sellers such as the risk of rising natural gas costs and the lack of payment assurances. Trial Staff also contends that CDWR sought "a weighted average cost of long-term contract energy expected to be within the combined average cost of energy supply reflected in the IOU's retail rates, as of January 2001." Trial Staff notes that CDWR's purchasing strategy later changed when it became willing to accept "tolling" agreements. Trial Staff asserts that CDWR's primary goal was to achieve a diversity of supply sufficient to cover the net short for the summer of 2001 at an average price not to exceed the $70/MWh benchmark established by those in charge of the negotiations with the objective of depriving the spot market of its volume and thus taming its out-of-control prices.

Trial Staff concludes that CDWR mostly succeeded in meeting its objectives: (1) forming a portfolio of short, intermediate and long-term contracts covering a variety of energy products (e.g., 24-by-7 or baseload supply and 6-by-16 peaking service) at an average price that fell below the $70/MWh benchmark it had set and (2) stabilizing the market by entering into long-term contracts. Trial Staff claims that CDWR did not have a formal process in place for reviewing or evaluating the contracts until mid-March 2001 which led to ill-advised decisions or choices. Trial Staff concludes that CDWR's RFBs and its purchasing strategies were the reason that CDWR may have purchased supply under contracts with longer terms than it would have liked. Trial Staff notes that CDWR issued RFBs in which the entire risk of the rising cost of gas was placed on the sellers, the sellers had no assurance that CDWR would meet its financial obligations and CDWR set its pricing goals significantly below the current market prices.

Trial Staff contends that, given the number of parties who were interested in selling power to the State of California on a long-term basis, CDWR had options and did not lack bargaining power due to the crisis that existed. Trial Staff argues that, in fact, it was the sellers who may have lacked alternatives, given the fact that CDWR was in essence "the sole purchaser" who controlled the information sellers had on the State's success in procuring adequate future supply. In response to CDWR's contention that these numbers are deceiving because many of the bids were less than 100 MW when CDWR needed 12,000-15,000 MW, many of the offers did not start deliveries until after the summer of 2001 and many of the sellers were unknown entities with no experience in the power industry, Trial Staff states that these arguments assume that the referenced sellers were the only ones with whom CDWR was negotiating while the evidence presented indicates otherwise.

In response to CDWR's contention that it was not "the only game in town" due to sellers profitable alternative of selling their power in the dysfunctional, high priced spot market and the circumstances under which it was purchasing (i.e., continuing Stage 3 alerts and its inability to continue purchasing in the high priced spot market), Trial Staff notes that CDWR's witness admitted that CDWR was "essentially a single purchaser," with an enormous demand that was not elastic, CDWR did not expect the high prices in the spot market to last beyond a year or two at most and CDWR and sellers knew that once CDWR began to procure long-term supplies it would have an adverse affect on the lucrative spot market. Trial Staff also notes that CDWR negotiated with sellers on an individual basis and controlled the information sellers had on its negotiations with other suppliers which affect sellers' ability to judge whether their offers would be accepted. Trial Staff notes that, even if CDWR lacked options or believed that it lacked options in these negotiations, sellers did not given that impression due to the situation and the press reports. Trial Staff also notes that, after executing the first few long-term contracts, CDWR gained negotiating leverage and could be more selective regarding prices and terms.

Trial Staff argues that contemporaneous statements made by CDWR and the Governor indicated that they fully supported the price, terms and conditions of these contracts at the time they were executed. Trial Staff notes that the CDWR witness who informed the public about CDWR's contracting efforts confirmed his press statement reported on April 20, 2001 that "[i]f the prices just get ridiculous altogether, there's a policy call to be made, and we'll cross that bridge when we get there."

Trial Staff provides a contract by contract review of the Dynegy, El Paso, Morgan Stanley and Sempra agreements to demonstrate that CDWR was not forced to accept unreasonable rates, terms or conditions, but rather achieved its targeted objectives and willingly agreed to enter into these contracts.

iii. Sellers

Sellers state that the evidence demonstrates that CDWR established and achieved its long-term contract objectives: (1) CDWR established and achieved the objective of obtaining power at a portfolio average price of $70/MWH; and (2) CDWR established and achieved non-price objectives.

iv. Allegheny

Allegheny argues that it entered into arm's-length negotiations in good faith with CDWR at the solicitation of CDWR. Allegheny states that the terms of the solicitation and the contract were largely dictated by CDWR.

Allegheny notes that, by the time CDWR signed its contract with Allegheny late in the process, long-term agreements had been reached by CDWR with over 30 parties for more than 8,000 MW and CDWR had reached its goal of contracting for fifty percent of the "net short." Allegheny asserts that, by that time, CDWR was negotiating contract terms and conditions that were more beneficial to CDWR than the prior contracts.

