



SPRING 2008 OPERATING COMMITTEE LEGAL UPDATE MATERIALS

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Below are summaries of Federal Energy Regulatory Commission (“FERC”) decisions and court cases decided since September 12, 2007, involving or significantly discussing WSPP, or liquidated damages, termination payments, and defaults in connection with gas and electricity contracts.

I. FERC Proceedings Bearing Upon WSPP

- A. Docket Nos. RM05-17-001, 002 and RM05-25-001, 002, *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890-A, 121 FERC ¶ 61,297 (2007).**

On December 28, 2007, FERC issued Order No. 890-A, its order on rehearing and clarification of Order No. 890, which amended the regulations and the *pro forma* open access transmission tariff (“OATT”) adopted in Order Nos. 888 and 889. In Order No. 890-A, FERC specifically required WSPP to file a revised OATT containing the revised non-rate terms and conditions of the *pro forma* OATT as stated in Appendix C of Order No. 890-A. *Id.* at P 38. As related to WSPP, FERC affirmed its finding in Order No. 890 that the make-whole formulaic damages provision in WSPP Service Schedule C was sufficiently firm for designation as a network resource. *Id.* at P 822. FERC further found it acceptable that WSPP’s Service Schedule C, as a firm “LD” contract, provided for recovery of the market price of replacement power in the event the buyer decides to run its more expensive generation to cover the interruption inasmuch as LD was a remedy for a failure to perform and not an alternate form of performance. *Id.* at P 834.

Regarding the WSPP’s rehearing request concerning the provision in Order No. 890 requiring undesignations by 10 a.m. the day before, FERC noted its issuance of a notice on September 7, 2007, *Preventing Undue Discrimination and Preference in Transmission Service*, 120 FERC ¶ 61,222, extending the effective date of the minimum lead time for undesignating network resources adopted in Order No. 890, and deferring the effectiveness of that particular OATT language. During this extension, the *pro forma* OATT will not specify the time by which network customers are required to terminate their network resources. *See* 120 FERC ¶ 61,222, at

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n.2. In Order No. 890-A, FERC deferred responding to the requests for rehearing on this issue pending further action in another order. *See* Order No. 890-A at P 931.

In response to a request for clarification by Sempra Global that transmission providers are obligated to offer and make available operating reserves regardless of where the merchant generation-customer is serving load, FERC stated that it would be inappropriate to require the transmission provider to use its own resources to provide additional operating reserves to loads in other control areas because transmission providers in those control areas are under their own obligation to make operating reserves available. *Id.* at P 505. However, FERC stated that a generator serving load outside the control area can make alternative comparable arrangements to provide reserves on behalf of its load by contracting with third parties. *Id.* at P 506.

B. Docket Nos. ER91-195-000 and EL07-69-000, WSPP Inc., 122 FERC ¶ 61,139 (February 21, 2008).

FERC determined that it is not just and reasonable to allow a seller to use the WSPP “up to” demand charge as a ceiling rate in markets where the seller does not have market-based rate authority, unless the seller justifies use of the “up to” demand charge based on its own fixed capacity carrying costs. *Id.* at P 22. FERC made this determination following an investigation it initiated based on its concern that the evolution and use of the WSPP Agreement ceiling rate resulted in circumstances in which the WSPP rate may no longer be just and reasonable for sellers that are found to have market power, or are presumed to have market power in a particular market.

FERC directed all sellers under the WSPP Agreement that lack market-based rate authorization, or that have lost or relinquished their market-based rate authority in some or all markets (including those sellers currently using the WSPP Agreement as mitigation), that wished to continue transacting under the WSPP Agreement, to make a filing by April 21, 2008, providing cost justification to demonstrate that use of the WSPP Agreement “up to” demand charge is just and reasonable for that particular seller. *Id.* at P 22. If a seller provides cost support demonstrating that the “up to” demand charge under the WSPP Agreement does not exceed the demand charge that the seller could cost-justify based on its own fixed costs, that seller would be permitted to continue to use the WSPP Agreement cap. Otherwise, that seller would be required to file a separate stand-alone rate schedule that is cost-justified based on its own costs. In the latter case, the seller could propose to use the non-rate terms and conditions of the WSPP Agreement, but would have to include those provisions as part of its stand-alone rate schedule. *See id.* FERC stated that the non-rate terms and conditions of the WSPP Agreement may continue without revision. *See id.* at P 31.

