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**UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

**Nos. 03-72522, *et al.*
(consolidated with Case No. 04-72781)**

**PACIFICORP,
PETITIONER,**

v.

**FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.**

**ON PETITION FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION**

**BRIEF OF RESPONDENT
FEDERAL ENERGY REGULATORY COMMISSION**

**CYNTHIA A. MARLETTE
GENERAL COUNSEL**

**DENNIS LANE
SOLICITOR**

**LONA T. PERRY
ATTORNEY**

**FOR RESPONDENT
FEDERAL ENERGY REGULATORY
COMMISSION
WASHINGTON, D.C. 20426**

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**BRIEF OF RESPONDENT
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STATEMENT OF THE ISSUE

Whether the Commission reasonably denied complaints seeking to modify contracts upon finding that Petitioners failed to meet the *Mobile-Sierra* public interest standard or to demonstrate any other grounds to justify abrogation.

STATUTORY AND REGULATORY PROVISIONS

The pertinent statutes and regulations are contained in the Addendum to this brief.

STATEMENT OF JURISDICTION

Respondent agrees with Petitioner's Statement of Jurisdiction.

STATEMENT OF THE CASE

I. Nature of the Case, Course of Proceedings, and Disposition Below

PacifiCorp filed complaints at FERC against certain sellers from whom PacifiCorp had purchased electric energy under bilateral contracts. The complaints alleged that dysfunctions in the California electricity spot markets caused the bilateral forward contracts complained of to be unjust and unreasonable, and sought the extraordinary remedy of contract modification. In *PacifiCorp v. Reliant Energy Servs. Inc.*, 99 FERC ¶ 61,381 (2002) ("June 2002 Order"), ER 166, the Commission set the complaints for hearing, including the issue of whether PacifiCorp must meet the *Mobile-Sierra*¹ public interest standard to obtain contract modification.

After the hearing, the Administrative Law Judge ("ALJ") concluded that the contracting parties intended the *Mobile-Sierra* standard to apply in these circumstances, and that PacifiCorp failed to meet its burden under that standard. *PacifiCorp v. Reliant Energy Servs. Inc.*, 102 FERC ¶ 63,030 (2003) ("Initial Decision" or "ID"), ER 1285. The Commission affirmed the ALJ's decision,

¹ *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) ("*Mobile*"); *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) ("*Sierra*") (collectively "*Mobile-Sierra*").

PacifiCorp v. Reliant Energy Servs. Inc., 103 FERC ¶ 61,355 (2003) (“Order on Initial Decision” or “OID”), ER 1494, and denied rehearing, *PacifiCorp v. Reliant Energy Servs. Inc.*, 105 FERC ¶ 61,184 (2003) (“Rehearing”), ER 1575. The Rehearing Order also determined that, as there was no ongoing harm and the past impact of the contracts was at most minimal, the Commission would exercise its discretion to decline enforcement or remedy even if PacifiCorp could establish that its contract rates were unjust and unreasonable.

This appeal followed.

II. Statement of Facts

A. Statutory and Regulatory Background

The Federal Power Act (“FPA”), 16 U.S.C. § 824, *et seq.*, gives FERC jurisdiction over the rates, terms, and conditions of service for the transmission and sale at wholesale of electric energy in interstate commerce. FPA § 206(a), 16 U.S.C. § 825e(a), provides that, whenever the Commission, after a hearing had upon its own motion or upon complaint, finds an existing rate “unjust, unreasonable, unduly discriminatory or preferential,” the Commission shall determine the just and reasonable rate to be thereafter in force. The Commission or the complainant has the burden of proof in any § 206 proceeding. 16 U.S.C. § 824e(b).

The *Mobile-Sierra* doctrine further defines what contract rates may be changed. Under *Mobile-Sierra*, where parties have negotiated a contract that sets fixed prices and denies either party the right to change such prices unilaterally, FERC may abrogate or modify the contract only if the public interest so requires. See *Texaco Inc. v. FERC*, 148 F.3d 1091, 1095 (D.C. Cir. 1998); *Metropolitan Edison Co. v. FERC*, 595 F.2d 851, 855 (D.C. Cir. 1979).

B. The Crisis in California Spot Markets²

In 1996, the California legislature restructured the State's power industry. See *In re: California Power Exch. Corp.*, 245 F.3d 1110, 1114 (9th Cir. 2001) ("*CalPX*"). That legislation created the California Power Exchange Corporation ("*CalPX*") and California Independent System Operator ("*CAISO*"). The *CalPX* administered a single-price auction market for day-ahead and day-of electricity trading. See *CalPX*, 245 F.3d at 1114. The *CAISO* operates the California transmission grid and administers a real-time imbalance market to ensure that supply meets demand at the time of delivery. *Id.* at 1115.

California required the three largest California investor-owned utilities ("*IOUs*") to divest substantial portions of their generation facilities, and froze the

² Spot market sales are sales for services lasting 24 hours or less, entered into the day of or day prior to delivery. Forward contracts are supply contracts for future delivery of a fixed quantity of power at a predetermined price, directly negotiated between buyer and seller.

IOUs' retail rates. *Id.* at 1114-15. To promote the CalPX spot market, the IOUs were required to bid their generation into and buy their requirements from the CalPX. *Id.*

In the summer of 2000, wholesale electricity prices in California increased significantly, particularly in the CalPX spot markets. *Id.* at 1115. On July 26, 2000, FERC instituted an investigation that identified three major factors contributing to the high spot market prices: (1) market fundamentals, such as significantly increased power production costs, increased demand due to unusually high temperatures, and a scarcity of available generation resources; (2) over-reliance on the spot markets as a result of the CPUC requirement that IOUs buy and sell through the CalPX; and (3) the possible exercise of market power at certain times in the spot markets. *San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.*, 93 FERC ¶ 61,121 at 61,354-55, 61,359 (2000) (“November 1 Order”).

The confluence of these factors caused “unjust and unreasonable rates for short-term energy (Day-Ahead, Day-of, Ancillary Services and real-time energy sales) under certain conditions.” *Id.* at 61,349-50. To remedy this situation, FERC instituted mitigation measures, including eliminating the requirement that IOUs buy and sell through the CalPX. *San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.*, 93 FERC ¶ 61,294 at 61,195 (2000) (“December 15 Order”).

The Commission, however, denied requests to extend market mitigation measures into the forward contract market because it was not found to be similarly flawed. *San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.*, 97 FERC ¶ 61,275 at 62,245 (2001) (“December 19 Order”).

C. PacifiCorp’s Contracts

In April, May and June of 2001, PacifiCorp executed contracts for 90-day delivery of power at fixed prices that reflected generally prevailing market prices. Rehearing ¶ 8, ER 1576; OID ¶ 16, ER 1496; ID ¶ 2, ER 1286. The contracts were brokered transactions, *i.e.*, a broker matched bids and offers between the parties, who did not negotiate face-to-face. ID ¶ 3, ER 1286. The contracts involved 6x16 blocks of power at 25 MW apiece, for delivery in June, July and August of 2002, some 12 to 14 months after execution of the contracts. *Id.* A 6x16 block was a standard product in the forward markets at the time, providing for delivery during the 16 heavy load hours of the day, *i.e.* daylight hours, six days per week, Sundays and holidays excepted. *Id.* The product was purchased generally by load serving entities that needed additional supplies for peak periods. *Id.* In seeking the brokered 6x16 packages, PacifiCorp followed its long-standing practice of varying the number of blocks purchased based upon the prices being offered in the market at the time, in an attempt to “dollar average” its peak power. *Id.* ¶ 4, ER 1287.

