125 FERC ¶ 61,312
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

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|---|---|---|
| Nevada Power Company and | Docket Nos. | EL02-28-006 |
| Sierra Pacific Power Company | | EL02-33-007 |
| | | EL02-38-006 |
| v. | | |
| Enron Power Marketing, Inc. | | |
| El Paso Merchant Energy | | |
| American Electric Power Services Corporation | | |
| Nevada Power Company | Docket Nos. | EL02-29-006 |
| | | EL02-30-006 |
| v. | | EL02-31-006 |
| | | EL02-32-006 |
| Morgan Stanley Capital Group | | EL02-34-006 |
| Calpine Energy Services | | EL02-39-006 |
| Mirant Americas Energy Marketing, L.P. | | |
| Reliant Energy Services | | |
| BP Energy Company | | |
| Allegheny Energy Supply Company, L.L.C. | | |
| Southern California Water Company | Docket No. | EL02-43-006 |
| v. | | |
| Mirant Americas Energy Marketing, L.P. | | |

Public Utility District No. 1 Docket No. EL02-56-006
Snohomish County, Washington

v.

Morgan Stanley Capital Group, Inc.

(Consolidated)

ORDER ON REMAND

(Issued December 18, 2008)

1. This case is before the Commission on remand from the Supreme Court of the United States.[1] In light of the Court's remand order, the Commission here orders a paper hearing to supplement the existing record.

2. This matter concerns a series of wholesale energy contracts entered into between 2000 and 2001, during the period of market dysfunction in the western United States. NV Energy, formerly known as Nevada Power Company and Sierra Pacific Company, Golden State Water Company, formerly known as Southern California Water Company (Golden State) and Public Utility District No. 1 Snohomish County, Washington (Snohomish), the buyers in the contracts here, filed complaints seeking abrogation or reformation of their bilateral wholesale energy contracts, and the Commission declined to direct any contract modification.[2]

3. In the Court's June 26, 2008 opinion, it required the Commission to "amplify or clarify" its findings on two points. First, the Court stated that the Commission's analysis should not be limited to whether consumers' rates increased immediately upon the relevant contracts going into effect, but rather should determine whether the contracts at issue imposed an excessive burden "down the line," relative to the rates consumers could

[1] *Morgan Stanley Capital Group, Inc. v. Pub. Util. Dist. No. 1 of Snohomish County*, 128 S. Ct. 2733 (2008) (*Morgan Stanley*). On November 3, 2008, the Ninth Circuit issued an order vacating its prior decision in the case and remanding the matter to the Commission for further proceedings consistent with the Court's *Morgan Stanley* opinion. *Pub. Util. Dist. No. 1 of Snohomish County v. FERC*, 2008 U.S. App. LEXIS 23290 (9th Cir. Nov. 3, 2008).

[2] *Nevada Power Co. v. Enron Power Mktg., Inc.*, 103 FERC ¶ 61,353 (2003).

have obtained (but for the contracts) after elimination of the dysfunctional spot market.[3] Second, the Court found that it was unclear from the Commission's orders whether the Commission found the evidence inadequate to support the claim that individual sellers' alleged unlawful activities affected the contracts at issue here. The Court stated 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."[4]

4. In this order, we establish a paper hearing to address the issues remanded by the Court. We reopen the record to allow the parties to submit the information described below on which the Commission will resolve this matter.

## I. Background

### A. Commission Proceedings

5. Between December 2001 and February 2002, complaints were filed at the Commission by buyers seeking to abrogate or reform contracts they had signed during the Western energy crisis. NV Energy, Golden State, and Snohomish filed complaints to modify their contracts. The complaints argued that the Commission had already determined that the dysfunctional California Independent System Operator Corporation (CAISO) and California Power Exchange (CalPX) spot markets had produced unjust and unreasonable spot prices, the dysfunctional spot markets had tainted the long-term markets and, therefore, the long-term contracts signed during the period of market dysfunction should be found unjust and unreasonable.[5]

6. The Commission held a hearing on the complaints to address "whether the dysfunctional California spot markets adversely affected the long-term bilateral markets, and, if so, whether modification of any individual contract at issue [was] warranted."[6] The hearing also addressed whether the *Mobile-Sierra* public interest standard of review

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[3] *Morgan Stanley* at 2750.

[4] *Id.* at 2750-51.

[5] On April 11, 2002, the Commission consolidated the NV Energy, Golden State, and Snohomish complaints and set them for hearing. *Nevada Power Co. v. Duke Energy Trading and Mktg., L.L.C.*, 99 FERC ¶ 61,047, at 61,191 (2002) (*Nevada Power*).