Allegheny contends that it had little bargaining power because it sought to enter into a long-term contract in the western markets. Allegheny claims that CDWR made several key demands on Allegheny as a precondition to entering into a contract, including: (1) Allegheny would commence service beginning in March 2001 through the summer 2001 peak periods; (2) Allegheny would back load the contract and sell peak power to the State at a subsidized rate of $61/MWh (when peak prices were approaching $450/MWh); and (3) Allegheny would assume all market exposure to changes in electricity and gas prices. Allegheny states that it agreed to these conditions.

Allegheny asserts that CDWR asked Allegheny to commit to a performance obligation with CDWR, which Allegheny describes as essentially a shell entity without assets, cash or credit, and that CDWR would not provide any guarantees from the State or any other creditworthy entity for CDWR's performance obligations.

Allegheny contends that CDWR had substantial bargaining leverage with Allegheny by virtue of the hundreds of offers in response to it solicitations and thousands of megawatts more offered outside the solicitation process. It asserts that CDWR kept the terms of these offers from Allegheny and that CDWR used this information in negotiations as leverage against Allegheny. Allegheny argues that CDWR had ample bargaining power and numerous options as illustrated by CDWR's insistence upon numerous unconventional contract terms, including agreeing to sell at a substantial loss in the initial period of the contract, which Allegheny states it had to accept.

Allegheny states that the contract prices were strictly based upon then-prevailing forward curves, not the current spot prices. It contends that it assumed all exposure to changes in market prices which was significant.

Allegheny states that it was required to and in fact hedged its obligations under the contract, including purchasing power at a loss in the high spot markets to honor its contract obligations to CDWR. It adds that it also entered into a long-term tolling arrangement in April 2001 at the height of the market dysfunctionality at a substantial cost to insure its performance for the entire contract term. Allegheny contends that both CDWR and Allegheny knew that Allegheny would be required to sell power to CDWR at a substantial loss in the early years, with the expectation that Allegheny would recoup such losses at the back-end of the contract. Allegheny states it incurred hundreds of millions of dollars in realized cash losses to date in honoring its obligations under the contract.

Allegheny asserts that CDWR set out to accomplish specific goals in procuring long-term power, including reducing its reliance on the spot market and providing a secure and reliable long-term source of supply. Allegheny states that it helped CDWR accomplish these goals.

v. Coral

Coral argues that Complainants failed to prosecute two of their three complaints against the Coral Agreement. It notes that Complainants had alleged that three provisions were unjust and unreasonable and thus should be abrogated or modified: (1) sec. 10.2(b) which subordinates CDWR's bond obligation to the payment to Coral for energy and capacity supplied to CDWR under the contract, (2) sec. 3.10 which provides Coral with most-favored-nations rights with regard to credit, security and payment priority and (3) sec. 3.6 which adopts the March 16, 2001 fixed prices, as modified May 25, 2001, by CDWR for energy deliveries from May 24, 2001 to December 31, 2005.

Coral responds that it was CDWR who proposed both the bond subordination and most-favored-nations provisions, and Complainants did not present any evidence demonstrating that these provisions were unreasonable. It notes that Complainants Coral-specific evidence focused entirely on the third disputed provision regarding price.

vi. Dynegy

Dynegy points out that Complainants did not discuss the particular terms of the Dynegy Agreement either in its direct or rebuttal case. Dynegy argues that the Dynegy Agreement was a mutually beneficial agreement sought by both parties. It contends that CDWR had the resources of the State behind it, was advised by consultants, had choices and wielded significant leverage during the negotiations. It states that the length of the Dynegy Agreement was not controversial during the negotiations. It notes that the Dynegy Agreement is not back-end loaded: the pricing provisions for the firm (fixed-price) and contingent (tolling agreement) power do not change over the life of the contract and Complainants benefit from the reduction in natural gas prices. It asserts that Complainants have no basis for complaining about the non-price provisions in the Dynegy Agreement.

vii. El Paso

El Paso contends that the El Paso Agreement arose out of an arms' length negotiation that required compromise on the part of each party to reach a mutually agreeable price term. El Paso states that, once CDWR indicated its unwillingness to enter into an agreement using standard industry credit protections, El Paso acquiesced and agreed to include CDWR's proposed terms, including its proposed "most-favored nation" clause (Section 3.10). It adds that it acquiesced to additional terms, most of which constitute the clauses that Complainants request be abrogated on the ground that they reflected unequal bargaining positions of the respective parties. It argues that CDWR had a savvy, experienced negotiating team and numerous options. It states that there is no evidence that CDWR was not content with the negotiation or the agreement reached. It contends that, to the extent CDWR operated under any limitations in its bargaining posture and in its choice to contract with a particular party, those limitations were self-imposed. It claims that, if CDWR had not been limited by the State's retail rate objectives and had acted over a longer timetable, California would have been able to take advantage of declining prices. It argues that CDWR and its advisors realized that El Paso had treated CDWR fairly in connection with the two 50 MW purchases because CDWR chose to pursue a follow-on contract with El Paso. It notes that during the negotiations CDWR representatives and the Governor gave assurances to El Paso that CDWR and California would perform their end of the deal.