None of the contracts went to physical delivery. ID ¶ 6, ER 1287. Shortly after the confirmation of the last of the contracts, *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 95 FERC ¶ 61,418 (2001) (“June 19 Order”), imposed price mitigation on the spot market throughout the West. *Id.* ¶ 7; Rehearing ¶ 12, ER 1577. In general, the mitigated prices were lower than the prices PacifiCorp had agreed to pay, and drove down prevailing market prices. ID ¶ 7, ER 1287. As a result, on May 2, 2002, PacifiCorp filed complaints seeking to modify certain of its contracts, alleging that the dysfunctions in the California spot markets caused those contracts, negotiated in the bilateral markets, to be unjust and unreasonable.

D. The Challenged Orders

1. The Order Setting PacifiCorp’s Complaints for Hearing

The Commission’s “long-standing policy, consistent with a substantial body of Supreme Court and other judicial precedent, has been to recognize the sanctity of contracts.” June 2002 Order ¶ 25, ER 171. “Preservation of contracts has, if anything, become even more critical since the policy was first adopted. Competitive power markets simply cannot attract the capital needed to build adequate generating infrastructure without regulatory certainty, including certainty that the Commission will not modify market-based contracts unless there are *extraordinary* circumstances.” *Id.* (emphasis in original).

However, given the circumstances here, FERC set PacifiCorp’s complaints for hearing on the issue of “whether the dysfunctional California spot markets adversely affected the long-term bilateral markets, and, if so, whether modification of any individual contract at issue is warranted.” *Id.* ¶ 26, ER 171. The Commission also set for hearing whether the contracts should be reviewed under the just and reasonable or the *Mobile-Sierra* standard. *Id.* ¶ 27, ER 171.

Under *Mobile-Sierra*, where parties contract for a particular rate and do not reserve a right to propose a rate change unilaterally, FERC cannot supersede that contract rate unless required by the public interest. *See, e.g., Boston Edison Co. v. FERC*, 233 F.3d 60, 64-65 (1st Cir. 2000). The challenged contracts were one-page confirmations that incorporated by reference the terms of either the standardized master contract developed by the Edison Electric Institute (the “EEIA”), or one developed by the Western Systems Power Pool (“WSPPA”). Rehearing ¶ 11, ER 1577; ID ¶ 3, ER 1286. The EEIA master contract is silent on the issue of the standard of review. *Id.* ¶ 19, ER 1289-90. Section 6.1 of the WSPPA master contract provides:

Nothing contained herein shall be construed as affecting in any way the rights of the Parties to jointly make application to FERC for a change in the rates and charges, classification, service, terms or conditions affecting WSPP transactions under Section 205 of the Federal Power Act and pursuant to FERC rules and regulations promulgated thereunder.

Id.

2. The Order on Initial Decision

a. The *Mobile-Sierra* Standard Applies

The ALJ concluded that *Mobile-Sierra* applied to the contested contracts, and that PacifiCorp failed to meet its burden under that standard. ID ¶¶ 19, 36, ER 1289-90, 1294. The Commission affirmed the ALJ. OID ¶¶ 3-4, ER 1494.

While WSPPA § 6.1 allows parties jointly to seek modification of the rates, terms, and conditions of the contracts under FPA § 205, 16 U.S.C. § 824d, it does not expressly address parties' unilateral rights to seek an FPA § 206 rate change. *Id.* Nonetheless, the reference to a “joint” § 205 filing demonstrates that the parties considered and addressed filing rights, evidencing an intent that neither seller nor buyer retained filing rights other than the joint § 205 filing right specified, and therefore *Mobile-Sierra* applied. OID ¶ 29, ER 1498-99.

As the EEIA was silent on the issue of the applicable standard for a contract change, PacifiCorp had the burden to present evidence on the parties' intent, but failed to offer extrinsic evidence on this point. OID ¶ 30, ER 1499. Based on the record evidence that showed the contracts at issue were firm, short-term, 90-day arrangements made through third-party brokers, the Commission concluded that the parties intended the *Mobile-Sierra* standard to apply. *Id.* “[I]n that context, it could hardly have occurred to either PacifiCorp or any of the Respondents that it, or its counterparty, might apply to the Commission for a change in the contract

prices.’” *Id.* (quoting ID ¶ 17, ER 1289). Thus, the public interest standard applied to the challenged contracts entered into under the EEIA. *Id.*

PacifiCorp contended that *Mobile-Sierra* did not apply because FERC had not previously reviewed and determined the market-based rate contracts at issue to be just and reasonable. *Id.* ¶ 32, ER 1499. That contention ignores, however, FERC’s initial review under FPA § 205 to determine whether a seller lacks market power or has taken steps to mitigate it. Only after such a showing does FERC authorize a seller to make sales at market-based rates, pre-determining that competition will keep future rates in a just and reasonable range. *Id.*, ER 1499-1500 (citing *State of Cal. ex rel. Lockyer v. British Columbia Power Exch. Corp.*, 99 FERC ¶ 61,247 at 62,063, *on reh’g*, 100 FERC ¶ 61,295 (2002), *aff’d in part, remanded in part*, *Lockyer v. FERC*, 383 F.3d 1006 (9th Cir. 2004) (“*Lockyer*”).

b. The *Mobile-Sierra* Standard Was Not Met

PacifiCorp alleged that contract modification was warranted because its contracts were the product of dysfunctions in the CAISO and CalPX spot markets. OI D ¶ 33, ER 1500. To assess PacifiCorp’s claims, the hearing addressed whether the dysfunctional spot markets adversely affected the forward contract markets and, if so, whether modification of PacifiCorp’s challenged contracts was warranted. *Id.*

The Commission’s assessment relied on not only the evidentiary record in this proceeding, but also the findings of the Staff Report³ and evidence submitted in the 100-Day Discovery Proceeding.⁴ *Id.* ¶ 61, ER 1504. The Staff Report found that spot market distortions influenced forward power prices, particularly those for contracts of one to two years time to delivery, and the Staff Report and the 100-Day Discovery Proceeding evidence suggested that the CAISO and CalPX markets were subjected to market manipulation. *Id.* However, even if that

³ The Commission Staff’s Final Report on Price Manipulation in Western Markets in Docket No. PA02-2-000 (“Staff Report”).

⁴ On November 20, 2002, 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 manipulation that may have occurred during the California energy crisis of 2000-2001 (the “100-Day Discovery Proceeding”). *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Serv.*, 101 FERC ¶ 61,186 (2002), *on reh’g*, 102 FERC ¶ 61,164 (2003).

evidence were assumed to establish that spot market dysfunctions caused forward prices to be unjust and unreasonable, that did not prove that these particular challenged contracts were contrary to the public interest. *Id.*

Here, PacifiCorp failed to demonstrate that any of the three public interest prongs announced in *Sierra*,⁵ or any other evidentiary factor, warranted a finding that any challenged contract should be modified as contrary to the public interest. *Id.* ¶ 62, ER 1504. No credible record evidence showed that the challenged contracts placed PacifiCorp in financial distress so as to threaten its ability to continue service, imposed an excessive burden on its customers, or were unduly discriminatory. *Id.* ¶ 63, ER 1504. PacifiCorp's estimates of its "out of market" costs associated with the challenged contract were not credible, and, even if they were, the negative impact of those costs on PacifiCorp and its customers did not justify abrogation of the contracts. *Id.* ¶ 64, ER 1504-05. The total amount of power involved in the challenged contracts represents only about one-half of one percent of PacifiCorp's portfolio. *Id.* Further, if PacifiCorp were able to pass these costs through to its ratepayers, the rate increase would amount to 1.5 percent,

⁵ In *Sierra* the Court stated that: "the sole concern of the Commission would seem to be whether the rate is so low as to adversely affect the public interest – as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory." 350 U.S. at 355.

