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# Update on FERC, Proposed Legislation, CFTC, and Courts

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WSPP Operating Committee  
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Arnold B. Podgorsky  
Patrick Morand  
[podgorsky@wrightlaw.com](mailto:podgorsky@wrightlaw.com)  
[morand@wrightlaw.com](mailto:morand@wrightlaw.com)  
Wright & Talisman, PC  
Washington, DC  
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# Overview of Update

- FERC
  - Developments in Electricity Markets
  - Enforcement and Compliance
- Federal Legislative & Regulatory Matters
  - Financial Reform and Energy Markets
  - Proposed Position Limits
  - Nuclear Project Financing
- Courts
  - *Mobile-Sierra* Expanded?

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# FERC – Developments in Electricity Markets

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## Transmission Planning Processes Under Order No. 890 Docket No. AD09-8-000

- On October 8, 2009, FERC issued a request for comments regarding the effectiveness of the current transmission planning processes, the treatment of resources in the planning process, the development of regional and inter-regional transmission plans, and the effectiveness of cost allocation methods.
- FERC expressed concern that a lack of coordinated planning over the seams of current planning regions could be needlessly increasing costs or resulting in discrimination among potential users of the grid.

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## Transmission Planning Processes Under Order No. 890 Docket No. AD09-8-000 (cont.)

- Another concern identified by FERC is the lack of mechanisms to allocate and recover the costs of certain types of new transmission facilities and upgrades to existing facilities.
- Comments were due on November 23, 2009, and Reply Comments were due on December 18, 2009.
- No further action appears to have been taken in the subject docket.

# *Integration of Variable Energy Resources, Notice of Inquiry, 130 FERC ¶ 61,053 (2010).*

- On January 21, 2010, FERC issued a notice of inquiry seeking comments regarding the integration of variable energy resources (“VERs”) into the grid.
  - The notice of inquiry is intended to address the unique challenges VERs present, such as location constraint and limited dispatchability.
  - Specifically, FERC seeks comments on the extent to which barriers exist that may impede reliable and efficient integration of VERs into the grid and whether reforms of existing policies are needed to eliminate those barriers.
  - Comments are due on April 12, 2010.
- FERC seeks comments on the impact of integrating VERs in the following subject areas:
  - Data and Forecasting
  - Scheduling Flexibility and Scheduling Incentives
  - Day-ahead Market Participation and Reliability Commitments
  - Balancing Authority Coordination
  - Reserve Products and Ancillary Services
  - Capacity Markets
  - Real-time Adjustments

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*Electricity Market Transparency Provisions of Section 220 of the Federal Power Act, Notice of Inquiry, 130 FERC ¶ 61,039 (2010).*

- On January 21, 2010, FERC issued a notice of inquiry seeking comments on its proposal to require non-jurisdictional market participants to file Electric Quarterly Reports (“EQRs”).
  - EQRs are intended to ensure that FERC has the information necessary to examine and monitor price formation and market liquidity and to identify possible exercises of market power.
  - Currently, approximately 29% of electric utility sales are made by non-jurisdictional market participants.
  - FERC stated that applying the EQR filing requirements to all market participants would aid its oversight and surveillance of wholesale electric markets and increase price transparency.
  - Comments are due on March 30, 2010.

# Reliability Standards

- *Mandatory Reliability Standards for the Calculation of Available Transfer Capability*, Order No. 729, 129 FERC ¶ 61,155 (2009).
  - On November 24, 2009, FERC approved, and directed modifications to, six Modeling, Data and Analysis (“MOD”) Reliability Standards submitted by NERC.
  - The MOD Reliability Standards address the reliability aspects of available transfer capability and available flowgate capability, while the associated NAESB business practice standards (discussed below) focus on the competitive aspects of these processes.
  - The MOD Reliability Standards will become effective on the first day of the first calendar quarter that is twelve months beyond the date that they are approved by all applicable regulatory authorities.

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## Reliability Standards (cont.)