C. Docket No. EL02-129-004, Southern California Water Company, 122 FERC ¶ 61,161 (February 21, 2008).

On remand from the D.C. Circuit, *Southern California Water Company v. FERC*, 433 F.3d 840 (D.C. Cir. 2005), FERC modified its prior holdings concerning how Southern California Water Company (“SoCal Water”) was to determine a cost-justified rate for a sale to Mirant Americas Energy Marketing, LP (“Mirant”) made during April 2001, in the midst of the

California energy crisis. SoCal Water does not own any electric generating facilities and made the sale under the WSPP Agreement using energy from an agreement for around-the-clock energy. In April of 2001, SoCal Water did not have market-based rate authority, and, in the orders remanded by the court, FERC had determined that SoCal Water's price of \$20 below the spot market price at SP15 (the name for the spot market in the South of Path 15 zone) was an unauthorized sale at market-based rates and, therefore, violated statutory filing requirements for the making of jurisdictional sales.

Finding that FERC misapplied the concept of "forecasted incremental cost" as used in the WSPP Agreement, the court instructed FERC to properly determine SoCal Water's incremental cost in selling energy to Mirant. *See* 433 F.3d at 846. The court offered two meanings of the phrase "forecasted incremental cost," as contained in the WSPP Agreement. *SoCal*, 122 FERC ¶ 61,161, at P 14. First, the court stated that it could mean only the cost of the last unit sold, in which case the cost of the last unit would be applied to all units sold under the contract, consistent with the method used by FERC and regional transmission organizations in defining the wholesale price to be paid for units of the same service sold for delivery in the same time frame. *Id.* Second, the court stated that "forecasted incremental cost" could also mean the weighted average of the total forecasted cost of all additional units sold above some base amount, not just the cost of the last unit. *Id.* at P 15.

The focus of FERC's order on remand was the determination of the forecasted incremental cost SoCal Water incurred in making April 2001 sales to Mirant for the purpose of calculating refunds in the event that the revenues collect by SoCal Water exceeded the ceiling price. FERC noted that the maximum rate a seller may charge under the WSPP Agreement is defined by two components: (1) the seller's forecasted incremental cost; and (2) a fixed cost component that may be "up to" the amount permitted by the WSPP Agreement. *Id.* at P 17. FERC determined that the appropriate interpretation of "additional increment of energy" which establishes the "forecasted incremental cost" under the WSPP Agreement is the weighted average cost per megawatt of the entire sale. *Id.* at P 19.

FERC also stated that the WSPP Agreement did not contemplate resale transactions like the purchase power agreement at issue here, and in resale arrangements, the "cost" of the units sold must be derived from the purchase of power under a separate transaction. *Id.* at P 23. FERC concluded that SoCal Water's sale price in question was capped at the actual unit dollar purchase price of power it acquired under other contracts, plus the fixed cost component permitted by the WSPP Agreement. *Id.* Therefore, the per hour megawatt cost used to determine the weighted average cost must be increased by the fixed cost component as stated in the WSPP Agreement. *Id.* at P 24. FERC ordered SoCal Water to submit a compliance filing calculating its forecasted incremental costs as of April 1, 2001, using FERC's methodology. *Id.* FERC deferred ruling on an appropriate remedy concerning whether SoCal Water's compliance filing demonstrated that SoCal Water (now Golden State Water Company) collected revenues in excess of the ceiling price. *Id.* at P 25.