1.8 percent and 2.7 percent for PacifiCorp's residential, commercial and industrial customers respectively. *Id.*

Far from being in financial distress, as reported by its ultimate shareholder, Scottish Power, PacifiCorp expected to double its operating profit to £ 1 billion or more within the next three years of the hearing. *Id.* ¶ 65, ER 1505. PacifiCorp's operating profit for the quarter ending September 30, 2002 was £ 141 million. *Id.* The challenged contracts had no effect on PacifiCorp's access to capital; its debt ratings, both for long-term and short-term debt, were average to above-average. *Id.* PacifiCorp also failed to show that the challenged contracts were unduly discriminatory. *Id.* ¶ 66, ER 1505.

In addition, FERC considered the totality of the circumstances surrounding the challenged contracts, but found no evidence supported contract modification. *Id.* ¶ 67, ER 1505. Sellers did not exercise market power, given that PacifiCorp's contracts were standard products arranged through third-party brokers, and, consequently, the sellers were price takers. *Id.* As the challenged contracts provided more energy than actually needed to serve its loads, PacifiCorp was able to sell the surplus on the forward market. *Id.* PacifiCorp sold power at wholesale to 98 different buyers during the relevant period, and sold for the period from December 2001 through April 2002 one-and-one-half times the total amount it purchased under the contracts at issue. *Id.* Indeed, PacifiCorp sold power to

intervenor-respondent Williams at prices ranging from \$150 to \$330/MWh, as compared to the challenged contract prices, ranging from \$126/MWh to \$262/MWh, with a weighted average price of \$181/MWh. *Id.* ¶ 68, ER 1505.

The challenged contracts fit into PacifiCorp's overall purchase pattern. From May 2000 until June 19, 2001, PacifiCorp purchased power from 80 different sellers, and made more than 250 forward contracts for delivery at prices that ranged from \$100 to \$570/MWh.⁶ *Id.* ¶ 70, ER 1505. Considering the number of sellers available and of purchases made, FERC reasonably inferred that PacifiCorp had choices, *i.e.* it was free to reject offers and turn to other suppliers. *Id.* The record showed further that PacifiCorp failed to hedge for the risk of lower spot market prices through portfolio diversification. *Id.* ¶ 69, ER 1505.

Finally, nothing in the record before the ALJ, in the Staff Report, or in the 100-Day Discovery Proceeding evidence supported a finding of market manipulation specific to the challenged contracts. *Id.* ¶ 72, ER 1506.

Therefore, the only ground for contract modification was PacifiCorp's dissatisfaction with its contracts. *Id.* ¶ 73, ER 1506. Such dissatisfaction does not render uneconomic contracts contrary to the public interest under the FPA. *Id.* (citing *Sierra*, 350 U.S. at 354-55; *Potomac Elec. Power Co. v. FERC*, 210 F.3d

⁶ Following Enron's bankruptcy and PacifiCorp's settlement with Morgan Stanley, there are now at issue nine contracts from three sellers.

403, 409 (D.C. Cir. 2000) (“*PEPCO*”); *Papago Tribal Auth. v. FERC*, 723 F.2d 950, 953 (D.C. Cir. 1983) (“*Papago*”). Because the record showed that the challenged transactions resulted from PacifiCorp’s voluntary choices, not from unfairness, bad faith or duress in the original negotiations, PacifiCorp was not entitled to change its bargains. *Id.*

3. The Rehearing Order

a. The *Mobile-Sierra* Standard Applies

On rehearing, the Commission reaffirmed that the public interest standard applied to any unilateral changes in the challenged contracts. “[W]here parties have negotiated a . . . contract that sets firm prices . . . and that denies either party the right to change such prices [] unilaterally, the Commission may abrogate or modify the contract only if the public interest so requires.” Rehearing ¶ 24, ER 1578 (quoting *Texaco*, 148 F.3d at 1095).

PacifiCorp and intervenor Public Utility District No. 1 of Snohomish County, Washington (“Snohomish”) reiterated the argument that the just and reasonable, rather than the public interest, standard must be applied because the market-based contracts at issue had not been previously reviewed by the Commission. Rehearing ¶ 25-26, ER 1578. However, nothing requires specific review of each market-based rate contract to assure that it is just and reasonable because FERC’s initial finding that a seller lacks or has mitigated market power in

the relevant market means competition will keep the seller's market-based rates in the just and reasonable range. *Id.* ¶ 27 ER 1578-79. Subsequently, if a party wishes to challenge a market-based rate contract entered into pursuant to market-based rate authority, the party must satisfy the public interest standard where the parties have not reserved the right to make unilateral changes to the contract. *Id.* ¶ 28, ER 1579. *Mobile-Sierra* was intended to avoid market uncertainty by preventing parties whose deals have become uneconomic from undoing them, absent a public interest justification. Nothing presented here warranted an exception to *Mobile-Sierra* simply because these were market-based contracts. *Id.*

While FERC's initial grant of market-based rate authority cannot assure that all rates the seller subsequently charges will be just and reasonable under all circumstances, FPA § 206 complaint procedures offer a means to address market-based rates that are no longer just and reasonable. *Id.* ¶ 30, ER 1579. Sellers with market-based rate authority are on notice that their transactions are subject to review and to prospective remedial action, including the possible loss of their market-pricing authority. *Id.* This remedial authority does not include contract abrogation where the contract is subject to *Mobile-Sierra* limitations. *Id.*

Here, there was no showing that the sellers exercised market power while selling under their market-based rate authorization. Thus, nothing supported modifying the limits on contract changes set in the challenged contracts. *Id.*

Although the Commission fulfills its FPA § 205 initial review obligation to assure just and reasonable rates when market-based rate authority is originally granted, *id.* ¶ 31, ER 1580, a *Mobile-Sierra* contract requires application of the public interest standard of review, whether or not the contract itself has ever previously been filed with or reviewed by FERC. Rehearing ¶ 32, ER 1580; OID ¶ 7 and n. 12, ER 1495 (citing *Richmond Power & Light v. FPC*, 481 F.2d 490, 493 (D.C. Cir. 1973); *Borough of Lansdale v. FPC*, 494 F.2d 1104, 1112 (D.C. Cir. 1974)). Consequently, the Commission under court precedent may not change a contract subject to *Mobile-Sierra* simply because it is no longer just and reasonable, but only where required by the public interest. *Id.* ¶ 31, ER 1580. Application of the public interest standard does not equate to a finding that the contract rates are unjust and unreasonable, and, here, no showing was made that the challenged contracts allowed unjust and unreasonable rates. Rehearing ¶ 31, ER 1580.

PacifiCorp contended that, because contractual silence with respect to the FPA § 206 standard of review meant there was no mutual intent as to what standard to apply, the just and reasonable standard governs. Rehearing ¶ 35, ER 1580. However, while the contracts were silent on the specific issue of a party's right to make changes under FPA § 206, the related contract language, as well as

evidence regarding the parties' intentions, show an intent that *Mobile-Sierra* apply. *Id.* ¶ 38, ER 1581.

As WSPPA § 6.1 allows parties jointly to seek rate changes under FPA § 205, it can be reasonably inferred that the parties intended to prohibit other filings, including unilateral filings by either party. *Id.* ¶ 41, ER 1581. That suffices to show waiver of PacifiCorp's § 206 rights. *Id.* ¶ 44, ER 1581-82.