viii. Mirant

Mirant argues that the only evidence in the record on the specific circumstances of the Mirant Agreement shows that Mirant did not exert any undue leverage in entering into this contract.

ix. Morgan Stanley

Morgan Stanley argues that CDWR, not Morgan Stanley, had superior bargaining power in their contract negotiations.

x. Sempra

Sempra claims that the Sempra Agreement was the result of a lengthy negotiation process in which CDWR enjoyed significant bargaining power over Sempra and Sempra had few options available to it.

b. Reply Briefs

i. Complainants

Complainants argue that whether or not CDWR exercised or held bargaining leverage is not a factor to be considered in whether the resulting contracts are just and reasonable. They claim in any case that CDWR's contracts undermine any bargaining leverage argument as none of the contracts were priced below the forward curves. They assert also that Respondents had other options for power sales and it was their choice to remain in the spot market during a period of unprecedented pricing.

ii. Trial Staff

Trial Staff contends that Complainants did not show that the bids CDWR received for power supply reflected continued expectations of dysfunction in the spot markets. Trial Staff notes that, according to Complainants, the fact that CDWR had to accept contract terms that it was not content with supports their claim that CDWR did not have superior leverage in the negotiations. However, Trial Staff argues that Complainants fail to mention that in order for CDWR to meet its purchasing objective of keeping the average price of its portfolio at or below $70/MWH, CDWR was going to have to accept longer term contracts with a levelized price, regardless of the leverage it may or may not have had at the bargaining table. Trial Staff argues that this price target combined with the fixed-price contracts CDWR was seeking had an impact on the type of offers that

CDWR was receiving in response to its RFBs. Trial Staff notes that Complainants contend that the offers that CDWR received did not come close to the amount of energy needed to make it through the summer of 2001; in support, Complainants refer to Exhibit CAL-157 which reflects the bids CDWR received in response to the two RFBs. Trial Staff argues that Exhibit CAL-157 does not tell the real story because it does not include the offers CDWR was receiving from suppliers outside of the RFB process - offers that were for significant amounts of energy.

iii. Allegheny

Allegheny points out that Complainants have dropped the contention raised in its Complaint that the contracts contained "onerous," non-price terms which justified abrogating or modifying the contracts. It notes that Complainants concedes that these terms were “the product of negotiations” between the parties and that, "in some cases, CDWR was able to negotiate on material terms, including price." Allegheny asserts that, at hearing, Complainants elected not to put on a fact witness to contest Mr. Koenig’s testimony that many of the key terms in the Allegheny contract, including those relating to price and duration, were driven by the CDWR. Allegheny argues that this was not surprising given the numerous contracts rejected by CDWR on the basis of price, (including rejecting Allegheny’s initial offers) and CDWR ability to impose "dealbreaker" ultimatums on Allegheny. Allegheny states that CDWR’s abandonment of its claims with respect to non-price terms, coupled with Mr. Koenig’s unrebutted testimony regarding price negotiations, compels a finding that Sellers did not have bargaining power over CDWR in the forward bilateral markets with respect to both price and non-price terms.

Allegheny states that Complainants misstate the record regarding CDWR's negotiating position with Allegheny and that the CDWR received valuable and significant megawatts from Allegheny in the front end of the contract and could have received more. First, it asserts that the Allegheny $61/MWh Agreement provides for 750 MW of 6x16 peaking power from April 1,2001 to June 30, 2001 and 250 MW of 6x16 peaking energy from July 1,2001 to September 30,2001 at a subsidized, fixed price despite tight supply conditions and the high volatility in the market. Second, Allegheny states that it made numerous offers in response to CDWR’s RFBs, many of which CDWR rejected or changed to suit its needs.