[6] *Id.*

or the ordinary just-and-reasonable standard of review should be applied.[7] Finally, the Commission instructed the Administrative Law Judges (ALJs) who presided over the hearings to consider the "totality of purchases and sales and the conditions present at the time the contracts were entered into."[8] The Commission listed examples of relevant evidence, including the terms of the contracts, the available alternatives at the time of sale, the relationship of the rates to the benchmark long-term contract price established by the Commission, the effect of the contracts on the financial health of the purchasers, and the impact of contract modification on national energy markets.[9]

7. A hearing on the contracts was held, and on December 19, 2002, the ALJ issued an initial decision.[10] The ALJ concluded that the *Mobile-Sierra* public interest standard applied, and the buyers had failed to demonstrate that the spot market sufficiently adversely affected the forward market to merit revision of the contracts under that standard.[11]

8. On June 26, 2003, the Commission affirmed the ALJ's initial decision denying the complaints.[12] The Commission concluded that the *Mobile-Sierra* public interest standard applied to all the contracts. The Commission further stated that it had considered both the Staff Report[13] as well as the evidence of market manipulation submitted in the 100 Days Discovery Proceeding,[14] and concluded that such evidence, even if assumed to be

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[7] *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956); *F.P.C. v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956).

[8] *Nevada Power*, 99 FERC at 61,191.

[9] *Id.*

[10] *Nevada Power Co. v. Enron Power Mktg., Inc.*, 101 FERC ¶ 63,031 (2002).

[11] *Id.* P 95.

[12] *Nevada Power Co. v. Enron Power Mktg., Inc.*, 103 FERC ¶ 61,353 (2003) (*Nevada Power Co.)*; *Pub. Util. Comm'n of the State of California v. Sellers of Long Term Contracts to the California Dep't of Water Res.*, 103 FERC ¶ 61,354 (2003).

[13] The Staff Report refers to the report prepared by Commission staff regarding manipulation in the West. Final Report on Price Manipulation in Western Markets, Docket No. PA02-2-000 (March 2003).

[14] The 100 Days Discovery Proceeding was created on November 20, 2002 when the Commission issued an order allowing parties in the Docket No. EL00-95, *et al.* proceeding to adduce evidence that was either indicative or counter-indicative of market

(continued…)

true, was not determinative of whether the rates, terms and conditions of the contracts were contrary to the public interest, as required under *Mobile-Sierra*.[15] The Commission determined that under the factors identified in *Sierra*, as well as under a totality-of-the-circumstances test, the complainants had not demonstrated that the contracts threatened the public interest.[16]

9. On November 10, 2003, the Commission denied requests for rehearing of its June 26, 2003 order and reaffirmed its conclusion that the record in the proceeding did not support modification of the contracts at issue.[17]

### B. Ninth Circuit Decision

10. On appeal, the Ninth Circuit Court of Appeals remanded the case to the Commission, stating that it found two flaws in the Commission's analysis.[18] First, the Ninth Circuit found that rates set by contract are presumptively reasonable only when the Commission has had an initial opportunity to review the contracts without applying the public interest standard, that this initial review must include an inquiry into "the market conditions in which the contracts at issue were formed," and that market "dysfunction" is a ground for finding a contract not to be just and reasonable.[19] Second, the Ninth Circuit found that even assuming that the *Mobile-Sierra* standard applied, the standard for overcoming that presumption is different for a purchaser's challenge to a contract, namely, whether the contract rate exceeds a "zone of reasonableness."[20]

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manipulation that may have occurred during the California energy crisis of 2000-2001. (100 Days Discovery). The submission of evidence was completed on March 20, 2003.

[15] *Nevada Power Co*., 103 FERC at P 94.

[16] *Id.* P 96-110.

[17] *Nevada Power Co. v. Enron Power Mktg., Inc.*, 105 FERC ¶ 61,185 (2003).

[18] *Pub. Util. Dist. No. 1 of Snohomish County v. FERC*, 471 F.3d 1053 (9th Cir. 2006).

[19] *Id*. at 1085-97.

[20] *Id*. at 1088-90.

### C. Supreme Court Decision

11. On review of the Ninth Circuit's decision, the Court clarified that there is only one statutory standard under the Federal Power Act for assessing wholesale electricity rates, the just-and-reasonable standard. The *Sierra* and *Mobile* cases did not create an extra-statutory standard for the review of contract rates.[21] The Court also clarified that the three situations indentified in *Sierra* and *Mobile* (impairment of the financial ability of the public utility to continue its service, imposition of an excessive burden on other consumers, and undue discrimination) are not the only examples of serious harm to the public interest.[22]

12. The Court rejected several aspects of the Ninth Circuit's interpretation of the operation of the *Mobile-Sierra* presumption. First, the Court rejected the notion that the *Mobile-Sierra* presumption is inapplicable to the Commission's initial review of a contract, reasoning that there is no support in the statute for applying the just-and-reasonable standard differently depending on *when* a contract is challenged.[23] Second, the Court held that the *Mobile-Sierra* presumption functions the same for buyers as it does for sellers, rejecting as not "accord[ing] an adequate level of protection to contracts" the Ninth Circuit's "zone-of-reasonableness" test for evaluating high-rate challenges.[24] Third, the Court rejected the Ninth Circuit's holding that a contract must be formed within a fully functioning market in order to trigger the *Mobile-Sierra* presumption.[25]

13. While the Court concluded that the existence of a dysfunctional spot market is not dispositive of the applicability of the public interest standard, the Court nonetheless stated that "if the 'dysfunctional' market conditions under which the contract was formed were caused by the illegal action of one of the parties [to the contract], FERC should not apply the *Mobile-Sierra* presumption."[26] Therefore, the Court remanded the matters to the Commission with direction to "amplify or clarify" its findings on two points discussed below.