- *Standards for Business Practices and Communication Protocols for Public Utilities*, Order No. 676-E, 129 FERC ¶ 61,162 (2009).
  - On November 24, 2009, FERC amended its regulations to incorporate by reference the business practice standards, the NAESB WEQ Version 002.1 standards, which are intended to enable public utilities to implement requirements of Order Nos. 890, 890-A, and 890-B regarding conditional firm service and the posting requirements for available transfer capability-related information.
  - FERC will require public utilities to modify their OATTs to include the NAESB WEQ Version 002.1 standards on or before the first day of the first quarter occurring 365 days after approval of the NERC MOD reliability standards.

## Reliability Standards (cont.)

- *Revised Mandatory Reliability Standards for Interchange Scheduling and Coordination*, Order No. 730, 129 FERC ¶ 61,233 (2009).
  - On December 17, 2009, FERC approved three revised Interchange Scheduling and Coordination (“INT”) Reliability Standards developed by NERC: INT-005-3 (Interchange Authority Distributes Arranged Interchange); INT-006-3 (Response to Interchange Authority); and INT-008-3 (Interchange Authority Distribution of Information).
  - The INT Reliability Standards incorporate separate timing tables for the Western Interconnect and Eastern Interconnect, and an increase in the reliability assessment times for WECC from 5 minutes to 10 minutes for requests submitted less than 60 minutes (but no less than 15 minutes) prior to ramp start time.
  - FERC accepted the INT Reliability Standards as mandatory and enforceable with an effective date of January 25, 2010.

## Reliability Standards (cont.)

- *Transmission Loading Relief Reliability Standard and Curtailment Priorities*, Notice of Inquiry, 130 FERC ¶ 61,033 (2010).
  - On January 21, 2010, FERC issued a notice of inquiry requesting comments on the interplay between Reliability Standard IRO-006-4 (Reliability Coordination – Transmission Loading Relief) and the curtailment priorities set forth in FERC’s *pro forma* OATT (e.g., sections 13.6 and 14.7).
  - NERC’s Interchange Distribution Calculator apparently can cause a reliability coordinator acting pursuant to Reliability Standard IRO-006-4 to curtail a firm interchange transaction crossing over a constrained flowgate prior to curtailing a non-firm native network load transaction across the same flowgate. FERC sought input from the electric industry on the issue and how best to proceed.
  - Comments are due on March 29, 2010.

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*Wholesale Competition in Regions with Organized Electric Markets, Order No. 719-B, 129 FERC ¶ 61,252 (2009).*

- On January 21, 2010, FERC issued Order No. 719-B, reaffirming the final rule in Order No. 719 that each RTO or ISO must reform its market rules to ensure the market price for energy reflects the value of energy during an operating reserve shortage.
  - Prior to Order No. 719, some RTO and ISO market rules did not allow for prices to rise sufficiently during operating reserve shortages to allow supply to meet demand.
  - Order No. 719 did not remove price caps during periods of system emergencies, but rather directed RTOs and ISOs to establish pricing that better matches market supply and demand and allows the market price to more accurately reflect market conditions.

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*Credit Reforms in Organized Wholesale Electric Markets,*  
Notice of Proposed Rulemaking, 130 FERC ¶ 61,055 (2010).

■ Background

- Most wholesale electric markets developed credit practices on a case-by-case basis, depending on individual needs.
- Due to the current financial crisis, there is concern that these varying credit practices would not be sufficient to protect the markets, and subsequently the consumers, from the high costs associated with credit risks and credit defaults.
- As a result, on January 21, 2010, FERC proposed new rules to be incorporated in RTOs' and ISOs' OATTs.

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## Credit Reform in Organized Wholesale Electric Markets (cont.)

### ■ Proposed Rules

- Limit the settlement (i.e., billing) period to 7 calendar days while making final payment due in no more than an additional 7 days in order to reduce default exposures.
- Cap unsecured credit at \$50 million per market participant in energy markets.
- Eliminate unsecured credit in Financial Transmission Rights markets, due to their unique characteristics and inherent risks.
- Clarify the status of each RTO and ISO as a party in each transaction in order to manage defaults and offset market obligations.
  - There are significant Bankruptcy implications by having RTOs and ISOs “take title” to the underlying positions.