Allegheny also argues that Complainants fail to address the evidence demonstrating that CDWR had ample bargaining power and achieved its objective. In response to Complainants' claims that the responses to the RFBs, which separately provided bids for approximately 13,000 and 16,000 MWs, respectively, would have given CDWR "at most about 5,000 MW under contract for the summer of 2001, about one third of the projected peak net short energy demand," Allegheny argues that Complainants provide no evidence that CDWR did not or could not negotiate with the bidders about providing power in the summer of 2001 or earlier. Allegheny avers that CDWR used its considerable leverage to get Allegheny to supply peaking power in the spring and summer of 2001, after Allegheny proposed to provide power beginning in October 2001. Allegheny argues that Complainants assume that CDWR negotiated only with the sellers that provided further responses to the RFBs, but note that, to the contrary, CDWR's internal documents demonstrate that CDWR negotiated and contracted with many other sellers outside of the RFB process. Allegheny claims that not once in Complainants' Initial Brief do they mention that CDWR rejected at least 45 proposed contracts, involving thousands of megawatts, more than half of which were rejected because of the price terms. Allegheny asserts that rejection of these proposed contracts "came in various stages of negotiations" and that CDWR rejected some proposals "almost immediately on the initial price offering."

iv. Dynegy

Despite worries about the State's creditworthiness, Dynegy states that it entered into short-term contracts in an effort to assist the State with its energy crisis during on-going contract negotiations. Dynegy asserts that throughout these negotiations the State threatened to use the Governor's office as well as the media as leverage, backed out of deals, and demanded renegotiation.

Dynegy argues that the State's claim of uneven bargaining power is misplaced. According to Dynegy, the State uses an inaccurate profit estimate as proof that Dynegy had uneven bargaining power that Dynegy used to compel the State to accept prices that contained spot market dysfunction premiums. Dynegy responds that its contract helped the State meet important goals. Dynegy states that the Dynegy Agreement was for a short-term, the contract prices were under the forward curves at the time the contract was made, and the agreement did not backload capacity, instead making 1000 MW immediately available. Dynegy concludes that the State's complaints about contracts with Sellers do not apply to the Dynegy Agreement.

Dynegy contends that the State knew what it was bargaining for with Dynegy and obtained what it wanted through its negotiations with Dynegy. According to Dynegy, the result was short, medium and long-term contracts with an average price of $70/MWH. Dynegy asserts that the State was content with its bargain but now reaches a different conclusion.

v. El Paso

According to El Paso, testimony shows that prices were mutually agreed upon and were negotiated at arms' length.

vi. Mirant

Mirant asserts that Complainants have mischaracterized the facts in an effort to show undue bargaining strength on the part of Mirant. Mirant states that when these distortions are eliminated and the context is understood, it is clear that Mirant did not have superior bargaining strength in its negotiations with CDWR, and, if anything, the evidence shows that CDWR may have had superior leverage given its status as the biggest (and virtually the only) creditworthy purchaser in California. Mirant states that, contrary to Complainants' position that Mirant was seeking to avoid a long-term deal and focus on alleged higher profits in the short-term market, Mirant actually refrained from making a shorter-term deal pending completion of its May negotiations with CDWR.

vii. Morgan Stanley

Morgan Stanley asserts that Complainants have not proven, and cannot prove, that Morgan Stanley exercised superior bargaining power in negotiating its contract with CDWR. It contends that the rate, terms and conditions in the contract reflect the outcome of arm's-length negotiation between sophisticated market participants and, if anything, the record evidence shows that CDWR, rather than Morgan Stanley, had the superior bargaining power in the contract negotiations.

viii. Sempra

Sempra asserts that CDWR had bargaining leverage over Sempra because CDWR was "the only game in town" for purposes of securing a long-term contract of the magnitude that could be used to support the significant amounts of generation that Sempra wished to develop in and around California, while CDWR had a broad variety of sellers willing to make sales to it and had secured a large percentage of the power it wished to have under contract prior to the execution of the Sempra Agreement. Sempra also states that Trial Staff confirmed that, by the time the Sempra Agreement was executed, CDWR had significant bargaining power over potential suppliers and that as early as February 2001, a CDWR negotiator felt that CDWR had the ability to tell a potential supplier to "take a hike" and that it "only stands to reason that once CDWR executed the first few long-term contracts, it gained greater negotiating leverage and could be more selective as to what prices and terms it would accept."

Sempra contends that it made repeated concessions to CDWR throughout the negotiation process, including modifications to Sempra's initial bids that resulted in Sempra making sales to CDWR during the summer of 2001 at below-market rates, reducing the amounts of baseload energy that Sempra would provide to CDWR and taking on transmission risks that would ordinarily be allocated to the buyer. Sempra states that, although Complainants now claims that CDWR did not want large amounts of power in the later years, a review of Sempra's initial bids reveals that Sempra had offered CDWR the option of having Sempra provide smaller amounts of power, over a shorter period, than the parties eventually agreed to in the executed Sempra Agreement.