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[21] *Morgan Stanley* at 2745.

[22] *Id.* at 2747.

[23] *Id*. at 2745.

[24] *Id*. at 2747-49.

[25] *Id.* at 2746.

[26] *Id.*

## II. Discussion

### A. Additional Hearing[27]

14. The Court directed the Commission to amplify or clarify its findings on: (1) whether the contracts at issue imposed an excessive burden on consumers "down the line," relative to the rates they could have obtained after elimination of the dysfunctional spot market, or otherwise seriously harmed the public interest; and (2) whether any of the sellers involved in this case engaged in unlawful activities in the spot market that affected any of its contracts that are at issue. With regard to the first issue, the Court reviewed the Commission's orders in this matter and found that it was unclear whether the Commission considered the effect of the contracts at issue on consumers beyond the immediate point at which the contracts went into effect.[28] The Court could not discern if the Commission "looked simply to whether consumers' rates increased immediately upon the relevant contracts' going into effect, rather than determining whether the contracts imposed an excessive burden on consumers 'down the line,' relative to the rates they could have obtained (but for the contracts) after elimination of the dysfunctional market."[29] With respect to this point, the Court noted that even if consumers paid more than they would have in the absence of the contracts, the rates should be disallowed only "if that increase is so great that, even taking into account the desirability of fostering

[27] The Commission notes that a motion was filed seeking to have the Commission consider only the existing hearing record to address the issues remanded by the Court. Morgan Stanley Capital Group, Inc. and Mirant Energy Trading, LLC November 7, 2008 Motion for Implementation of Remand Procedures. For the reasons set out in the body of this order, we deny that motion. Other parties made filings seeking different hearing procedures and requesting settlement procedures. Snohomish November 24, 2008 Answer and Cross Motion; Golden State November 24, 2008 Answer; Mirant December 9, 2008 Answer; Nevada Attorney General December 9, 2008 Answer; Nevada Respondents December 9, 2008 Answer; Morgan Stanley December 9, 2008 Answer; NV Energy December 9, 2008 Answer and Motion; Golden State December 16, 2008 Answer. To the extent the requested hearing procedures differ from those outlined below they are denied, and to the extent the requested hearing procedures conform to the procedures outlined below they are accepted.

[28] *Morgan Stanley* at 2749-50.

[29] *Id.*

market-stabilizing long-term contracts, the rates impose an excessive burden on consumers or otherwise seriously harm the public interest[.]"[30]

15. With regard to the second issue, the Court stated that it was "unable to determine from the Commission's orders whether it found the evidence inadequate to support the claim that sellers' alleged unlawful activities affected the contracts at issue here."[31] The Court directed the Commission to amplify or clarify its findings on this point, explaining, "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."[32] The Court emphasized that when unlawful market activity directly affects contract negotiations, such activity eliminates the premise on which the *Mobile-Sierra* presumption rests: that the contract rates are the product of fair, arms-length negotiations.[33] Thus, the Court required that the Commission provide additional explanation regarding the causal connection between any unlawful market activity and the contracts at issue.

16. This dispute is now seven years old, and the Commission has encouraged the parties to resolve this matter outside of litigation.[34] The Commission continues to encourage resolution through settlement if possible.[35]

17. The parties to this proceeding have been afforded numerous opportunities to develop evidence and present their arguments to the Commission, including a trial-type hearing and an oral argument before the full Commission. The record in this proceeding is voluminous. The Court's opinion does not require the Commission to reopen the record to allow the submission of new evidence, but rather gives the Commission the flexibility to reconsider the evidence already provided and, based on that evidence, determine if a need for contract modification has been demonstrated. However, the Commission has determined it appropriate to reopen the record to allow the parties an

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[30] *Id.* at 2750.

[31] *Id.* at 2751.

[32] *Id.* at 2750.

[33] *Id.*

[34] *See, e.g., Nevada Power Co.*, 99 FERC ¶ 61,047, at 61,193 (2002).