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## Credit Reform in Organized Wholesale Electric Markets (cont.)

### ■ Proposed Rules – cont.

- Establish minimum participation criteria to ensure participants have adequate risk management capabilities and adequate capital
  - FERC did not propose specific criteria for market participation, but believes it appropriate to establish such criteria in each RTO and ISO
- Clarify when an RTO or ISO may require additional collateral because of a “material adverse change.”
  - FERC proposed a standardized 2-day period for market participants to post additional collateral.
- Limit the amount of time participants can “cure” their financial position by posting additional collateral.
- Comments are due on March 29, 2010.

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# FERC – Enforcement and Compliance

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# FERC Enforcement Activities in 2009 and Priorities for 2010

- On December 17, 2009, FERC issued its Report on Enforcement for 2009.
  - FERC estimated that approximately 70% of the investigations opened in 2009 involved allegations of market manipulation.
  - FERC approved 22 settlements for a total of \$38.3 million in civil penalties and an additional \$38.6 million, plus interest, in disgorgement of unjust profits. Most of these were in the natural gas market, including the following examples:
    - Energy Transfer Partners, L.P. fined \$5,000,000 in civil penalties, and \$25,000,000 in disgorgement; resulting from violations of the code of conduct for person holding blanket marketing certificates.
    - Amaranth Advisors fined \$7,500,000 in civil penalties resulting from violations of the Natural Gas Anti-Market Manipulation Rule.
    - ONEOK, Inc. fined \$4,500,000 in civil penalties and \$1,915,000 in disgorgement resulting from violations of the Natural Gas Anti-Market Manipulation Rule.
    - Tenaska Marketing Ventures fined \$3,000,000 in civil penalties and \$1,973,000 in disgorgement resulting from violations of the Natural Gas Anti-Market Manipulation Rule.

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## FERC Enforcement Activities in 2009 and Priorities for 2010 (cont.)

- In addition to providing information on enforcement activities in 2009, the Report provided FERC's enforcement priorities for 2010, which include:
  - Fraud and market manipulation
  - Serious violations of reliability standards
  - Anticompetitive conduct
  - Conduct that threatens transparency of regulated markets

# Transparency of FERC Enforcement Process

- On December 17, 2009, FERC issued an order intended to make its energy market enforcement process more transparent by informing consumers of matters under investigation by the Office of Enforcement.
- If the Office of Enforcement determines that a subject has violated one or more FERC requirements, it will send the subject a letter outlining the bases for the preliminary determination.
- After the subject has had an opportunity to respond to the preliminary determination letter, the Office of Enforcement may direct the Secretary to issue a notice that includes the following information:
  - Identity of the subject under investigation
  - Time and place of the alleged conduct
  - Rules, regulations, statutes or orders allegedly violated
  - Description of the alleged wrongful conduct

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# NERC Enforcement Actions – Procedures

- NERC (or a Regional Entity) may impose a penalty on a user, owner or operator of the Bulk-Power System for a violation of the Reliability Standards.
- A penalty imposed by NERC may take effect no earlier than 31 days after NERC files with the Commission a notice of penalty.
- An entity subject to a notice of penalty may file an application for FERC review within 30 days of the date NERC filed the notice (FERC also may review any notice on its own motion).
- If FERC reviews a notice of penalty, it typically will respond within 60 days. Unless FERC orders otherwise, review of a notice of penalty by FERC will not operate as a stay of the proposed penalty, but as a matter of policy FERC typically will stay the penalty.
- FERC may affirm, set aside or modify a proposed penalty, or remand the determination of the proposed penalty to NERC for further proceedings.