PacifiCorp also asserted that the Commission erred in considering extrinsic evidence in interpreting the EEIA, as controlling New York law, specifically *Schmidt v. Magnetic Head Corp.*, 97 A.D. 2d 151 (N.Y. App. Div. 1983), prohibits resort to extrinsic evidence to supply terms where contracts are silent. Rehearing ¶ 47, ER 1582. However, while *Schmidt* held that new terms could not be read into a contract based upon extrinsic evidence, it did not speak to whether silence in a contract in a FERC-jurisdictional contract requires a public interest or just and reasonable standard (assuming *arguendo* that New York law would control on this point in any event). *Id.* ¶ 49, ER 1582. Thus, the Commission properly considered extrinsic evidence in evaluating the intent of the parties on the standard issue. *Id.* That evidence showed that, in entering into these firm, short-term commodities futures contracts, the parties would not have anticipated that one side might apply to the Commission for a rate change. *Id.* ¶ 50, ER 1583.

b. The *Mobile-Sierra* Standard Was Not Met

Under the three *Sierra* factors and the totality of the circumstances tests, PacifiCorp failed to show that contract modification was required in the public interest. *Id.* ¶ 53, ER 1583. No showing of fraud, duress or the exercise of market power raised concerns about the contract formation. *Id.* ¶ 55, ER 1584. PacifiCorp’s purported \$53 million “out-of-market” cost estimate was based on arbitrary assumptions, and therefore not credible, and, even if accurate, the negative effects on PacifiCorp or its customers were not sufficient to justify abrogation of the contracts. *Id.* ¶ 57, ER 1584.

The Commission also rejected as unsupported PacifiCorp’s claimed \$1 billion loss from its participation in the western markets. *Id.* ¶ 59, ER 1584. Further, the claim represents alleged losses over PacifiCorp’s entire portfolio, not those purportedly attributable to the challenged contracts. *Id.* As PacifiCorp sold as well as bought, it made gains as well as suffered losses, for example, selling to Williams at prices ranging from \$126/MWh to \$330/MWh whereas prices in the challenged contracts range from \$126/MWh to \$262/MWh, with a weighted average of \$181/MWh. *Id.*

PacifiCorp failed to hedge for the risk of declining spot market prices by pursuing a diversified portfolio, or taking advantage of other available alternatives. *Id.* ¶ 60, ER 1584. While PacifiCorp contended that it was inappropriate to focus

on its buying practices, those buying practices demonstrate that PacifiCorp had choices and was not unfairly induced to enter into the contracts at issue. *Id.* ¶ 62, ER 1585. The Commission also rejected a related argument that PacifiCorp had to purchase the power at issue to serve its native load, as PacifiCorp's purchases went well beyond what was needed to serve native load, as evidenced by its sales at wholesale to 98 different buyers during the relevant period, in amounts that were one-and-a-half times the total amount it purchased under the contracts at issue. *Id.* ¶ 63, ER 1585.

c. The Commission's Discretion to Decline to Enforce or Remedy the Alleged Violations.

In June 2001, FERC established mitigation measures to correct spot market dysfunctions. *Id.* ¶ 66, ER 1585. The last of the PacifiCorp contracts expired in September 2002. *Id.* Thus, even if PacifiCorp's contracts rates were not just and reasonable, there was no ongoing harm. *Id.* The challenged contracts had terminated without threatening PacifiCorp's ability to continue service. *Id.* As demonstrated above, *supra* section b, the challenged contracts, even under PacifiCorp's flawed assumptions, had little impact on PacifiCorp or its ratepayers. *Id.* ¶ 67, ER 1585. Any impact was largely self-inflicted, as PacifiCorp was a sophisticated player with alternatives. *Id.* Moreover, none of the contracts went to physical delivery, but all were settled financially. *Id.*

Accordingly, even if PacifiCorp had shown that its rates were not just and reasonable, remedial action was not warranted. *Id.* (citing *Heckler v. Chaney*, 470 U.S. 821 (1985)). The same considerations, combined with the desire to maintain certainty in the market, weighed against ordering refunds. *Id.*, ER 1586. As PacifiCorp had not made a convincing argument to justify regulatory intervention, upholding the contracts best served the public interest. *Id.*

SUMMARY OF ARGUMENT

The gravaman of PacifiCorp and Snohomish's arguments -- the Commission's alleged failure to adequately consider the dysfunctions in the California spot markets in denying PacifiCorp's complaints -- fails for several reasons.

First, PacifiCorp and Snohomish failed to address, let alone undermine, the Commission's exercise of discretion under *Heckler v. Chaney*, 470 U.S. 821 (1985), to decline enforcement or remedy even if PacifiCorp had shown its rates to be unjust and unreasonable. Any ongoing harm from any unjust and unreasonable rates due to spot market dysfunctions had been corrected, and PacifiCorp's challenged contracts had all expired, with little impact on either the financial health of PacifiCorp or its ratepayers.

Second, the Commission gave PacifiCorp and Snohomish full opportunity at hearing to show that the dysfunctional spot market adversely affected the forward bilateral market and that, as a result, the challenged contracts should be modified in the public interest. No credible showing was made that the spot market dysfunctions adversely affected the forward markets as alleged. The evidence in this proceeding, as well as the Staff Report and the 100-Day Proceeding evidence, showed at most a correlation between prices in the spot and forward markets, which did not establish causation. Similarly, PacifiCorp's assertions that it lost \$1

billion as a result of spot market dysfunctions generally, and \$53 million “out of market” costs attributable to the challenged contracts specifically, were unsupported and lacked credibility.

Third, even if PacifiCorp had shown that the spot market dysfunctions produced unjust and unreasonable rates in the forward markets, that would be inadequate to require modification of the challenged contracts. Under *Mobile-Sierra*, a fixed-rate contract may be modified only upon a particularized showing that the contract challenged is contrary to the public interest. PacifiCorp failed to meet that standard here either under the three-pronged *Sierra* test or the totality of the circumstances as the evidence showed the challenged contracts had little impact on PacifiCorp or its ratepayers. The challenged contracts accounted for only one-half of one percent of PacifiCorp’s energy portfolio, and the alleged \$53 million loss would result in only a *de minimis* increase in retail rates for PacifiCorp’s customers if it were passed through.

PacifiCorp and Snohomish argue that *Mobile-Sierra* is inapplicable because the challenged market-based rate contracts had not been previously filed with or reviewed by FERC under the just and reasonable standard of FPA § 205. Initial § 205 review of market-based rates occurs when FERC authorizes a seller to sell at market-based rates based on a finding that the seller lacks or has mitigated its market power. When, subsequently, the seller and buyer agree to a fixed rate

contract, *Mobile-Sierra* applies if the parties do not preserve their rights to seek unilateral rate changes. PacifiCorp presented no reason that these fixed-rate, market-based rate contracts should be excepted from *Mobile-Sierra*, particularly where, as here, no evidence indicated any seller exercised market power in violation of its market-based rate authority. This distinguishes the instant matter from *Lockyer v. FERC*, 383 F.3d 1006 (9th Cir. 2004), in which the Court found that FERC had authority under the FPA to remedy seller violations of market-based rate authority tariffs, and abrogation of *Mobile-Sierra* contracts was not at issue.

Further, the Commission reasonably determined, upon review of the contract language and record evidence of the parties' intent, that the parties expected *Mobile-Sierra* to apply to the challenged contracts. The Commission's reasonable interpretation of the contracts and evaluation of the record evidence are entitled to deference.

ARGUMENT

I. STANDARD OF REVIEW

Generally, the Court reviews FERC's orders to determine whether they are arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. *City of Fremont v. FERC*, 336 F.3d 910, 914 (9th Cir. 2003). FERC's decision not to take enforcement action, however, is presumed immune from judicial review. *Heckler v. Chaney*, 470 U.S. at 831-33; *Friends of the Cowlitz v. FERC*, 253 F.3d 1161, 1162, 1170-72 (9th Cir. 2001), *amended in other parts*, 282 F.3d 609 (9th Cir. 2002); *Baltimore Gas and Electric Co. v. FERC*, 252 F.3d 456, 458-62 (D.C. Cir. 2001).

The Commission's function in applying *Mobile-Sierra* is "not only to appraise the facts and draw inferences from them but also to bring to bear upon the problem an expert judgment and determine from analysis of the total situation on which side of the controversy the public interest lies." *Metropolitan Edison*, 595 F.2d at 858-59. The Commission's policy assessments are owed "great deference." *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 702 (D.C. Cir. 2000) ("TAPS"). See *Brannan v. United Student Aid Funds, Inc.*, 94 F.3d 1260, 1263 (9th Cir. 1996) ("We defer to the specific policy decisions of an administrative agency unless they are arbitrary, capricious, or manifestly contrary to statute").