[35] As discussed above, the Commission notes that numerous parties have requested settlement procedures. The Commission's Dispute Resolution Service has contacted the parties to explore the possibility of settlement.

additional opportunity to present evidence of whether the seller under a particular contract at issue in this proceeding engaged in unlawful spot market activity and whether there is a "causal connection" between that seller's alleged unlawful spot market activity and its negotiations with the buyer under that contract.[36]

18. In addition, the appeal process in this matter has been lengthy. Five years have passed since the Commission denied the complaints. The parties now have access to a large amount of data on how market prices and consumer rates changed, or did not change, over those five years. Thus, given this matter's unique circumstances, as discussed below, we will also reopen the record to allow parties to present the "down-the-line" evidence referred to by the Court.[37]

### B. Down-the-Line Burden Imposed by the Contract

19. The Court found that "[t]he standard for a buyer's challenge must be the same, generally speaking, as the standard for a seller's challenge: The contract rate must seriously harm the public interest."[38] Thus, the Commission reopens the record for evidence on: (1) the difference "down the line" between having the contracts at issue in effect and not having them in effect; and (2) whether that difference seriously harms the public interest.[39] We note that the Court did not precisely define "down the line" but stated that "the Commission may have looked simply to whether consumers' rates increased immediately upon the relevant contracts going into effect, rather than determining whether the contracts imposed an excessive burden on consumers 'down the line,' relative to the rates they could have obtained (but for the contracts) after elimination of the dysfunctional market."[40] The Commission concludes 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.

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[36] *Morgan Stanley* at 2751.

[37] *Texas Railroad Comm'n*, 41 FERC ¶ 61,213 (1987) (considering new evidence); *Southwestern Pub. Serv. Co.*, 60 FERC ¶ 61,052 (1992) (reopening record); *but see PacifiCorp v. Reliant Energy Serv., Inc.*, 103 FERC ¶ 61,355 (2003) (denying request to reopen record).

[38] *Morgan Stanley* at 2747.

[39] *Id.* at 2750.

[40] *Id.*

20. A relevant factor in this down-the-line analysis is the cost of substitute power in the absence of the contracts. The Commission concludes that the appropriate measure of the cost of substitute power at a particular point in time in the duration of a contract is the actual market prices available at that time for comparable forward contracts. For those contracts with negotiated non-rate terms, parties should provide evidence on how to account for those non-rate terms in establishing a market price for substitute power.

21. Further, while evidence of the difference between market prices and the contract price is important, it is not dispositive. Buyers attempting to demonstrate an excessive burden on consumers must submit evidence on: (1) given the contract, what consumers' rates were; (2) what consumers' rates would have been down the line in the absence of the contract; and (3) how the difference imposes an excessive burden on consumers. The Court emphasizes that the impact on consumers is a key element of this analysis.[41]

22. A buyer attempting to demonstrate that a contract impairs its ability to continue to provide service must submit evidence on: (1) the down-the-line costs of the contract that are borne by the buyer and not passed through to consumers; and (2) how those costs impair the buyer's ability to continue to provide service.

23. As stated above, the "down the line" burden should be measured by actual market data up to the date of the issuance of this order or (if the contract has expired) through the life of the contract. Further, the parties should submit actual data and not speculation or modeling when presenting evidence.[42]

### C. Spot Market Manipulation

24. The Court found, "the mere fact of a party's engaging in unlawful activity in the spot market does not deprive its forward contracts of the benefit of the *Mobile-Sierra* presumption. . . . Where, however, causality has been established, the *Mobile-Sierra* presumption should not apply."[43] Thus, the Commission reopens the record for evidence on: (1) whether the seller under a particular contract at issue in this proceeding engaged in unlawful market activity (violations of relevant Commission tariffs, rules or regulations governing markets, in effect at the time) in the spot market; and, if so (2)

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[41] *Id.*

[42] The Commission reiterates that parties should demonstrate the cost of comparable forward contracts, not simply available spot market prices.

[43] *Morgan Stanley* at 2751.

whether such activity had a direct effect on the negotiations of the contract at issue (i.e., a causal connection between an unlawful activity and the terms of the contracts).

25. Whether any of the sellers in this case engaged in unlawful market activity in the spot market must be determined based on the relevant laws, regulations, orders, and tariffs in effect at the time of the Western energy crisis. The Western energy crisis predated, and, in fact, was one of the motivations for the anti-manipulation provisions of the Energy Policy Act of 2005.[44] Further, at the time of the crisis, neither the Commission's regulations nor its grants of market-based-rate authority contained market behavior rules prohibiting market manipulation or defining prohibited market manipulation.[45] However, there was a provision in the then-current CAISO and CalPX tariffs, known as the Market Monitoring and Information Protocol or "MMIP," that addressed "gaming" and "anomalous market behavior." The MMIP bars all participants in the CAISO and CalPX markets from engaging in gaming or anomalous behavior in those markets.[46] Moreover, the Commission has provided guidance on the categories of

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[44] Pub. L. No. 109-58, § 1283, 119 stat. 594 (2005) (adding new section 222 to the FPA).

[45] This situation, in fact, lead the Commission to act after the Western energy crisis to address market behavior more directly. *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 105 FERC ¶ 61,218 (2003), *reh'g denied* 107 FERC ¶ 61,175 (2004) (adding market behavior rules to all market based rates tariffs); *see also Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 114 FERC ¶ 61,165, *reh'g denied* 115 FERC ¶ 61,053 (2006) (rescinding some of the rules and removing other rules from the tariffs as they were included in Order No. 670, which codified the EPAct anti-manipulation authority).