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# NERC Enforcement Actions – Penalties

- NERC will determine a Base Penalty Amount by considering Violation Risk Factors and the Violation Severity Level.
- Base Penalty Amounts can range from \$1,000 per violation per day for a violation with a low Violation Risk Factor and a low Violation Severity Level, to \$1,000,000 per violation per day for a violation with a high Violation Risk Factor and a severe Violation Severity Level.
- NERC may then adjust the Base Penalty Amounts based on repetitive violations, compliance history, self-disclosure, corrective actions, etc.
- FERC encourages NERC (or the Regional Entity) to settle enforcement actions. Any such settlement entered into by NERC or a Regional Entity is subject to FERC review.
- In 2009, the settlements ranged from \$0 to \$250,000, except for the settlement related to the Florida Blackout which was settled with Florida Power & Light for \$25,000,000.

## ...Don't Forget About Antitrust Issues

- In Docket Nos. IN08-2-000 & EL07-39-000, FERC's Office of Enforcement determined that KeySpan-Ravenswood, LLC had not violated FERC's anti-manipulation regulations when, for a period of about 2 years, it consistently offered its capacity in the New York City electricity capacity market at its bid cap, while entering into a swap agreement with Morgan Stanley Capital Group that gave KeySpan a financial interest in the electricity capacity sales of its largest competitor, Astoria.
- On February 22, 2010, the Department of Justice's Antitrust Division filed a civil antitrust complaint in the U.S. District Court for the Southern District of New York, along with a proposed settlement requiring KeySpan to disgorge profits of \$12 million for violating antitrust laws. The DOJ said the swap agreement likely resulted in a price increase for retail electricity suppliers and, in turn, an increase in electricity prices for consumers.
- According to the DOJ, the swap agreement provided KeySpan with revenues from Astoria's capacity sales, in addition to its own, with the anticompetitive effect of eliminating KeySpan's incentive to sell its capacity at lower prices and resulting in retail electricity prices in New York City that were likely higher than they would have been without this anticompetitive agreement.

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# Federal Legislative Matters

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# Proposed Financial Reforms and Energy Markets

- Current Derivatives Regulatory Framework
  - Derivatives include, among other things, futures and swaps. Futures are traded on exchanges regulated by the Commodity Futures Trading Commission (“CFTC”); swaps are not traded on an exchange but over-the-counter (“OTC”), and currently are not regulated.
  - CFTC-regulated exchanges manage credit risk through the use of clearinghouses which guarantee payments to parties through a system of margin. Traders deposit an initial margin payment before trading, and as the futures contracts are “marked to market” at the end of each day, the traders that have lost money that day post additional margin (i.e., the “margin call”).

## Proposed Financial Reforms and Energy Markets (cont.)

- Current Derivatives Regulatory Framework – cont.
  - In the OTC derivatives market, firms act as dealers and absorb the credit risk of customer default. OTC contracts are not standardized and do not have a universal system of margin. Consequently, large uncollateralized losses can build up in the OTC market.
  - For example, AIG accumulated huge losses in the OTC market resulting in margin calls that it could not meet and required tens of billions of dollars from the government to avoid bankruptcy.

## Proposed Financial Reforms and Energy Markets (cont.)

### ■ Proposed Derivatives Regulatory Framework

- On December 11, 2009, the House narrowly passed H.R. 4173, the Wall Street Reform and Consumer Protection Act of 2009, by a vote of 223-202.
- The House bill provides for the regulation of OTC derivatives by requiring all standardized swap transactions between “swap dealers” and “major swap participants” to be cleared and traded on regulated exchanges.
- The House bill included amendments exempting end users from the definitions of “swap dealer” and “major swap participant,” thus exempting them from the requirement to clear and trade swaps on regulated exchanges.
  - Energy companies, as end users of commodities (e.g., natural gas for power production), use OTC derivatives to hedge against price fluctuations in those commodities.

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## Proposed Financial Reforms and Energy Markets (cont.)

- Proposed Derivatives Regulatory Framework – cont.
  - The Senate is reviewing H.R. 4173. According to Senate Agricultural Committee staff, the Senate will issue a draft bill by mid-March and a marked-up bill by the end of March.
  - Senate staff indicated that both Democrats and Republicans support an end user exemption, and that the exemption will happen, the only question is how big it will be.