The Commission's interpretation of contracts is entitled to deference. *City of Seattle v. FERC*, 923 F.2d 713, 716 (9th Cir. 1991). Likewise, the Commission's reasonable interpretation of its own orders will be upheld. *Mid-Continent Area Power Pool v. FERC*, 305 F.3d 780, 783 (8th Cir. 2002); *Texaco*, 148 F.3d at 1099.

The Commission's factual findings are conclusive if supported by substantial evidence. FPA § 313(b), 16 U.S.C. § 825l(b). Substantial evidence “means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion. If the evidence is susceptible of more than one rational interpretation, [the Court] must uphold [FERC's] findings.” *Bear Lake Watch, Inc. v. FERC*, 324 F.3d 1071, 1076 (9th Cir. 2003) (quoting *Eichler v. SEC*, 757 F.2d 1066, 1069 (9th Cir. 1985)). Thus, even if PacifiCorp's evidence were accepted as reliable and probative of the points they claim, the Commission must nonetheless be affirmed if substantial evidence supports its findings. *Ash Grove Cement Co. v. FTC*, 577 F.2d 1368, 1379 (9th Cir. 1978).

The Court likewise defers to the Commission on questions of methodology and evaluating competing expert opinions. *Bear Lake*, 324 F.3d at 1077. *See also Sierra Pacific Power Co. v. FERC*, 793 F.2d 1086, 1088 (9th Cir. 1986). Absent clear error, the Court also defers to the ALJ's determination of the weight and inference to be accorded disputed evidence. *Ash Grove*, 577 F.2d at 1379.

II. FERC PROPERLY EXERCISED ITS DISCRETION TO DECLINE ENFORCEMENT OR REMEDIATION OF THE VIOLATIONS PACIFICORP ALLEGED.

The Commission properly exercised its discretion to decline to take enforcement action or to provide a remedy even if PacifiCorp succeeded in showing that its contract rates were unjust and unreasonable. Rehearing ¶ 66, ER 1585 (citing *Heckler v. Chaney*, 470 U.S. 821). The spot market dysfunctions PacifiCorp relies upon for contract abrogation were remedied by June 2001 mitigation measures that restored order to the market, and the last of PacifiCorp's contracts expired in September 2002. *Id.* Accordingly, there could be no ongoing harm. *Id.* Moreover, as discussed more fully *infra* Sections III and IV, before their expiration the challenged contracts had little impact on the financial health of PacifiCorp, which expected to double its operating profit to £ 1 billion over the next three years, or on PacifiCorp's ratepayers, who at worst would suffer *de minimis* rate increases, even assuming PacifiCorp's flawed estimates of the impact of the challenged contracts to be true. *Id.* ¶ 67, ER 1585. PacifiCorp, a sophisticated player in the forward market, failed to pursue available alternatives. *Id.* Moreover, none of the contracts went to physical delivery, but were settled financially. *Id.*

These same considerations, combined with the desire to maintain certainty in the market, also would have counseled against ordering refunds had PacifiCorp

demonstrated unjust and unreasonable rates. *Id.*, ER 1586. Maintaining certainty in the market benefits customers by encouraging new supply sources. Based on *Mobile-Sierra* and other judicial precedent, the Commission has a long-standing policy of respecting the sanctity of contracts. June 2002 Order ¶ 25, ER 171. The contract stability protected by the FPA (and its sister statute, the Natural Gas Act), as reflected in the *Mobile-Sierra* doctrine, benefits the public by allowing for the long term planning and investment needed to develop economical and reliable service. *See, e.g., Mobile*, 350 U.S. at 344 (“By preserving the integrity of contracts, [the doctrine] permits the stability of supply arrangements which all agree is essential to the health of the natural gas industry.”); *Boston Edison Co. v. FERC*, 856 F.2d 361, 372 (1st Cir. 1988) (“The linchpin of *Mobile* is the idea that the law, by maintaining the integrity of contracts, ‘permits the stability of supply arrangements which all agree is essential to the health of the . . . industry.’”) (quoting *Mobile*, 350 U.S. at 344) (alterations in original)). Further, “[p]reservation of contracts has, if anything, become even more critical since the policy was first adopted. Competitive power markets simply cannot attract the capital needed to build adequate generating infrastructure without regulatory certainty, including certainty that the Commission will not modify market-based contracts unless there are *extraordinary* circumstances.” June 2002 Order ¶ 25, ER 171 (emphasis in original).

This desire to maintain certainty in the market, balanced against PacifiCorp's failure to show that the public interest justified regulatory intervention, resulted in FERC's determination that it would decline to enforce or to provide a remedy even if PacifiCorp proved its contract rates were unjust and unreasonable. Rehearing ¶ 67, ER 1586. Such decisions fall within FERC's sole discretion. "An agency's decision not to prosecute or enforce, whether through civil or criminal process, is a decision generally committed to an agency's absolute discretion." *Senate of the State of Cal. v. Mosbacher*, 968 F.2d 974, 976 (9th Cir. 1992) (quoting *Chaney*, 470 U.S. at 831). *See also Cowlitz*, 253 F.3d at 1170. This recognizes that an agency is best equipped to balance "factors which are peculiarly within its expertise," such as whether a violation occurred, how agency enforcement resources are best spent, and whether an enforcement action best fits the agency's overall policies. *Sierra Club v. Whitman*, 268 F.3d 898, 903 (9th Cir. 2001) (quoting *Chaney*, 470 U.S. at 831-32). *See also Cowlitz*, 253 F.3d at 1171.

While this presumption of non-reviewability may be rebutted where an agency's substantive statute has guidelines that are to be followed in exercising enforcement powers, the FPA contains no such guidelines. *See, e.g., Cowlitz*, 253 F.3d at 1171. In reviewing the comparable provisions of the Natural Gas Act, *Baltimore Gas* concluded that, although the Act denies FERC discretion to permit natural gas companies to charge unjust and unreasonable rates, the statute is

“utterly silent on the manner in which the Commission is to proceed against a particular transgressor,” and therefore the Commission’s enforcement discretion is absolute. 252 F.3d at 461. Thus, under *Chaney*, even if the Commission found a violation of the FPA here, based on its view of competing priorities and policy considerations, the Commission “could lawfully decline to prosecute any such violations,” and “such a decision would be immune from judicial review.” *Cowlitz*, 253 F.3d at 1171. *See also Chaney*, 470 U.S. at 828, 831-33; *Baltimore Gas*, 252 F.3d at 458-62.

The Court also lacks jurisdiction to review this issue because PacifiCorp and Snohomish failed to seek FERC rehearing of it. Only issues raised on rehearing can be addressed on judicial review. FPA § 313(b) (“No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in application for rehearing unless there is reasonable ground for failure to do so.”). *See City of Orrville, Ohio v. FERC*, 147 F.3d 979, 990 (D.C. Cir. 1998) (court lacks jurisdiction to hear arguments not made on rehearing); *Platte River Whooping Crane Critical Habitat Trust v. FERC*, 876 F.2d 109, 113 (D.C. Cir. 1989) (parties seeking review must themselves raise on rehearing all objections urged on appeal).

