

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Nevada Power Company and Sierra Pacific Power Company)	
v.)	
Enron Power Marketing, Inc.	)	Docket Nos. EL02-28-006
El Paso Merchant Energy	)	EL02-33-007
American Electric Power Services Corporation	)	EL02-38-006
Nevada Power Company)	
v.)	
Morgan Stanley Capital Group Inc.	)	Docket Nos. EL02-29-006
Calpine Energy Services, L.P.	)	EL02-30-006
Mirant Americas Energy Mktg., L.P.	)	EL02-31-006
Reliant Energy Services	)	EL02-32-006
BP Energy Company	)	EL02-34-006
Allegheny Energy Supply Co., L.L.C.	)	EL02-39-006
Southern California Water Company)	
v.)	
Mirant Americas Energy Mktg., L.P.	)	Docket No. EL02-43-006
Public Utility District No. 1 of Snohomish County, Washington)	
v.)	
Morgan Stanley Capital Group Inc.	)	Docket No. EL02-56-002

(consolidated)

**ANSWER OF
THE ELECTRIC POWER SUPPLY ASSOCIATION**

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure,¹ the Electric Power Supply Association ("EPSA")² hereby answers the motion for clarification

¹ 18 C.F.R. § 385.213 (2008).

² EPSA is the national trade association representing competitive power suppliers, including generators and marketers. These suppliers, who account for 40 percent of the installed generating capacity in the United States, provide reliable and competitively priced electricity from environmentally responsible facilities serving global power markets. EPSA

of the Commission’s December 18, 2008 order on remand³ filed in the above-captioned proceedings by Morgan Stanley Capital Group Inc. (“MSCG”) and Mirant Energy Trading, LLC (“MET”).⁴ As discussed below, EPSA shares the concerns of MSCG and MET about the potential interpretation – or, to be more precise, misinterpretation – of discussion in the December 18 Order as inviting complainants to seek to prove an “excessive burden” on consumers, such that they could overcome the *Mobile-Sierra*⁵ presumption, “down the line” by comparing challenged contract rates with rates in contracts entered substantially later and having substantially different tenors. Such an approach cannot be squared with the Supreme Court’s decision remanding this case to the Commission,⁶ inasmuch as it would essentially equate “excessive burden” with “buyer’s remorse.” It would also represent exceedingly bad public policy, because it would discourage forward contracting.

I. BACKGROUND

In its June 26, 2003 order in the above-captioned proceedings, the Commission denied complaints in which Nevada Power Company (“NPC”), Sierra Pacific Power Company (together with NPC, the “Nevada Companies”), Southern California Water

seeks to bring the benefits of competition to all power customers. The comments contained in this filing represent the position of EPSA as an organization, but not necessarily the views of any particular member with respect to any issue.

³ *Nevada Power Co. v. Enron Power Mktg., Inc.*, 125 FERC ¶ 61,312 (2008) (the “December 18 Order”).

⁴ Motion for Clarification of Order on Remand of Morgan Stanley Capital Group Inc. and Mirant Energy Trading, LLC, Docket Nos. EL02-28-006, *et al.* (filed Jan. 22, 2009) (the “Clarification Request”).

⁵ *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) (“*Mobile*”); *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956) (“*Sierra*”).

⁶ *Morgan Stanley Capital Group Inc. v. Pub. Util. Dist. No. 1 of Snohomish County*, 128 S. Ct. 2733 (2008) (“*Morgan Stanley*”).