[46] Order to Show Cause Concerning Gaming and/or Anomalous Market Behavior, *American Electric Power Service Corp.* 103 FERC ¶ 61,345, at P 19 (2003), *order on reh'g*, 106 FERC ¶ 61,020 (2004) (Gaming Order). Section 2.1.3 of the MMIP defined "gaming" as:

> Taking unfair advantage of the rules and procedures set forth in the PX or ISO Tariffs, Protocols or Activity Rules, or of transmission constraints in periods in which exist substantial Congestion, to the detriment of the efficiency of, and of consumers in, the ISO Markets. "Gaming" may also include taking undue advantage of other conditions that may affect the availability of transmission and generation capacity, such as loop flow, facility outages, level of hydropower output or seasonal limits on energy imports from out-of-state, or actions or behaviors that may otherwise render

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activities occurring at the time of the crisis that constituted gaming and anomalous behavior in violation of the MMIP.[47] These categories are: withholding of generation, both economic and physical;[48] False Import;[49] Cutting Non-Firm;[50] Circular

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> the system and the ISO Markets vulnerable to price manipulation to the detriment of their efficiency.
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> *See id*. P 17
>
> Section 2.1.1 of the MMIP defined "anomalous market behavior" as:
>
> [B]ehavior that departs significantly from the normal behavior in competitive markets that do not require continuing regulation or as behavior leading to unusual or unexplained market outcomes. Evidence of such behavior may be derived from a number of circumstances, including: withholding of Generation capacity under circumstances in which it would normally be offered in a competitive market; unexplained or unusual redeclarations of availability by Generators; unusual trades or transactions; pricing and bidding patterns that are inconsistent with prevailing supply and demand conditions, e.g., prices and bids that appear consistently excessive for or otherwise inconsistent with such conditions; and unusual activity or circumstances relating to imports from or exports to other markets or exchanges.
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> *See id*. P 18.

[47] *See id*. P 37-60; *Investigation of Anomalous Bidding Behavior and Practices in the Western Markets*, 103 FERC ¶ 61,347, at P 2 (2003) (Withholding Order).

[48] With regard to economic withholding the Commission has previously determined sellers' bids into the CAISO and CalPX markets above $250 per MW to warrant investigation under MMIP. Withholding Order at P 3.

[49] This practice took advantage of the price differentials that existed between the day-ahead or day-of markets and out-of-market sales in the real-time market. A market participant made arrangements to export power purchased in the California day-ahead or day-of markets to an entity outside the state and to repurchase the power from the out-of-state entity, for which the out-of-state-entity received a fee. The "imported" power was then sold in the California real-time market at a price above the cap. Gaming Order at P 37.

[50] This practice involved the scheduling of non-firm power by a market participant that did not intend to deliver or could not deliver the power. Upon receipt of the congestion payment for cutting the schedule, the market participant then canceled the non-firm power after the hour-ahead market closed but kept the congestion payment. *Id.* P 42.

Scheduling;[51] Scheduling Counterflows on Out-of-Service Lines;[52] Load Shift;[53] Paper Trading;[54] Double Selling;[55] and Selling Non-Firm Energy as Firm.[56] For purposes of

[51] This practice involved the market participant scheduling a counterflow in order to receive a congestion relief payment. In conjunction with the counterflow, the market participant scheduled a series of transactions that included both energy imports and exports into and out of the CAISO control area and a transaction outside the CAISO control area in the opposite direction of the counterflow back to the original place of origin. With the same amount of power scheduled back to the point of origin, however, power did not actually flow and congestion was not relieved. *Id*. P 43.

[52] This practice involved a market participant submitting a schedule across an intertie line at the CAISO border that was known to be out of service and had been derated to zero capacity, thus creating artificial congestion. The market participant would then schedule a counterflow export, a "wheel out," and be paid for congestion relief in the day-ahead or hour-ahead market. However, because the line was completely constrained, the initial schedule was certain to be cut by the CAISO in real time and the market participant would receive a congestion payment for energy it did not actually supply. *Id.* P 44.

[53] This practice involved a market participant underscheduling load in one zone in California and overscheduling load in another, thereby increasing congestion in the direction of the overscheduled zone. Congestion "relief" occurred when the market participant later adjusted the two schedules to reflect actual expected loads. This adjustment created a counterflow toward the underscheduled zone, earning the market participant a congestion relief payment from the CAISO. The market participant had to own Firm Transmission Rights (FTRs) in the direction of the overscheduled zone to cover its exposure to CAISO congestion charges, but any of the FTRs that it did not use may have earned artificially high FTR payments from the CAISO. *Id*. P 45.

[54] This practice involved selling ancillary services in the day-ahead market even though the market participant did not have the required resources available to provide the ancillary services. The market participant then bought back these ancillary services in the hour-ahead market at a lower price. *Id.* P 49.