Despite the issue first being addressed in the Rehearing Order, it was incumbent upon PacifiCorp and Snohomish, if they wished to raise it on appeal, to

raise the issue in a request for rehearing of that order. *See Town of Norwood v. FERC*, 906 F.2d 772, 775 (D.C. Cir. 1990). The rehearing requirement is an express statutory limitation on the Court’s jurisdiction that neither the Court nor FERC has discretion to waive. Its purpose is to give the Commission an opportunity to consider objections before they are presented to the Court. *California Dept. of Water Resources v. FERC*, 306 F.3d 1121, 1125 (D.C. Cir. 2002). As no objections to this determination were presented to the Commission, the Court has no jurisdiction to entertain any. Further, as PacifiCorp and Snohomish ignored this issue in their opening briefs, they should be deemed to have waived any arguments regarding this finding. *United States v. Alcam Elec. & Eng’g, Inc.*, 197 F.3d 1014, 1020 (9th Cir. 1999) (argument raised for first time in reply brief was waived); *Eberle v. City of Anaheim*, 901 F.2d 814, 817-18 (9th Cir. 1990) (argument appellant failed to raise in opening brief was waived).

III. NO SHOWING WAS MADE THAT SPOT MARKET DYSFUNCTIONS ADVERSELY AFFECTED THE FORWARD MARKETS GENERALLY OR THE CHALLENGED CONTRACTS SPECIFICALLY.

The gravamen of PacifiCorp’s complaint rests upon the purported effect of the dysfunctions in the CalPX and CAISO spot markets on the challenged contracts. PacifiCorp contends that “[a]n extensive record” showed that the spot markets adversely affected the forward markets and that the Commission “simply

ignored this evidence.” Brief for Petitioner PacifiCorp (“PB”) 32-36. *See also* Brief of Intervenor Snohomish (“IB”) 34-36, 57-59.

To the contrary, the Commission ordered a full evidentiary hearing so PacifiCorp could show whether the spot market dysfunctions adversely affected the forward markets, and, if so, what modification of the challenged contracts was warranted in the public interest. June 2002 Order ¶ 27, ER 172. Moreover, the Commission considered not only the evidentiary record developed at the hearing, but also the Staff Report and the evidence submitted in the 100-Day proceeding. OID ¶¶ 3, 61, ER 1494, 1504.

Despite these opportunities, PacifiCorp failed to show that spot market dysfunctions adversely affected forward markets. OID ¶¶ 45, 88, ER 1502, 1508. PacifiCorp’s testimony established only a correlation between price trends in the spot and forward markets, which had some probative weight, but did not amount to causation. *Id.* ¶ 45, ER 1502. Certainly, current spot market conditions can affect current forward prices as participants consider spot prices in negotiating forward contracts. *Id.* But the structural problems that led to high prices in the spot markets were not present in the forward market where these contracts were negotiated. *Id.* Thus, participants in the forward market could not expect dysfunctional spot prices would carry over to forward markets. *Id.* Further, generally speaking, as spot market prices rise, forward market prices will also

escalate, bringing price-reducing resources into the marketplace and causing buyers to reduce their demand. *Id.* Bringing new supply and reducing customers demand are not adverse effects, but, rather, means for the market to rebalance supply and demand to competitive price levels. In short, and contrary to PacifiCorp's assertion, the Commission did consider the evidence presented; it simply found that PacifiCorp failed to establish that the CalPX and CAISO spot market dysfunctions adversely affected forward prices. OID ¶ 88, ER 1508.

The Commission also found PacifiCorp's assertion that it suffered \$1 billion in losses from its participation in the western markets unsupported. Rehearing ¶ 59, ER 1584. Likewise, PacifiCorp's estimate of its "out of market" costs associated with the challenged contracts was not credible because it was based on arbitrary assumptions. Rehearing ¶ 57, ER 1584; OID ¶ 64, ER 1504-05. The Commission and the ALJ are entitled to deference in their assessment of competing expert opinions and the weighing of evidence. *Bear Lake*, 324 F.3d at 1077. *See also Sierra Pacific*, 793 F.2d at 1088; *Ash Grove*, 577 F.2d at 1379.

PacifiCorp asserts that the Commission "turned a blind eye to evidence of market manipulation." PB 34. *See also* IB 34-36. After considering all the record evidence, the Staff Report and the 100-Day Discovery Proceeding evidence, the Commission found no evidence of market manipulation specific to the contract negotiations challenged here. OID ¶ 72, ER 1506. Further, the ALJ afforded no

weight to PacifiCorp's testimony purporting to establish that the sellers exercised market power. OID ¶ 44, ER 1502. The ALJ found to the contrary that "the record in this case contains not a shred of evidence that the Respondents or any of them colluded or otherwise acted in concert with respect to prices or terms and conditions of service in the forward markets for electricity in the Western United States at or about the time that the contracts at issue were entered into." ID ¶ 32, ER 1293. PacifiCorp's position that "market power" consisted of charging rates higher than PacifiCorp's unsupported estimate of the cost of production plus a reasonable return was rejected as lacking credibility. OID ¶ 44, ER 1502; ID ¶ 57, ER 1299. Notwithstanding PacifiCorp and Snohomish's focus on Enron market manipulation as evidence of market power, PB 32, IB 34, PacifiCorp withdrew its complaint against Enron when its Enron contracts were terminated following Enron's bankruptcy. OID n. 25, ER 1496.

Contrary to PacifiCorp's and Snohomish's view (*see* PB 32; IB 14-15, 51-54), the Commission did not find that a credible showing of adverse effects of the spot market on the forward markets would be irrelevant, Rehearing ¶ 65, ER 1585, or fail to consider the market circumstances under which these contracts were executed. "Instead, as the public interest standard applied to the challenged contracts, the Commission properly found the relevant inquiry to be whether the adverse effect, if any, demonstrated that contract abrogation was required in the

public interest.” *Id.* As discussed above, PacifiCorp failed to demonstrate any credible adverse effect that warranted abrogation, and, as discussed below, also failed to show any circumstances whatsoever that would justify modifying its contracts in the public interest.

IV. NO SHOWING WAS MADE THAT THE CHALLENGED CONTRACTS WERE CONTRARY TO THE PUBLIC INTEREST.

Even if PacifiCorp’s allegations that the spot market dysfunctions generally had an effect on forward contracts were accepted as true, that would not answer whether the challenged contracts are themselves contrary to the public interest. Rehearing ¶ 18, ER 1577. Contract abrogation under *Mobile-Sierra* requires findings specifically addressing the challenged contract and its particular impact on the public interest. “[T]he public interest necessary to override a private contract ... requires analysis of the manner in which the contract harms the public interest and of the extent to which abrogation or reformation mitigates the contract’s deleterious effect.” *Texaco*, 148 F.3d at 1097. *See, e.g., Atlantic City Elec. Co. v. FERC*, 295 F.3d 1, 14 (D.C. Cir. 2002) (reversing FERC orders modifying *Mobile-Sierra* contract for failure to make a particularized finding that the public interest required modification of the individual contract at issue). Here, the Commission examined the evidence under the three *Sierra* factors,⁷ as well as considered the

⁷ In *Sierra* the Court stated that “the sole concern of the Commission would seem to be whether the rate is so low as to adversely affect the

totality of the circumstances, in evaluating whether the challenged contracts had sufficient adverse impact on PacifiCorp or its ratepayers to render the contracts contrary to the public interest. OID ¶ 62, ER 1504; Rehearing ¶ 53, ER 1583.

PacifiCorp failed to show that the challenged contracts were contrary to the public interest under the *Sierra* factors. *See* Rehearing ¶ 54, ER 1583; OID ¶ 61, ER 1504. PacifiCorp was not in financial distress as a result of the contracts; quite the opposite, PacifiCorp was expected to double its operating profit to £ 1 billion or more over the next three years. OID ¶ 65, ER 1505. PacifiCorp's operating profit for the quarter ending September 30, 2002 was £ 141 million. *Id.* PacifiCorp's access to capital was not impeded as a result of the challenged contracts; its debt ratings, both for long-term and short-term debt, remained at the average to above-average level. *Id.* This is hardly surprising given that the total power involved here represented only about one-half of one percent of PacifiCorp's portfolio. Rehearing ¶ 57, ER 1584; OID ¶ 64, ER 1504. PacifiCorp also failed to submit evidence showing the challenged contracts were unduly discriminatory. OID ¶ 66, ER 1505.