D. Docket Nos. RM07-19-000 and AD07-7-000, Wholesale Competition in Regions with Organized Electric Markets, 122 FERC ¶ 61,167 (2008).

On February 22, 2008, FERC issued a Notice of Proposed Rulemaking (“NOPR”) proposing to amend its regulations to improve the operation of organized wholesale electric markets in the areas of: (1) demand response and market pricing during a period of operating reserve shortage; (2) long-term power contracting; (3) market-monitoring policies; and (4) the responsiveness of regional transmission organizations (“RTOs”) and independent system operators (“ISOs”) to stakeholders and customers, and ultimately to the consumers who benefit from and pay for electricity services. FERC proposed to require that each RTO and ISO make certain filings that propose amendments to its tariff, in order to comply with the proposed requirements in each area, or that demonstrate that its existing tariff and market design already satisfy the requirements. The issuance of the NOPR follows FERC’s June 22, 2007 issuance of an Advanced Notice of Proposed Rulemaking (“ANOPR”) on the same issues. *See Wholesale Competition in Regions with Organized Electric Markets*, 119 FERC ¶ 61,306 (2007).

In the ANOPR, FERC sought comments on the following questions or whether it should:

- Require or encourage efforts to develop new standardized forward products.
- Would standardized products better facilitate long-term contracting? If so, what role should the Commission play? Should it encourage RTOs or ISOs to play an active role in this area or would that place them in a position of undertaking commercial functions? Is this a role better played by NAESB or other industry groups?” ANOPR at P 93.

WSPP submitted comments stating that the electric industry already has standardized numerous forward products for bi-lateral trades, with those products having regional variations. WSPP noted it already has a FERC-approved process in place for the development of any new products that FERC may desire that would apply to WSPP trades. If FERC provided guidance as to what new products it may desire, WSPP would commit to using its process to attempt to develop those products, to allow Commission staff involvement, to providing status reports, and to filing any new products.

In the NOPR, FERC proposed to require ISOs and RTOs to dedicate a portion of their web sites for market participants to post offers to buy or sell power on a long-term basis. *See* NOPR at P 155. However, FERC did not propose the other potential actions considered in the ANOPR, and did not proposing to address other long-term contracting issues raised by some commenters. *See id.* Comments on the NOPR are due April 21, 2008.

E. Docket No. ER08-426-000, WSPP Inc., Letter Order (March 11, 2008).

FERC issued a letter order accepting two modifications proposed by WSPP to the WSPP Agreement. The first modification was to the force majeure provision. Various WSPP members had opined that counterparties lacked a clear or complete understanding that transmission interruption is an excuse only in the very limited circumstances specified in section 10, and that this lack of clarity had tended to foster dispute. WSPP proposed to revise section 10 of the WSPP Agreement to eliminate the language that was reportedly confusing to some members, and to add language to cover the substance of the deleted language. The second modification proposed by WSPP was the addition of a “Bookout” remedy permitting counterparties to resolve non-performed transactions by entering into substitute transactions with mutually-agreed terms.

This includes non-performance that had already occurred and non-performance that was anticipated to occur. WSPP's Bookout proposal was entirely voluntary.