Sempra argues that, contrary to Complainants' claim that ISO spot market dysfunctions forced CDWR to enter into contracts with the Sellers, CDWR was under no obligation to enter into any long-term contracts in order to satisfy its obligations under California law, much less the ten plus year Sempra Agreement, and, indeed, CDWR was not legally obligated to purchase power under contracts of any duration. Further, Sempra claims that the record evidence demonstrates that, even to the extent CDWR believed it was compelled to purchase power, its need was only for near-term purchases for the summer of 2001. Moreover, it contends that record evidence demonstrates that CDWR sought to enter into long-term contracts with market participants such as Sempra to encourage the entry of new generation, a goal separate and apart from any need to acquire near-term supplies.

4. Equities of Modification or Abrogation

a. Initial Briefs

i. Complainants

Complainants assert that contract reformation here would not impede the making of contracts in the normal course. They argue that sellers would know that, absent a declared market dysfunction which they would be aware of, their contracts would not be reformed. They state that, even in such circumstances, sellers would know that sellers would recover a healthy rate of return even if reformation were ordered. They contend that, if no remedy is available in these circumstances and another crisis occurs, the public would be loathe to enter into forward contracts for which no remedy would be available. They assert that the public would opt instead to stay in spot markets and seek refunds. They conclude that for these reasons the denial of a remedy here would deter forward buying precisely when it is otherwise desirable.

ii. Trial Staff

Trial Staff notes that contract modification may have an adverse impact on the efficient operation of the power market, on investment in new generation and on the willingness of market participants to enter into long-term contracts in the future. Trial Staff points out that any increase in prices associated with the potential regulatory risk of abrogation or modification of contracts will eventually be borne by customers in the form of higher energy costs. Trial Staff argues that the issue of investor confidence is of utmost concern and that contract abrogation or modification should not be permitted, therefore, unless a sufficient showing has been made that such an extraordinary remedy is required given the adverse affect such action could have on investor confidence in the industry.

iii. Sellers

Sellers argue that Complainants have not shown that the contracts place an excessive burden on customers. Sellers argue that sound policy demands that the sanctity of these contracts be affirmed. Sellers request that the Commission discourage other states from pursuing California's restructuring initiatives. Sellers assert that the abrogation or modification of the contracts at issue will discourage forward contracting and defeat the solution that the Commission prescribed for California's energy crisis. Sellers point out that, if it grants the complaint, the Commission will discourage needed investment in generation.

iv. Allegheny

Allegheny concludes that Complainants failed to meet their burden of proof that Allegheny's contract was contrary to the public interest or even that modification would be appropriate under the lower burden "just and reasonable" standard. It states that by contrast it has demonstrated that it would be substantially financially harmed if the agreement were abrogated. It argues that the Commission should not modify or abrogate the instant contracts but rather affirm the sanctity of the instant contracts.

v. Mirant

Mirant contends that Complainants have failed to provide evidence that would support abrogation or modification of the Mirant Agreement under the "public interest" standard. Mirant argues that Complainants have not shown that the challenged contracts impose any burden on customers, did not attempt to argue that the Mirant Agreement is contrary to the public interest based upon a comparison with the Commission's

$74/MWh. Mirant asserts that Complainants have not offered any credible evidence to counter Mirant's testimony on the specific and immediate detrimental effects of contract abrogation, as demonstrated by the current statements and reports of ratings agencies.

vi. Morgan Stanley

Morgan Stanley argues that Complainants did not offer any evidence that the Morgan Stanley Agreement itself will impact CDWR's financial ability to continue service, constitutes an excessive burden on other CDWR wholesale customers, or is unduly discriminatory against other CDWR wholesale customers. It contends that the Morgan Stanley's Agreement to supply 50 MWh of forward wholesale power amounts to a mere fraction of the power CDWR contracted for to serve California during the relevant period and could not have any material impact on CDWR's financial ability to continue service, constitute an excessive burden on wholesale customers or unduly discriminate against wholesale customers.

Morgan Stanley argues that abrogation of the Morgan Stanley Agreement or substitution of the $74/MWh benchmark as requested by Complainants would cause Morgan Stanley significant losses. It states that, if the contract is modified, Morgan Stanley will be less willing to enter into forward wholesale electricity contracts in the future and prices in any such contract would include a risk premium to protect Morgan Stanley and its shareholders from increased regulatory risk. Additionally, it claims that such an action would not be in the public interest because it would not promote the Commission's goal of a viable competitive wholesale power market.

vii. Sempra

Sempra notes that the Sempra Agreement provides incentives for the construction of new generation which will directly benefit California and its customers but places Sempra at risk because the generation is unlikely to be profitable under current spot market and current expected future spot market prices. Sempra states that abrogation of the Sempra Agreement would be disastrous for Sempra in terms of its ability to develop and construct new generation and may result in the company ceasing to exist.