Nor did PacifiCorp demonstrate a ratepayer impact sufficient to render the contracts contrary to the public interest. PacifiCorp's asserted "out of market" \$53

public interest – as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory.” 350 U.S. at 355.

million loss associated with these contracts, *see* PB 57, as discussed *supra* in Section II, was based on arbitrary assumptions and therefore not credible. Rehearing ¶ 57, ER 1584; OID ¶ 64, ER 1504. Further, even assuming the validity of this estimated “loss,” and assuming it were entirely charged to ratepayers, PacifiCorp’s retail rates would only increase by 1.5 percent, 1.8 percent, and 2.7 percent for PacifiCorp’s residential, commercial, and industrial customers, respectively. Rehearing ¶ 57, ER 1584; OID ¶ 64, ER 1504. Such *de minimis* increases, even if realized, would not satisfy the stringent *Mobile-Sierra* public interest standard. Rehearing ¶ 58, ER 1584.

Snohomish contends that *de minimis* rate increases may be considered unjust and unreasonable, IB 55-57, but that does not answer whether such increases, if they actually occurred, would render the instant contracts contrary to the public interest. Rehearing ¶ 58, ER 1584. *See, e.g., Boston Edison*, 233 F.3d at 68 (unjust and unreasonable rates may not be so high as to be contrary to the public interest). It is unlikely that rate increases at such low levels would justify contract modification. For example, *PEPCO* affirmed FERC orders denying contract modification under *Mobile-Sierra* where PEPCO’s contract rate was twice that paid by other customers. *PEPCO*, 210 F.3d at 409.

The Commission rejected PacifiCorp’s claimed \$1 billion loss from participation in the western markets as unsupported and as immaterial to the issues

here because it represents losses over PacifiCorp's entire portfolio, not losses attributable to the challenged contracts. Rehearing ¶ 59, ER 1584. Further, PacifiCorp sold as well as bought, and thus made gains as well as suffered losses. *Id.* See also OID ¶ 68, ER 1505.

Likewise, nothing in the extensive evidentiary record on the totality of the circumstances surrounding the challenged contracts supported contract modification. *Id.* ¶ 67, ER 1505. The circumstances did not show PacifiCorp was forced to buy this power on terms set by the sellers. PacifiCorp's contracts were standard products arranged through independent third-party brokers, where the sellers were price takers, not price makers. *Id.* PacifiCorp regularly sought brokered 6x16 packages in order to "dollar average" the cost of peak power by varying the number of packages obtained based upon the changing market prices. *Id.* See also ID ¶ 4, ER 1287. Because PacifiCorp purchased more energy than needed to serve its "shoulder" loads (*i.e.* those adjacent to the peaks), it was able to sell the surplus and recoup some of the expenditure. OID ¶ 67, ER 1505. PacifiCorp sold to 98 different buyers during the relevant period, and during the period from December 2001 through April 2002 sold one-and-one-half times the total amount it purchased under the contracts at issue. *Id.* Indeed, PacifiCorp was able to sell power to intervenor-respondent Williams at prices ranging from \$150 to \$330/MWh, as compared to the challenged contracts' price range from

\$126/MWh to \$262/MWh, with a weighted average price of \$181/MWh. *Id.* ¶ 68, ER 1505. As PacifiCorp's purchases exceeded the amount needed to serve its native load, the Commission rejected PacifiCorp's argument that it had to make the purchases to serve its native load. Rehearing ¶ 63, ER 1585.

PacifiCorp's failures to hedge for the risk of declining spot market prices, to pursue a diversified portfolio and take advantage of other available alternatives to reduce risks associated with market volatility, such as purchasing option contracts, all weighed against modifying the contracts to relieve PacifiCorp of improvident bargains. Rehearing ¶ 60, ER 1584; OID ¶ 69, ER 1505.

From May 2000 until June 19, 2001, PacifiCorp entered into more than 250 forward contracts with 80 different sellers, at prices that ranged from \$100 to \$570/MWh. OID ¶ 70, ER 1505. Considering the number of sellers available and the purchases actually made, the Commission reasonably concluded that PacifiCorp had choices, *i.e.* it was free to reject offers and turn to other suppliers, and thus was not coerced into entering into the contracts at issue. *Id.*

While PacifiCorp contends that it is inappropriate to focus on its buying practices, PB 58-60, PacifiCorp's buying practices showed the number of choices available, which undermined the claim that it had no alternative but to enter into the challenged contracts. Rehearing ¶ 62, ER 1585. Further, the terms of the challenged contracts were consistent with PacifiCorp's established buying

practices, and not aberrational. Finally, PacifiCorp was given full opportunity to offer any relevant evidence at the hearing that would have shown these contracts resulted from factors other than its buying practices. OID ¶¶ 89-90, ER 1508.

In short, nothing in this record, the Staff Report, or the 100-Day Discovery Proceeding evidence supported a finding of market manipulation specific to the contracts at issue here. OID ¶ 72, ER 1506. While Snohomish argues that there was “reason to question what transpired at the contract formation stage,” IB 34, no showing was made of fraud, duress or the exercise of market power to raise concerns about the contract formation. Rehearing ¶ 55, ER 1584.

Therefore, the record indicated that PacifiCorp’s only basis for seeking contract modification was its dissatisfaction with its contracts. *Id.* ¶ 73, ER 1506. Allegations that contracts have become uneconomic by the passage of time do not render them contrary to the public interest under the FPA. *Id.* (citing *Sierra*, 350 U.S. at 354-55; *PEPCO*, 210 F.3d at 409; *Papago*, 723 F.2d at 953). Because the record demonstrated that the challenged transactions were the result of PacifiCorp’s voluntary choices, and did not show unfairness, bad faith or duress in the original negotiations, PacifiCorp was not entitled to change its bargains. *Id.*

V. THE *MOBILE-SIERRA* PUBLIC INTEREST STANDARD WAS PROPERLY APPLIED.

A. *Mobile-Sierra* Applies to Market-Based Rate Contracts.

PacifiCorp and Snohomish contend that, by applying the *Mobile-Sierra* public interest standard, the Commission failed in its statutory responsibility to determine that the contract rates are just and reasonable. PB 27-29; IB 17-22. Because market-based rate contracts are not individually reviewed under FPA § 205 when they are executed, PacifiCorp and Snohomish argue that an individualized just and reasonable determination is required before *Mobile-Sierra* applies. PB 37-38; IB 26-27.⁸

The Commission is not, however, required to specifically review each market-based rate contract to assure that it is just and reasonable but, rather, a showing that a seller lacks or has mitigated market power in the relevant market assures that competition will keep market-based rate sales in the just and reasonable range, thereby satisfying FPA § 205. Rehearing ¶ 27, ER 1578-79. Subsequently, if a party wishes to challenge a market-based rate contract entered into pursuant to market-based rate authority, the party must do so under FPA § 206

⁸ Snohomish further argues that the burden of proof should be imposed on the sellers with each contract being considered as if it were a seller's rate filing under FPA § 205. IB 29-31. As this matter arose from PacifiCorp's FPA § 206 complaint, and the statute imposes the burden of proof on the complainant, Snohomish's argument is contrary to the statute and must be rejected.