Company (“SCWC”) and Public Utility District No. 1 of Snohomish County, Washington (“Snohomish”) challenged rates in forward contracts on the grounds that the complainants had failed to satisfy the *Mobile-Sierra* public interest standard.⁷ It reached this conclusion after applying the three factors set forth in *Sierra*, including that which asks whether the challenged contract rates “cast upon other consumers an excessive burden,”⁸ and examining the “totality of circumstances” surrounding the contracts.⁹ With respect to the excessive burden factor, the Commission appeared to focus on the fact that the challenged contracts did not produce significant *immediate* rate increases.¹⁰ The Supreme Court found the Commission’s analysis “flawed – or at least incomplete,” because it failed to consider whether the challenged contracts also “imposed an excessive burden on consumers ‘down the line,’ relative to rates they could have obtained (but for the contracts). . . .”¹¹ The Court directed the Commission to “amplify or clarify” its prior findings on this point.¹²

In the December 18 Order, the Commission reopened the record “for evidence on: (1) the difference ‘down the line’ between having the contracts at issue in effect and

⁷ *Nevada Power Co. v. Enron Power Mktg., Inc.*, 103 FERC ¶ 61,353 at P 4 (2003) (the “June 26, 2003 Order”).

⁸ *Sierra* at 355.

⁹ June 26, 2003 Order at P 102.

¹⁰ See *id.* at P 98 (“[I]n the event that the Nevada Companies are required to pay all the Respondents . . . , the resulting rate increase would be no more than 5 percent.”); *id.* at P 99 (“The record evidence establishes that there was no rate increase for SCWC’s ratepayers who are permanent residents of SCWC’s service territory. . . .”); *id.* at P 100 (“Snohomish’s rate increase occurred prior to Snohomish’s negotiating [the challenged] contract. . . .”).

¹¹ *Morgan Stanley* at 2750.

¹² *Id.* at 2751. The Commission was also directed to “amplify or clarify” its findings with respect to alleged spot market manipulation, consistent with the Court’s determination that “if it is clear that one party to a contract engaged in such extensive unlawful market manipulation as to alter the playing field for contract negotiations, the Commission should not presume that the contract is just and reasonable.” *Id.* at 2750-51.

not having them in effect; and (2) whether that difference seriously harms the public interest.”¹³ The Commission concluded that “for purposes of this proceeding, ‘down-the-line’ should be measured based on the life of the contract for those contracts that have already expired, and based on the contract period up to the date of the issuance of this order for contracts that have not yet expired.”¹⁴ The Commission explained that one relevant factor in measuring the “down the line” impact “is the cost of substitute power in the absence of the contracts,” where that cost is measured by “the actual market prices available at that time for comparable forward contracts.”¹⁵ The Commission made a point of emphasizing that “the parties should submit actual data and not speculation or modeling when presenting evidence” regarding the “down the line” impact of the challenged contracts.¹⁶ The Commission also stated that “parties should demonstrate the cost of comparable forward contracts, not simply available spot market prices.”¹⁷

II. THE CLARIFICATION REQUEST

In the Clarification Request, MSCG and MET ask the Commission to clarify that the term “comparable forward contracts” means “contracts for the same service and of the same, or substantially similar, vintage and tenor as a challenged contract.”¹⁸ MSCG and MET express concern that “certain language in the [December 18] Order [] is subject to the misinterpretation that a forward contract of a later vintage or different

¹³ December 18 Order at P 19.

¹⁴ *Id.*

¹⁵ *Id.* at P 20.

¹⁶ *Id.* at P 23.

¹⁷ *Id.* at n.42.

¹⁸ Clarification Request at 3.

tenor than a challenged contract is ‘comparable.’”¹⁹ In fact, they add, a complainant in a related case has already construed the December 18 Order in just that way.²⁰ MSCG and MET explain, and submit an affidavit from Mr. Jeffrey D. Tranen supporting their position, that a reading of the December 18 Order as inviting comparisons of the challenged contracts with contracts of different vintage and tenor “makes no economic sense and would be contrary to good public policy.”²¹

III. ANSWER

EPSA is filing this answer because it is deeply concerned about the chilling effect that a reading of the December 18 Order as inviting a comparison of challenged contracts with contracts of later vintages and different tenors could have on forward contracting. Such a reading is flatly inconsistent with *Morgan Stanley* and would represent exceedingly bad public policy. Nonetheless, both the CPUC Cross Motion and at least one of the requests for rehearing submitted in these proceedings²² demonstrate that, absent the clarification sought by MSCG and MET, this is precisely the way those advocating unilateral contract modification will spin the Commission’s December 18 Order.