b. Reply Briefs

i. Complainants

Complainants argue that they have shown that the public will bear unjust and unreasonable rates and that the public interest in competitive markets is threatened by allowing Respondents' exploitation of the spot market dysfunction in order to reap windfall profits in the forward markets. Complainants contend that the public should not have to bear the dysfunctional future spot market rates that the Commission has determined they should not bear for spot market purchases from October 2, 2000 through June 20, 2001 merely because the rates are embedded in long-term contract prices. Moreover, the public interest in restoring confidence in the electric industry and avoiding the creation of uneconomic demand-side incentives should outweigh the regulatory risk to the sellers. Complainants further argue that because the sellers' market-based rate authority is regulated by the Commission, sellers were aware of the likelihood that, once the market was no longer competitive, they would have to justify their contract rates.

Complainants state that contracts that are the product of arm's-length negotiation between discriminating buyers and sellers in a competitive marketplace should naturally fall under the "sanctity of contracts" and be upheld. They assert, however, that such is not the case in the instant matter. Here, high forward contract prices for delivery of power greatly exceeded prices that would result from a normally functioning competitive future spot market. Thus, the public should not be burdened with rates based on expected noncompetitive market conditions. In response to Respondents' challenge that reforming the contracts could cause future buyers and sellers to determine that contracts are not safe from hindsight modification, Complainants answer that argument by suggesting that the Commission explicitly state the reasons for any contract modification that might take place in these circumstances, stating that regulatory risk through modification of power purchase agreements has always been part of the electricity market landscape.

Complainants contend that failing to reform these contracts under these extraordinary circumstances will create disincentives for future buyers to enter into forward contracts because they will lose the possibility of refunds for spot market purchases. They state that, if the contract prices reflect an expectation that the spot market dysfunctions would inflate prices over competitive levels for 2001, 2002 and 2003, then public policy dictates that the Commission alleviate the burden of those prices on the public.

ii. Sellers

Sellers argue that the State has wrongly attempted to use its own flawed policies on market restructuring as a reason for relieving the State of its contractual obligations to Sellers. Sellers contend that modifying the CDWR contracts will signal that the Commission will protect states from their own mistakes, such as implementing fundamentally flawed restructuring plans, even to the extent of modifying freely negotiated commercial contracts. In short, Sellers maintain that the State should take responsibility for its own errors, especially regarding retail matters over which the Commission has little, if no, jurisdiction.

iii. Dynegy

Dynegy argues that to allow the contract to be rewritten would send a negative message to market participants who might refuse to negotiate the next time markets are tight.

iv. Sempra

Sempra also avers that the State fails to justify the abrogation or modification of the Sempra Agreement under either the Mobile-Sierra "public interest" standard or the "just and reasonable" standard. First, it contends that the State fails to provide any direct evidence showing the Sempra Agreement to be unjust and unreasonable and instead attempts to attack the Sempra Agreement based solely on flawed and invalid comparisons. It claims that Complainants do not provide accurate information on the Sempra Agreement because, for example, the price in the Sempra Agreement is linked to a gas index price for the period from June 1, 2003 through September 30, 2011, rather than through September 30, 2003, as Complainants claims. In addition, the price for power provided on a 6 x 16 basis under the Sempra Agreement during the gas index price period is not "$3 l/MWH + (gas index x 10,500)" as Complainants represents. Thus, it argues that Complainants mistakes a key element of the pricing provisions of the Sempra Agreement: the heat rate for 6 x 16 power.

Sempra states that there is also no value in Complainants' comparison of the Sempra Agreement to the Dynegy and Coral Agreements. It notes that the Dynegy contract is a three and a half year contract under which Dynegy will supply power to CDWR from existing generation resources. In contrast, it points out that the Sempra Agreement has a term of more than ten years and is structured with the intent of allowing Sempra to develop and construct new generation sufficient to meet its delivery obligations under the Sempra Agreement. As for the Coral Agreement, it claims that Complainants' witnesses admitted that the Coral Agreement and the Sempra Agreement were dissimilar, and, in rebuttal testimony, they "evaluated the...Coral contract[], taking into account the peculiarities of product mix and contract duration" in order to contrast rates in the Coral Agreement to the Commission's $74/MWH benchmark." However, Sempra notes that the witnesses testified that they could not undertake a similar evaluation of the Sempra Agreement because the Sempra Agreement was "just too far from the paradigm to permit any meaningful comparison."