# Proposed Financial Reforms and Energy Markets (cont.)

- Proposed Derivatives Regulatory Framework: CFTC Perspective
  - CFTC Chairman Gary Gensler blames OTC derivatives for playing a central role in the recent economic crisis and advocates the CFTC regulation of OTC derivatives, including regulation of swap dealers, an increase in transparency of OTC products, and moving the clearing and trading of swaps onto centralized exchanges.
  - Chairman Gensler posits that, while requiring swaps to be traded on centralized exchanges may create some additional costs (e.g., margin costs), the benefit of reduced risk to the public greatly outweighs any such costs and, in the long run, the increased transparency will reduce the overall cost of trading.
  - Chairman Gensler disagrees with granting an end user exemption, and if Congress does grant such an exemption, it should be very narrowly tailored. Regardless of whether an exemption is granted, Chairman Gensler advocates for greater transparency, arguing that the only person who benefits from a lack of transparency is Wall Street.

## Proposed Financial Reforms and Energy Markets (cont.)

- Proposed Derivatives Regulatory Framework: CFTC vs. FERC
  - FERC is concerned that H.R. 4173 proposes a revised definition of “swap” that arguably is broad enough to include RTO market products like financial transmission rights (“FTRs”), and thereby remove jurisdiction over such products from FERC, placing them under CFTC.
  - The House bill directs FERC and CFTC to negotiate an MOU to resolve any overlapping or conflicting jurisdiction. FERC worries that an MOU may not be sufficient, and prefers that Congress establish a more definitive jurisdictional line between itself and CFTC.
  - The Farm Bill of 2008 is one example of legislation where Congress avoided overlap of FERC and CFTC jurisdiction; CFTC determines whether electricity or natural gas futures contracts traded on the Intercontinental Exchange (“ICE”) qualify as significant price discovery contracts (“SPDCs”) subject to position limits.
  - Another possibility is that, even if FTRs are determined to be swaps, CFTC could exercise its exemption authority and delegate regulation to FERC after negotiating an MOU on enforcement.

# CFTC Proposed Position Limits

- On January 14, 2010, CFTC issued a notice of proposed rulemaking in which it would set position limits for futures and options contracts in four major energy commodities:
  - Henry Hub natural gas
  - light sweet crude
  - New York Harbor No. 2 heating oil
  - New York Harbor gasoline blendstock.
- The proposed speculative position limits are intended to limit the concentration of positions and promote fair and orderly markets, and apply to the CFTC-regulated exchanges on which the four energy commodities are traded, the New York Mercantile Exchange (“NYMEX”) and the Intercontinental Exchange (“ICE”).

# CFTC Proposed Position Limits (cont.)

- Currently, the energy futures and options contracts on NYMEX and the single SPDC on ICE (Henry Hub natural gas) are subject to position accountability rules during non-spot months and to speculative position limits during spot months.
- The proposed regulations would not change the requirements set by NYMEX and ICE, but would supplement them.
- The proposed regulations would set position limits for all months combined (“AMC”), any single month and the spot month as follows:
  - The AMC position limit would be 10% of the first 25,000 contracts of open interest and 2.5% of open interest beyond 25,000 contracts
  - The single month position limit is set at 2/3 of the AMC position limit
  - The spot-month limit is 25% of the estimated deliverable supply

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## CFTC Proposed Position Limits (cont.)

- The proposed position limits would be aggregated across physically-settled and cash-settled contracts on NYMEX and ICE for positions outside of the spot month, and aggregated across accounts based on ownership (i.e., non-spot month positions owned by one entity would be aggregated regardless if they are controlled and traded by different advisors).
- The proposed regulations provide for two types of exemptions:
  - (1) a bona fide hedging exemption
  - (2) a limited risk management exemption for swap dealers for positions held outside of the spot month.