II. Court Decisions

A. *Morgan Stanley Capital Group v. Public Utility District No. 1 of Snohomish County Washington*, 128 S. Ct. 30 (2007).

On September 27, 2007, the United States Supreme Court granted a petition for certiorari of the Ninth Circuit's decision in *Public Utility District No. 1 of Snohomish County Washington v. FERC*, 471 F.3d 1053 (9th Cir. 2006). The Ninth Circuit held that FERC erred in its reliance on *Mobile-Sierra* and in the standard it used in determining that the contracts at issue did not affect the public interest. Specifically, the court held that three criteria are required to establish the *Mobile-Sierra* presumption: "(1) the contract by its own terms must not preclude the limited *Mobile-Sierra* review; (2) the regulatory scheme in which the contracts are formed must provide FERC with an opportunity for effective timely review of the contracted rates; and (3) where, as here, FERC is relying on a market-based rate setting system to produce just and reasonable rates, this review must permit consideration of all factors relevant to the propriety of the contract's formation." *PUD v. FERC*, 471 F.3d at 1061. The Ninth Circuit found that two of the criteria were not met and remanded to FERC regarding its application of *Mobile-Sierra*, and alternatively, "to allow FERC the opportunity to review these complaints in the first instance in light of these holdings to determine whether the challenged rates meet the statutory standard." *Id.* at 1057.

Below are quotes from the oral argument held before the Court on February 13, 2008. The Supreme Court has not ruled.

Justice Scalia: "Didn't your clients know that the market was chaotic at the time they entered into this long-term contract? I mean does come as a surprise that after the fact, now that you're paying more than market price is, you want to kick over a long-term contract you entered into? What has changed? Did you not know that the market was chaotic? Wasn't that the very reason you entered in the long-term contract?" Transcript of Oral Argument at 35:17-25.

Justice Scalia: "But so long as it's a factor extrinsic to the parties to the contract, what difference does it make to the buyer whether the flukishness of the market is caused by the weather or by manipulation by somebody other than the seller?" Transcript of Oral Argument at 41:23-42:2.

B. *Wah Chang v. Duke Energy Trading and Marketing, LLC*, 507 F.3d 1222 (9th Cir. 2007).

On November 20, 2007, the Ninth Circuit affirmed the dismissal of a complaint arising out of the California energy crisis, where a customer sought to recover damages because of the difference between the rate it was charged for electricity, which was a retail rate based upon the wholesale rate, and the rate that it claimed a "fair rate" would have been were it not for manipulation of the market by the defendants and others. *Id.* at 1224. The court found that, like all other claims seeking a "fair rate" determination by the courts arising from the California energy crisis, the filed rate doctrine barred the claim sought by the customer, even though the

customer attempted to distinguish its claim on the grounds that it was a retail customer. *Id.* at 1226. The court found that to be “an asthenic distinction at best.” *Id.*

C. *In re: Western States Wholesale Natural Gas Antitrust Litigation*, 2008 U.S. Dist. LEXIS 18873 (D. Nev. 2008).

On February 18, 2008, the U.S. District Court of Nevada denied motions for dismissal and summary judgment filed by the defendant natural gas companies. The court found that the plaintiffs, a group of Wisconsin corporations, sufficiently alleged that they had purchased natural gas from the defendants, who bought, sold, transported, and stored natural gas, and that the plaintiffs adequately pled their claim under Wisconsin statutory law that the contracts for natural gas at issue were void because they were entered into while the defendants were in conspiracy. *Id.* at *31. The court dismissed the motions without prejudice, allowing the defendants to reargue arguments as to the plaintiffs’ standing after the completion of discovery to determine whether plaintiffs purchased gas from defendants. *Id.* at *47 and *50.

III. FERC Orders

A. Docket No. RM01-8-006, *Revised Public Utility Filing Requirements for Electric Quarterly Reports*, Order No. 2001-G, 120 FERC ¶ 61,270 (2007).

On September 24, 2007, FERC issued Order No. 2001-G, which adopted an Electric Quarterly Report (“EQR”) Data Dictionary, which collects the definitions of certain terms and values used in filing EQR data. As related to the WSPP Agreement, FERC required in Field Nos. 19 and 50, where a tariff reference is required, that any cost-based sale made under the WSPP Agreement should cite the WSPP OATT, and that market-based sales made under the WSPP Agreement should cite the Seller’s market-based rate tariff. *Id.* at P 17.

B. Docket Nos. EL07-49-000 and EL07-50-000, *Californians for Renewable Energy, Inc. v. California Public Utilities Commission*, 120 FERC ¶ 61,272 (2007).