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Public Utilities Commission of the State of California

v. Docket Nos. EL02-60-000 and EL02-60-003

Sellers of Long Term Contracts to the California Department of Water Resources

California Electricity Oversight Board

v. Docket Nos. EL02-62-000 and EL02-62-003

Sellers of Energy and Capacity Under Long-Term Contracts with the California Department of Water Resources

(Issued June 26, 2003)

Wood, Chairman, concurring in part:

In voting on this order, I do not agree with the ALJ's interpretation that the case law is now clear that where a contract fails to specifically provide that the contract may be unilaterally altered, Mobile-Sierra automatically requires that proposed changes to the contract meet the "public interest" standard of review. See Partial Initial Decision at P 28. I concur in the conclusion that the public interest standard of review applies to the contracts at issue in this case based solely on the specific evidence surrounding execution of those contracts and the parties' intent.

____

Pat Wood, III
Chairman

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Public Utilities Commission of the State of California	Docket Nos. EL02-60-000 and EL02-60-003
v.	
Sellers of Long Term Contracts to the California Department of Water Resources	
California Electricity Oversight Board	
v.	Docket Nos. EL02-62-000 and EL02-62-003
Sellers of Energy and Capacity Under Long-Term Contracts with the California Department of Water Resources	(Consolidated)

(Issued June 26, 2003)

MASSEY, Commissioner, dissenting:

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

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

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

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

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

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

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

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

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

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

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

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

> (t)his action does not constitute approval of any service, rate, charge, classification...or any...contract...affecting such rate or service..., nor shall

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

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

> such action be deemed as recognition of any claimed contractual right or obligation affecting or relating to such service or rate; and such action is without prejudice to any findings or orders which have been or may hereafter be made by the Commission in any proceeding...

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

Second, even ignoring the rather plain language of the above-quoted paragraph, any possible presumption of the justness and reasonableness of contracts negotiated pursuant to the blanket authorization was flatly contradicted by the conclusions reached in the Commission's November 1, 2000 and December 15, 2000 orders, and in the July 2001 order requiring refunds. The November order found the market in California to be seriously flawed, and market conditions "have caused and continue to have the potential to cause, unjust and unreasonable rates for short term energy." Further: "There is clear evidence that the California market structure and rules provide the opportunity to exercise market power when supply is tight and can result in unjust and unreasonable rates."[4] In the December 15 order the Commission said that "we reaffirm our findings that unjust and unreasonable rates were charged and could continue to be charged, unless remedies are implemented."[5] It should be clear from both the breathtaking rise in prices after the December order and the June 2001 intervention by the Commission that the remedies in the December order did not work. Effective remedies were not put in place until June 2001 when the Commission imposed full time price controls. I would also note that the Commission's grant of market based pricing authority "depends on a functioning competitive market... unimpaired by market manipulation." Implicit in the grant of such authority is "a presumption that a company's behavior will not involve fraud or deception."[6] Circumstances indicate that this condition and presumption were not fulfilled. The Commission has found evidence of market manipulation in the California markets and is also investigating whether sellers withheld power from the market or engaged in excessive bidding.

In light of all of these circumstances, the predetermination rationale is without merit. The Commission's July 2001 order granting refunds for a nine month period

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

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

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

beginning October 2, 2000 and ending June 19, 2001 was based upon a finding that during such period spot prices were not just and reasonable. It defies logic to rely upon a "predetermination" of justness and reasonableness contradicted by later Commission orders that reviewed real market conditions, found the opportunity to exercise market power, and required several billions of dollars in refunds based upon the explicit conclusion that actual prices charged in fact were not just and reasonable.

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

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

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

[8]93 FERC at 61,982.

[9]93 FERC at 61,994.

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

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

A second fundamental issue in this case is whether the dysfunctional California spot markets adversely affected the long-term bilateral markets. I frankly do not understand why the hearing order in this case treated this as an open issue, and I said so at the time. The relationship between the spot market prices and long term contract prices seems rather obvious, and the Commission has explicitly recognized that "maintaining an accurately priced spot market is the single most important element for disciplining longer term transactions."[10] In our Standard Market Design proposal, the Commission found that:

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

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

> Therefore, the operation of the California electricity market can affect prices throughout the entire Western Interconnection. The Staff Report

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

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

> demonstrates that during the summer of 2000 correlations between PX prices and Western bilateral prices were quite strong.[12]

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

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

The just and reasonable standard is met

The prices and other terms of the forward contracts at issue here are unjust and unreasonable and should be reformed. I base this conclusion on three factors. First, the Commission has found that the California spot markets resulted in unjust and unreasonable rates for the refund period (October 2, 2000 to June 19, 2001). This is the period during which the contracts at issue here were negotiated. Second, the California markets were subjected to various forms of manipulation, which may have included withholding.[15] Third, there was a clear nexus between the California spot market and the

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

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

[14]Western Markets Report at VI-18.