¹⁹ *Id.* at 6.

²⁰ See *id.* at 6-7 (discussing the Answer and Cross Motion of the Public Utilities Commission of the State of California for an Order Governing Procedures on Remand, Docket Nos. EL02-60-003, *et al.* (filed Jan. 14, 2009) (“CPUC Cross Motion”).

²¹ *Id.* at 7.

²² See Request for Rehearing of Public Utility District No. 1 of Snohomish County, Washington at 41, Docket No. EL02-60-007, *et al.* (filed Jan. 21, 2009) (interpreting the December 18 Order as allowing Complainants to demonstrate excessive burden “by reference to actual market prices up through the date of the order on remand, and by reference to available market prices for the remaining term of the contract[s]”); *id.* at 43 (arguing that Snohomish should be allowed to base its price comparison on contracts “of a short[er] term” than the challenged contract).

A. Assessing The Impact Of The Challenged Contracts On Consumers “Down The Line” By Comparisons With Contracts Of Different Vintage And Term Would Be Flatly Inconsistent With *Morgan Stanley*.

As the Commission correctly observed in the December 18 Order, the Supreme Court “did not precisely define ‘down the line.’”²³ Nonetheless, “down the line” must be understood in the context of both the Commission findings under review and the overall thrust of the *Morgan Stanley* decision. With that context, it is clear that the Court was not suggesting – and that the December 18 Order cannot properly be construed to hold – that a contract will be deemed to impose an excessive burden on consumers if the buyer could have gotten a better deal by entering a contract at a later date or for a different term. In fact, such a result would be flatly inconsistent with *Morgan Stanley*.

In directing the Commission to “amplify or clarify” its excessive burden findings,²⁴ the Court was reacting to the Commission’s apparently having “looked simply to whether consumers’ rates increased *immediately* upon the relevant contracts’ going into effect,”²⁵ with “the baseline for that computation [being] the rate [consumers] were paying before the contracts went into effect.”²⁶ Referring back to *Sierra*, which “involved a challenge 5 years into a 15-year contract,” the Court emphasized that “[t]he ‘excessive burden’ on other consumers to which the opinion referred was assuredly the current burden, and not only the burden imposed at the very outset of the contract.”²⁷ This context makes it apparent that the Supreme Court was concerned that the Commission had evaluated the burden on consumers solely by reference to a snapshot of the

²³ December 18 Order at P 19.

²⁴ *Morgan Stanley* at 2751.

²⁵ *Id.* at 2749.

²⁶ *Id.* at 2750.

²⁷ *Id.* (citing *Sierra* at 355).

immediate effect, if any, on retail rates at the beginning of the contract term and without considering whether the challenged contract resulted in higher rates over time relative to other contracts of comparable vintage and tenor.

The *Morgan Stanley* decision implicitly rejects comparisons of challenged contract rates to rates in contracts of different vintages when it describes the Federal Power Act (the “FPA”) as “recogniz[ing] that contract stability ultimately benefits consumers, even if short-term rates for a subset of the public might be high **by historical standards**. . . .”²⁸ After all, a finding that rates in a contract entered during time period A are high relative to rates in a contract entered during time period B is nothing more than a showing that the rates in the former may be high “by historical standards.”²⁹ But, as the Court made clear, such a showing is irrelevant to the question of whether those rates impose an excessive burden on consumers.

Moreover, the *Morgan Stanley* decision cannot reasonably be read to suggest that consumers are “burdened” whenever a load-serving entity has foregone the opportunity to purchase power at lower rates by entering into a forward contract, because such a reading would be at odds with the whole thrust of the decision. For example, the Court rejected holdings of the United States Court of Appeals for the Ninth Circuit³⁰ that would have “enabl[ed] sophisticated parties who weather market turmoil by entering long-term contracts to renounce those contracts once the storm has passed” and thereby “reduce[d] the incentive to conclude such contracts in the future” as having “no support in our case law and plainly undermin[ing] the role of contracts in the FPA’s

²⁸ *Id.* at 2749 (emphasis added).