On September 24, 2007, FERC dismissed two virtually identical complaints filed by Californians for Renewable Energy, Inc. (“CARE”) seeking FERC review and rejection of two certain wholesale contracts. One of the contracts at issue was a long-term, market-based rate contract entered into by parties in the California market, while the other was a long-term contract entered into by the California Department of Water Resources (“CDWR”), a state entity, and the City and County of San Francisco, the operational responsibility under which was subsequently allocated from CDWR to Pacific Gas and Electric Company (“PG&E”), an investor-owned utility, upon a directive from the California Public Utilities Commission (“CPUC”).

CARE argued that recent Ninth Circuit decisions required that all market-based rate transactions to be pre-filed at or approved by FERC, and that the contracts at issue were unjust and unreasonable. *Id.* at P 1. The recent Ninth Circuit decisions cited by CARE were: *Public Utility District No. 1 of Snohomish County Washington v. FERC*, 471 F.3d 1053 (9th Cir. 2006) (“Snohomish”); *Public Utilities Commission of the State of California v. FERC*, 474 F.3d 587 (9th Cir. 2006) (CPUC); and *Lockyer v. FERC*, 383 F.3d 1006 (9th Cir. 2004) (“Lockyer”).

FERC determined that CARE's argument that the Ninth Circuit "effectively gutted" FERC's market-based rate program mischaracterized the decisions in *Snohomish*, *CPUC*, and *Lockyer*, and that CARE presented no evidence that the contracts were unjust and unreasonable. *CARE*, 120 FERC ¶ 61,272, at P 29. FERC also stated that CDWR and San Francisco were state and municipal entities over which FERC did not have jurisdiction for the purpose of the contract, even though operational responsibility was allocated to PG&E, a jurisdictional entity, pursuant to a CPUC directive. *Id.* at P 49.

C. Docket Nos. EL03-180-000, et al., Enron Power Marketing, Inc., 122 FERC ¶ 61,002 (2008).

On January 3, 2008, FERC issued an order approving an uncontested settlement between various Enron companies (collectively "Enron") and Port of Seattle resolving all claims against Enron for disgorgement of profits and other remedies sought by Port of Seattle in various proceedings. The settlement provides that the standard of review for any modifications proposed by a settling party, a non-party, or FERC *sua sponte* will be the *Mobile-Sierra* public interest standard. *Id.* at P 5 & n.9.

D. Docket Nos. EL03-180-032, et al., Enron Energy Services Inc., 122 FERC ¶ 61,015 (2008).

On January 8, 2008, FERC issued an order approving an uncontested settlement ("Settlement") between various Enron companies (collectively "Enron"), Public Utility District No. 1 of Snohomish County, Washington ("Snohomish"), and FERC Trial Staff. Consistent with its belief that fair and reasonable settlements, rather than costly FERC and court litigation, are the most effective means to bring closure to the proceedings spawned by the California energy crisis, FERC approved the settlement, which resolved all issues as to Enron in various proceedings and dismissed Enron with prejudice from these proceedings.

Under the Settlement, Snohomish will pay Enron a termination payment of \$18 million of the \$180 million claim by Enron for Snohomish's termination of a Master Power Purchase and Sale Agreement. *Id.* at P 21. In addition, upon FERC's approval of this settlement, every timely proof of claim filed in Enron's bankruptcy proceedings seeking relief related to wholesale power transactions will be resolved. *Id.* at P 35. In approving the Settlement, FERC accepted the Settlement as a substitute and satisfaction for relief and remedies ordered in *El Paso Electric Company*, 108 FERC ¶ 61,071 (2004), and *Enron Power Marketing, Inc.*, 104 FERC ¶ 63,010 (2003). *Enron*, 122 FERC ¶ 61,015, at PP 36, 51-54. The Enron bankruptcy court also approved the settlement. *Id.* at P 39. In addition, FERC dismissed Enron, with prejudice, from several proceedings.