[15]See Enron Power Marketing, Inc., et al, 103 FERC ¶ 61,343 (2003) where the Commission revokes the market-based authorities and terminates the blanket marketing

(continued...)

forward contract markets. The unlawful California spot prices strongly influenced forward contract prices. And fourth, the prices in many of these contracts are multiples of the $74 MWh price the Commission had declared would be used as a rough just and reasonable benchmark.

The public interest standard is met

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

The Mobile-Sierra case law involves contracts negotiated under a cost of service regime, and thus we do not know how the courts would instruct the Commission to address contracts negotiated in a market-based regime, especially under market conditions characterized by dysfunctional market rules, widespread manipulative conduct, and a lack of effective regulatory oversight. We are on new ground here, and the Commission is free to decide what circumstances give rise to the public interest.[16] We are clearly not limited to the traditional three-prong test that gets so much attention. Today's order as well as court precedent point out that those three factors are only examples of what to consider in determining the public interest.[17] Indeed, the

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

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

[17]"This definition of what is necessary in the public interest was formulated in the context of a low-rate case. It was not and could not be an across-the-board definition of what constitutes the public interest in other types of cases." Northeast Utilities, 55 F.3d
(continued...)

Commission has great discretion in carrying out its statutory responsibilities, even where the public interest standard controls:

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

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

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

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

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[17](...continued)
at 690. Also see today's order at paragraph 5.

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

[19]Public Utilities Commission of California v. Sellers of Long Term Contracts, 99 FERC ¶ 61,087 (2002) at 61,383.

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

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

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

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

- As prices soared out of control, buyers had no basis to expect that this Commission would act forcefully to control them. The measures imposed in the December 2000 order were clearly ineffective and prices continued to rise. The Commission approved as just and reasonable spot prices of $273 MWh, $430 MWh and $300 MWh for the first three months of 2001, respectively,[22] and the Commission's then chairman reportedly advised Californians at the time that the only way out of the crisis was to "start putting shovels in the ground."[23]

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

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

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

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

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

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

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

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

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

There is simply no persuasive public interest rationale for protecting and sanctifying contracts negotiated in this unprecedented and extraordinary environment. Those market conditions certainly tainted any contracts negotiated during this time frame. It would simply defy logic to conclude that the high prices in these contracts were not

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

adversely influenced by market conditions that included the exercise of market power and widespread market manipulation. Upholding such contracts violates the public interest. These contracts must be reformed.

Remedy

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

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

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

William L. Massey
Commissioner

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

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Public Utilities Commission of the State of California v. Sellers of Long-Term Contracts to the California Department of Water Resources	Docket Nos. EL02-60-000 and EL02-60-003
California Electricity Oversight Board v. Sellers of Energy and Capacity Under Long-Term Contracts With the California Department of Water Resources	Docket Nos. EL02-62-000 and EL02-62-003
	(Consolidated)

(Issued June 26, 2003)

BROWNELL, Commissioner, concurring

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

2. I am writing separately to express my concern about one aspect of the order: the rationale for concluding that modification of the contracts is subject to the public interest standard of review. When these cases were set for hearing, I noted that existing judicial case law seemed to indicate that the public interest standard applied to all of these contracts based solely on the contracts' silence as to the buyer's right to seek unilateral

changes under section 206.[1] Nevertheless, I was willing to set the issue for hearing so that the parties and the ALJ could have an opportunity to further explore whether my understanding of the case law was accurate. Three ALJs have now independently come to the same conclusion: judicial case law establishes that in the absence of clear contractual language allowing unilateral contract modification, the party seeking the change must meet the public interest standard.[2]

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

Nora Mead Brownell

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[1] Public Utilities Commission of the State of California v. Sellers of Long-Term Contracts to the California Department of Water Resources, et al., 99 FERC ¶ 61,087 (2002) (citing Texaco Inc. v. FERC, 148 F.3d 1091, 1096 (D.C. Cir. 1998) and Boston Edison Co. v. FERC, 233 F.3d 60, 67 (1st Cir. 2000)).

[2] Public Utilities Commission of the State of California v. Sellers of Long-Term Contracts to the California Department of Water Resources, et al., 102 FERC ¶ 63,013 at P 28 (2003); Nevada Power Company and Sierra Pacific Power Company v. Duke Energy Trading and Marketing, L.L.C., et al., 101 FERC ¶ 63,031 at P 27 (2002); and PacifiCorp v. Reliant Energy Services, Inc., et al., 102 FERC ¶ 63,030 at P 18 (2003).