²⁹ *Id.*

³⁰ See *Public Util. Dist. No. 1 of Snohomish County v. FERC*, 471 F.3d 1053, 1089 (9th Cir. 2006) (“*Snohomish*”).

statutory scheme.”³¹ Allowing complainants in this and future cases to establish an “excessive burden” by comparing rates in contracts entered during a period of dysfunction with rates in contracts of later vintages, after “the storm has passed,”³² would have the same effect, and would, like the “perverse rule” of the Ninth Circuit that the Court rejected, “render[] contracts less likely to be enforced when there is volatility.”³³ Indeed, such an approach would, in effect, equate “excessive burden” with “buyer’s remorse.”

Similarly, the Supreme Court rejected the Ninth Circuit’s holding that contract rates impose an “excessive burden” to the extent that “consumers’ electricity bills ‘are higher than they would otherwise have been had the challenged contracts called for rates within the just and reasonable range,’ *i.e.*, rates that equal ‘marginal cost.’”³⁴ The Court recognized that “[a] presumption of validity that disappears when the rate is above marginal cost is no presumption of validity at all. . . .”³⁵ Of course, the same is true of a presumption of validity that disappears when the contract rate is above rates in contracts of later vintages or different tenors.

B. Assessing The Impact Of The Challenged Contracts On Consumers “Down The Line” By Comparisons With Contracts Of Different Vintage And Term Would Be Exceedingly Bad Public Policy.

To the extent the December 18 Order is interpreted as meaning that Complainants can show an excessive burden on consumers by comparing the

³¹ *Morgan Stanley* at 2747.

³² *Id.*

³³ *Id.* at 2746.

³⁴ *Id.* at 2748 (quoting *Snohomish* at 1089).

³⁵ *Id.*

challenged contract rates with rates in contracts of different vintages and tenors, it will, as MSCG and MET argue, “encourage complaints by parties second-guessing fixed price forward contracts, and thus chill the willingness of sellers to enter into such contracts.”³⁶ The pernicious effects of discouraging forward contracting are hard to overstate, because, as the Commission well knows, forward contracts are “critical in obtaining financing for new generation and ensuring adequate supplies for retail loads at predictable prices.”³⁷

As Mr. Tranen explains, forward contracts operate as a form of “insurance against volatile spot prices.”³⁸ The “price” of this insurance “reflects the perceived volatility over time,” and, as the uncertainty that increased the price disappears, “the price of the forward contract drops.”³⁹ Trying to compare contracts entered during the earlier period of greater uncertainty with otherwise similar contracts entered “after the storm has passed,”⁴⁰ as the Court put it, disregards entirely the insurance value of the forward contract. One can be sure that buyers would not consider contracts of later vintage to be valid points of comparison if the storm had worsened, and rates in later-

³⁶ Clarification Request at 11.

³⁷ The Electric Energy Market Competition Task Force, *Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy* at 4 (Apr. 2007), available at <http://www.ferc.gov/legal/fed-sta/ene-pol-act/epact-final-rpt.pdf>. See also, e.g., *Morgan Stanley* at 2749; CERA Advisory Services, *California Power Crisis Aftershock: The Potential Modification of Western Power Contracts* at 5-7 (Apr. 2007), available at <http://www2.cera.com/westernpowercontracts>. Cf. *Local 926 Int'l Union of Operating Eng'rs, AFL-CIO v. Jones*, 460 U.S. 669, 697 n.4 (1983) (stating that “[t]here can be no doubt that safeguarding the integrity of contractual relations is an interest of paramount importance in an economy such as ours”).

³⁸ Clarification Request, Attachment, Declaration under Penalty of Perjury and Affidavit of Jeffrey Tranen on behalf of Morgan Stanley Capital Group Inc. and Mirant Energy Trading, LLC at ¶ 9.

³⁹ *Id.*

⁴⁰ *Morgan Stanley* at 2747.