[55] This practice involved selling ancillary services in the day-ahead market from resources that were initially available, but later selling those same resources as energy in the hour-ahead or real-time markets. *Id.* P 50.

[56] This practice involved buying non-firm energy from outside California and then selling it to the CAISO as firm energy. *Id.* P 54.

this remand, these are the categories of behavior that could constitute "unlawful activity." Buyers in this proceeding who allege unlawful spot market manipulation by a particular seller therefore may submit any evidence with respect to these categories of MMIP violations.[57] Any party that wishes to rely on evidence previously submitted to the Commission must resubmit the evidence.

26. The Commission has also recognized that behavior that on its face appears to fall into one of the categories listed above is not a violation of the MMIP if there was a legitimate explanation for the behavior. The Commission explained:

> In this context, the Commission considers legitimate business behavior to be actions consistent with appropriate behavior in a competitive market, *i.e.*, actions taken to further a firm's business objectives but not involving manipulative, illegal, or otherwise anticompetitive acts. Engaging in manipulation, for example, in order to maximize profits, is not legitimate business behavior.[58]

27. The Commission has also provided examples of evidence that could establish a legitimate business explanation for transactions that appear to constitute False Imports,[59]

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[57] The Gaming Order noted that although Underscheduling Load and Overscheduling Load both technically violate the MMIP, Underscheduling Load had the effect of reducing power prices rather than increasing the profits of the entities that engaged in the strategy, and Overscheduling Load actually helped reduce reliability problems in the real-time market. *Id.* P 56-60. Therefore, the Commission decided it was inappropriate to seek disgorgement of profits for these two practices. Similarly, the Commission concludes that such practices do not, by themselves, constitute unlawful manipulation for purposes of this case.

[58] Withholding Order P 13 at n.15.

[59] Relevant evidence includes demonstrations that: (a) the "imported" power was actually imported from outside the state of California and not a fictitious import, i.e., not an export and import that constitutes a False Import, as described above; (b) the transaction was designed to work around a transmission constraint (such as on Path 15) which limited the movement of power between two points within the CAISO control area by using an uncongested transmission path (such as the Pacific DC intertie) to move the power to a point outside the CAISO control area and back to its intended destination; (c) the export and import were actually two independent and unrelated obligations such as a pre-existing long-term bilateral contractual export obligation followed by a real-time import from the same party in an unrelated transaction; or (d) the market participant was importing power on behalf of the CAISO or California Department of Water Resources

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Cutting Non-Firm,[60] and Paper Trading or Double Selling.[61] Sellers accused of unlawful manipulation in this case may submit evidence that the activity in question was, in fact, legitimate business behavior.

28. With regard to the showing of a causal connection, the Court stated that such evidence must demonstrate that the seller's behavior "directly affect[ed]" contract negotiations.[62] Thus, buyers presenting such evidence must demonstrate that a particular seller engaged in unlawful manipulation in the spot market and that such manipulation directly affected the particular contract or contracts to which the seller was a party.[63] Based on the Court's guidance on *Mobile-Sierra*, analysis of a generic link between the dysfunctional spot market and the forward markets is not adequate to establish a causal connection between a particular seller's alleged unlawful activities and the specific contract negotiations.[64]

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(CDWR), because suppliers were unwilling to assume the credit risk of dealing directly with the CAISO or CDWR. Gaming Order at P 67.

[60] Relevant evidence includes a demonstration that any energy that was scheduled, but did not flow was due to circumstances beyond the control of the market participant and without prior knowledge by the market participant that the energy would not flow. *Id.* P 68.

[61] Relevant evidence includes demonstrations that: (a) the resources to provide the ancillary services sold in the day-ahead market were actually available to the bidder; (b) ancillary services payments were not received for capacity that was not available to provide ancillary services, or (c) the CAISO requested that the market participant provide energy in the real-time market even though it knew that such energy was being held for ancillary services previously sold to the CAISO. *Id.*

[62] *Morgan Stanley* at 2750.

[63] The Nevada Attorney General's Answer argues that a recent decision of the United States Court of Appeals for the District of Columbia Circuit, precludes the application of the *Mobile-Sierra* presumption of justness and reasonableness to Nevada Consumer Protection's challenges to the contracts. Nevada Attorney General's Answer at 4 (citing *Maine Pub. Utils. Comm'n v. FERC*, 520 F.3d 464, 478 (D.C. Cir. 2008), *reh'g denied, Maine Pub. Utils. Comm'n v. FERC*, Docket No. 06-1403, *et al.*)). The Commission finds that, in establishing the additional procedures discussed herein, it is premature to address this issue.

[64] We note that Staff findings in the March 2003 Staff Report alone are insufficient

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### D. Paper Hearings[65]

29. A trial-type evidentiary hearing is not necessary for us to decide the two questions on which the Court directed us to amplify or clarify our previous findings.[66] Rather, a

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to establish the necessary causal connection.