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# Nuclear Project Financing

- EPA Act of 2005 authorized DOE to issue loan guarantees for projects that avoid, reduce, or sequester air pollutants or emissions of greenhouse gases, employing new or significantly-improved technologies.
  - On February 16, 2010, DOE offered conditional commitments for a total of \$8.3 billion in loan guarantees to Georgia Power for the construction and operation of two new 1,100 MW nuclear reactors in Georgia
  - These would be the first nuclear power plants built in the United States in over 30 years.

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# Nuclear Project Financing (cont.)

- Despite pledged loan guarantees from DOE, financing for nuclear projects is still hard to come by
  - Because banks are wary about lending and investors about buying bonds for new projects, utilities turned to the states for regulations that allow them to charge customers while construction is still in progress
  - However, businesses and other ratepayers are growing increasingly hostile toward utilities' recovery of expenses during construction and in some states they are challenging those laws
  - Consequently, the renaissance of nuclear energy may remain on hold for the foreseeable future.

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# Courts

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## The *Mobile-Sierra* Doctrine Generally

- The Federal Power Act requires that rates for the sale or resale of electricity in interstate commerce be “just and reasonable.”
- In 1956, the Supreme Court held in the *Mobile* and *Sierra* cases that FERC must “presume that the rate set out in a freely negotiated wholesale-energy contract meets the ‘just and reasonable’ requirement imposed by law,” and that the “presumption may be overcome only if FERC concludes that the contract seriously harms the public interest.”
- Based on these two cases, this principle is known as the *Mobile-Sierra* doctrine (sometimes called the “public interest standard”). It is important for energy contracts because it creates a high hurdle for anyone to later challenge the contract rate.

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## *Morgan Stanley Capital Group Inc. v. Public Utility District No. 1*

- In 2008, the United States Supreme Court considered two *Mobile-Sierra*-related questions:
  - does the *Mobile-Sierra* presumption (that contract rates freely negotiated between sophisticated parties meet the just and reasonable standard) apply only when FERC has had an opportunity to review a contract rate without the presumption? and
  - does the presumption generally imposes as high a bar to challenges by purchasers of wholesale electricity as it does to challenges by sellers?

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*Morgan Stanley Capital Group Inc. v. Public Utility District No. 1*  
(cont.)

- The Supreme Court answered “no” to the first question and “yes” to the second question.
- In other words, (1) there is no requirement that FERC first review the contract rate before presuming that it is just and reasonable (where it has been freely negotiated),

and

(2) the presumption applies equally to purchasers and sellers of wholesale electricity.

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## *NRG Power Marketing, LLC v. Maine Public Utilities Commission*

- On January 13, 2010, the Supreme Court considered yet another *Mobile-Sierra*-related question:
  - does the *Mobile-Sierra* public interest standard apply to challenges to contract rates brought by noncontracting parties?
- The Supreme Court answered “yes” to the question, overturning the D.C. Circuit’s decision.
- The Supreme Court explained that the public interest standard is not a standard independent of the just and reasonable standard, but rather defines what it means for a rate to satisfy the just and reasonable standard in the contract context.

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*NRG Power Marketing, LLC v. Maine Public Utilities Commission*  
(cont.)

- In holding that the public interest standard applies to challenges to contract rates brought by noncontracting parties, the Supreme Court explained the *Mobile-Sierra* doctrine does not overlook the interests of third parties (i.e., noncontracting parties) because the doctrine directs FERC to reject a contract rate that seriously harms the consuming public.

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## *NRG Power Marketing, LLC v. Maine Public Utilities Commission* (cont.)

- It should be noted that the Supreme Court remanded to the D.C. Circuit the issue of whether rates established by a settlement proceeding before FERC qualify as “contract rates” protected by the *Mobile-Sierra* doctrine.
  - On December 2, 2009, in a concurrence to the decision in *Xcel Energy Services Inc.*, 129 FERC ¶ 61,193 (2009), FERC explained that the standard of review that it must apply to changes proposed by noncontracting parties to settlements (rather than wholesale-energy sales contracts) is the just and reasonable standard set forth in FPA § 206.
  - Until the D.C. Circuit decides the issue on remand, the concurrence in *Xcel Energy Services Inc.* is the law.