[65] In directing this paper hearing, we remind parties that this order concerns only those contracts at issue in *Morgan Stanley*. *Sempra* and *Dynegy* matters both involved the Ninth Circuit's remand of the Commission's denial of complaints by the California Public Utilities Commission (CPUC) and the California Electricity Oversight Board (CEOB) to abrogate or modify contracts signed by the CDWR. *Sempra Generation, et al. v. Pub. Util. Comm'n of the State of California, et al.* 128 S. Ct. 2993 (2008); *Dynegy Power Mktg., Inc., et al. v. Pub. Util. Comm'n of the State of California, et al.* 128 S. Ct. 2993 (2008) (orders summarily vacating and remanding) (*Sempra* and *Dynegy*). The Court granted the petitions for certiorari, vacated the judgment of the Ninth Circuit, and remanded the case "for further consideration in light of" *Morgan Stanley*. In its original decision, the Ninth Circuit declined to address the issue of whether CPUC and CEOB, as complainants but not buyers, should be held to the same standard as the actual buyer, CDWR. The Ninth Circuit recently issued the mandate in those cases, and the Commission will issue a separate order addressing those cases at a later date. Therefore, this order does not address *Sempra* and *Dynegy*.

[66] In its answer, Golden State contends that its claims were not before the Court because no party filed a certiorari petition seeking review of the Ninth Circuit's judgment granting Golden State's petition for review. Golden State Answer at 12. Thus, Golden State claims that the Court's remand on the two issues of: (1) the "down the line" burden; and (2) whether unlawful activities in the spot market affected any of the contracts that are at issue "did not decide or even suggest that those are the only issues to be considered by the Commission upon the Ninth Circuit's remand[.]" *Id*. at 2. Therefore, Golden State maintains that its case presents additional issues, including the effect to be given to the Commission's December 2000 order adopting remedies for the California energy crisis. *Id*. at 2-3. The Commission disagrees with Golden State's position. When the Ninth Circuit sent this matter back to the Commission it ordered, "In light of the Supreme Court's ruling. . . we vacate our prior opinion and remand to the Federal Energy Regulatory Commission for further proceedings consistent with the Supreme Court's opinion." *Pub. Util. Dist. No. 1 of Snohomish County v. FERC*, 2008 U.S. App. LEXIS 23290 (9th Cir. Nov. 3, 2008). Therefore, the Ninth Circuit vacated its order, and the Commission will conduct its proceedings consistent with the Court's order. The Court's order concerned two issues, and therefore those are the two issues we address here.

(continued…)

paper hearing will allow the parties to supplement the already voluminous record.[67] Accordingly, we will allow the parties to file evidence as directed above.[68] Parties may include explanatory briefing to accompany the evidence.

30. The Commission will allow both buyers and sellers under the contracts at issue to supplement the record as described in detail above.[69]

31. The Commission emphasizes that this process is not an opportunity for parties to indiscriminately resubmit evidence already in the record in a blanket fashion. All

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[67] The use of a paper hearing rather than a trial-type evidentiary hearing has been addressed in several cases. *See, e.g.*, *Pub. Serv. Co. of Indiana*, 49 FERC ¶ 61,346 (1989), *order on reh'g*, 50 FERC ¶ 61,186, *opinion issued*, Opinion No. 349, 51 FERC ¶ 61,367, *order on reh'g*, Opinion No. 349-A, 52 FERC ¶ 61,260, *clarified*, 53 FERC ¶ 61,131 (1990), *dismissed*, *Northern Indiana Pub. Serv. Co. v. FERC*, 954 F.2d 736 (D.C. Cir. 1992). As the Commission noted in Opinion No. 349, 51 FERC at 62,218-19 & n.67, while the FPA and case law require that the Commission provide the parties with a meaningful opportunity for a hearing, the Commission is required to reach decisions on the basis of an oral, trial-type evidentiary record only if the material facts in dispute cannot be resolved on the basis of the written record, i.e., where the written submissions do not provide an adequate basis for resolving disputes about material facts.

[68] In Snohomish's recent Answer and Cross Motion, filed in response to Morgan Stanley and Mirant's Motion for Implementation of Remand Procedures, Snohomish proposes that the Commission proceed immediately to the remedy phase in this matter. Snohomish Answer at 15. The Commission finds that such an approach would be inconsistent with the Court's directive for the Commission to amplify or clarify the two issues discussed above. Therefore, the Commission rejects Snohomish's proposal to move directly to a remedies hearing.

[69] We understand that NV Energy may have reached settlement with some of the respondents since this case was appealed. We direct NV Energy in its brief to identify any such respondents and clarify the contracts that are still at issue. Also, we understand that parties in this matter may have been involved in bankruptcy proceedings during the course of the contracts at issue. We direct the parties to these contracts to identify any contracts that were addressed in the bankruptcy proceeding and explain the effect of the bankruptcy proceedings on the contracts. *See, e.g.*, January 3, 2008 Notice of Approval of Settlement by the United States Bankruptcy Court for the Southern District of New York, Docket Nos. ER07-1409-000, EL02-30-000, TX07-2-000.

submissions should pertain directly to the specific issues discussed above. Also, the Commission requests that if any party intends to rely on any evidence that was originally filed as "privileged" or "protected," when the party submits such evidence to the Commission, consider whether such privilege or protection is still necessary. Given the length of time that has passed since the documents were originally submitted, such status may no longer be appropriate.

32. Because expeditious resolution of this issue is desirable, we establish a submission deadline of 90 days from the date of this order. Reply submissions may be filed 90 days thereafter. The Commission is simply reopening its record to supplement its investigation as discussed above. For this reason, interested parties should limit their comments and not repeat arguments previously considered by the Commission. The Commission is setting a page limit for any briefs to 75 pages for initial briefs and 50 pages for replies (excluding evidentiary attachments).

33. As mentioned above, the Commission strongly encourages all parties in this matter to settle their disputes. Accordingly, we will hold the paper hearing in abeyance to allow the parties either to begin settlement discussions or to explore the possibility of settlement discussions. The Commission directs the Director of its Dispute Resolution Service (DRS) to continue to meet with the parties to determine whether they can agree to a process to foster negotiation and eventual agreement on the matters at issue.[70] If any parties to a contract at issue agree that they would rather participate in more formal settlement negotiations, they should inform the Chief ALJ, and the Chief ALJ will appoint a Settlement Judge.[71] If the parties desire, they may, by mutual agreement, request a specific judge as a Settlement Judge in the proceeding; otherwise the Chief Judge will select a judge for this purpose.[72]

34. With respect to settlement discussions that remain with the Director of DRS, we direct the Director of DRS to submit a progress report to the Commission on the parties' progress toward settlement within 30 days of the issuance of this order and every 30 days thereafter. Based on this report, the parties shall continue their settlement discussions or

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[70] 18 C.F.R. § 385.604 (2008).

[71] *Id*. at § 385.603.

[72] If the parties decide to request a specific judge, they must make their request to the Chief Judge by telephone at 202-502-8500 within five days of opting for formal settlement procedures. The Commission's website contains a listing of Commission judges and a summary of their background and experience (www.ferc.gov - click on Office of Administrative Law Judges).

the Commission will provide for the commencement of the paper hearings discussed above. With respect to matters that are referred to a Settlement Judge, the Settlement Judge shall report to the Chief Judge and the Commission within 30 days of appointment of the Settlement Judge concerning the status of settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions or provide for the commencement of the paper hearings discussed above.

The Commission orders:

(A) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by the FPA, particularly section 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R. Chapter I), the further proceedings directed in Ordering Paragraphs (B) – (C) below shall be conducted concerning the issues described in the body of the order.

(B) The parties to this proceeding are hereby directed to file evidence, as discussed in the body of this order, within 90 days of the termination of that party's settlement discussions. A party's submission should include explanatory briefs and shall include any and all exhibits, affidavits, and/or prepared testimony. All materials must be verified and subscribed as set forth in 18 C.F.R. § 385.2005 (2008).

(C) The parties to this proceeding may also file reply comments addressing the submissions filed by other parties in accordance with Ordering Paragraph (B) above, in the same format as described in Ordering Paragraph (B) above, within 90 days of the date of filing of initial briefs.

(D) Filings seeking certain hearing procedures are denied in part and accepted in part, as discussed above. To the extent the requested hearing procedures differ from those outlined above they are denied and to the extent the requested hearing procedures conform to the procedures outlined above they are accepted.

(E) The hearing shall be held in abeyance to provide time for settlement discussions, as discussed in Ordering Paragraphs (F) - (H) below.

(F) This proceeding is hereby referred to the Commission's DRS to continue bilateral, contract-specific settlement discussions. Within 30 days of the date of issuance of this order, the Director of DRS shall file a report with the Commission on the status of discussions and shall file updated reports every 30 days thereafter for matters that remain with the director of DRS. Based on this report, the parties shall continue their settlement discussions or the Commission will provide for the commencement of the paper hearings

discussed above.

(G) If parties to the contracts at issue agree to request the appointment of a Settlement Judge, then, pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2008), the Chief Administrative Law Judge is hereby directed to appoint a Settlement Judge in this proceeding to conduct settlement proceedings on a bilateral, contract-specific basis. Such Settlement Judge shall have all the powers and duties enumerated in Rule 603 and shall convene a settlement conference as soon as practicable after the Chief Judge designates the Settlement Judge. If the parties decide to request a specific judge, they must make their request to the Chief Judge in writing or by telephone within five days of opting for settlement judge procedures.

(H) Within 30 days of appointment, the Settlement Judge shall file a report with the Commission and the Chief Judge on the status of the settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions, or provide for the commencement of the paper hearings discussed above. If settlement discussions continue, the Settlement Judge shall file a report at least every 30 days thereafter, informing the Commission and the Chief Judge of the parties' progress toward settlement.

By the Commission.

( S E A L )

Nathaniel J. Davis, Sr.,
Deputy Secretary.