-- as to which the complainant bears the burden of proof -- and must satisfy the public interest standard unless the contract reserved the right for parties to make unilateral changes. *Id.* ¶ 28, ER 1579. *Mobile-Sierra* and its progeny were intended to avoid the uncertainty in the market that would occur if parties whose deals have become uneconomic were allowed to undo them. The Commission found no support for an exception to the *Mobile-Sierra* doctrine simply because the contract was entered into in a market-based rate regime. *Id.*

While the Commission's initial grant of market-based rate authority cannot assure that the rates the seller subsequently charges will be just and reasonable under all circumstances (PB 39, IB 20), FPA § 206 complaint procedures apply to address market-based rates that are no longer just and reasonable. Rehearing ¶ 30, ER 1579. Sellers with market-based rate authority are on notice that their transactions are subject to review which can result in prospective remedial action, including the possible loss of their market-pricing authority. *Id.* This remedial authority does not, however, require contract abrogation where a contract is subject to *Mobile-Sierra*. *Id.* Here, no showing has been made that the sellers exercised market power in selling under their market-based rate authorization, and thus the self-imposed limits on contract changes set by the parties remained applicable. *Id.* This result is consistent both with the Commission's responsibility to assure that

market-based rates are just and reasonable and the stricture of the *Mobile-Sierra* doctrine on contract modification. *Id.*

Thus, the Commission's review of a seller's market power when market-based rate authority is originally granted fulfills the Commission's FPA § 205 initial review obligation to assure just and reasonable rates. *Id.* ¶ 31, ER 1580. A market-based rate contract subsequently entered into and subject to *Mobile-Sierra*, may not be changed simply because it is no longer just and reasonable, but only if the public interest standard is met. *Id.* Courts have found that the agreement to a *Mobile-Sierra* contract requires application of the public interest standard of review, whether or not the contract itself has ever previously been filed with or reviewed by FERC. Rehearing ¶ 32, ER 1580; OID ¶ 7 and n. 12, ER 1495 (citing *Richmond Power*, 481 F.2d at 493; *Lansdale*, 494 F.2d at 1112).

The opposite result urged by PacifiCorp and Snohomish “stands the *Mobile-Sierra* doctrine on its head” because that doctrine “subordinate[s] the statutory filing mechanism to the broad and familiar dictates of contract law.” *Lansdale*, 494 F.2d at 1113. The Commission has no more power upon the initial review of a contract under FPA § 205(e) to change a *Mobile-Sierra* contractually-set rate than it does during subsequent FPA § 206 review to change a rate previously filed and approved. *Id.* n. 43. “The regulatory force of a contract arises before, and survives

in the absence of, the physical filing of the document with the Commission.” *Id.* at 1114.

Snohomish contends that *Lansdale* and other *Mobile-Sierra* cases cannot be read to extinguish FERC’s statutory authority to ensure that contracts are just and reasonable. IB 40-41. The public interest test *defines*, rather than extinguishes, the Commission’s statutory obligation to assure just and reasonable rates where the parties have, as permitted by the statute, mutually set rates by contract. In *Sierra*, the Commission approved contract modification where the contract rate was unjust and unreasonable to the utility, which the Supreme Court found to be “an erroneous standard.” *Id.* at 354. The FPA does not preclude parties from agreeing to -- and being held to -- contract rates that may be unjust and unreasonable to one of the parties. “[W]hile it may be that the Commission may not normally *impose* upon a public utility a rate which would produce less than a fair return, it does not follow that the public utility may not itself agree by contract to a rate affording less than a fair return or that, if it does so, it is entitled to be relieved of its improvident bargain.” *Id.* at 355. In such circumstances, a rate “may not be said to be either ‘unjust’ or ‘unreasonable’ simply because it is unprofitable to the public utility,” but only if “the rate is so low as to adversely affect the public interest.” *Id.*

This point is underscored by *Northeast Utils. Serv. Co.*, 50 FERC ¶ 61,266 at 61,838-39 (1990), *rev’d and remanded*, *Northeast Utils. Serv. Co. v. FERC*, 993

F.2d 937, 961 (1st Cir. 1993) (“*Northeast Utils. I*”), on remand, *Northeast Utils. Serv. Co.*, 66 FERC ¶ 61,332 (1994), *aff’d Northeast Utils. Serv. Co. v. FERC*, 55 F.3d 686 (1st Cir. 1995) (“*Northeast Utils. II*”) -- a case on which PacifiCorp and Snohomish repeatedly rely. PB 38; IB 21 & n. 50. In that case, the Court rejected the Commission’s conclusion that it could apply the just and reasonable standard in its initial review of a contract, for the benefit of non-parties to the contract. *Northeast Utils. I*, 993 F.2d at 961 (ruling that the Commission improperly conflated the “just and reasonable” and “public interest” standards). While *Mobile-Sierra* “allows for intervention by FERC where it is shown that the interests of third parties are threatened,” the public interest standard still must be applied, which “as formulated by the Supreme Court, is the protection of outside parties from ‘undu[e] discriminat[ion]’ or imposition of an ‘excessive burden.’” *Id.* (quoting *Sierra*, 350 U.S. at 355). Accordingly, the Commission “should have evaluated the [contract] under the public interest standard, not the just and reasonable standard.” *Id.* at 962. On remand, the Commission applied the public interest standard, *Northeast Utils.*, 66 FERC at 62,081, and the First Circuit affirmed. *Northeast Utils. II*, 55 F.3d at 691.

PacifiCorp and Snohomish contend that *Lockyer*, 383 F.3d 1006, undermines FERC’s ruling here. PB 39-41; IB 17-22. *Lockyer* upheld the market-based rate program, finding that the initial determination that a seller lacks market

power, coupled with sufficient post-approval reporting to permit an affected party to challenge the rate, satisfies the FPA § 205 requirement to assure just and reasonable rates. *Lockyer*, 383 F.3d at 1013, 1015-16. Here, the parties were fully able to, and did, challenge the rates in these market-based contracts. Further, the parties were given every opportunity at hearing to demonstrate how the circumstances surrounding the execution of these contracts, including showing that the sellers exercised market power, would satisfy the public interest standard. Rehearing ¶¶ 53-54, ER 1583. Notwithstanding this opportunity, PacifiCorp and Snohomish failed to show that these sellers exercised market power while selling under their market-based rate authorization, or that the public interest standard was met. Rehearing ¶ 30, ER 1579.

Thus, Snohomish's claims that FERC inadequately monitored for market power, IB 22-24, and therefore inappropriately "assumed" sellers had no market power, IB 23, are belied by PacifiCorp's and Snohomish's utter inability to support their claims that the sellers exercised market power. Accordingly, the holding in *Lockyer* regarding FERC's authority to remedy violations of market-based rate authority is inapplicable here.

Further, *Lockyer* addressed compliance with sellers' generally applicable tariffs, *see Lockyer*, 383 F.3d at 1016, and did not concern the separate issue of how to judge rates set in *Mobile-Sierra* contracts. While railroad and telephone

rates historically only could be set in generally-applicable tariff schedules, subject to just and reasonable review, the FPA and the Natural Gas Act departed from that approach. Recognizing that wholesale energy contracts were often made between sophisticated businesses enjoying presumptively equal bargaining power, Congress permitted rates to be set by private arrangements. *Verizon Communications, Inc. v. FCC*, 535 U.S. 467, 478-79 (2002). When parties agreed upon the rate, “the principal regulatory responsibility was not to relieve a contracting party of an unreasonable rate, . . . but to protect against potential discrimination by favorable contract rates between allied businesses to the detriment of other wholesale customers.” *Id.* at 479 (citation omitted).

On another tack, PacifiCorp argues that the Commission promised in the December 15 Order to assess forward contracts under a just and reasonable standard, using a \$74/MWh benchmark. PB 31-32 (citing December 15 Order, 93 FERC at 61,993-94). First, the advisory benchmark represented a suggested price for five-year contracts for around-the-clock supply, whereas all PacifiCorp contracts had terms of three months or less for 25 MW on-peak 6x16 blocks of power. Rehearing ¶ 34, ER 1580. No effort was made to adjust the benchmark rate to reflect the terms of PacifiCorp’s contracts, and, therefore, the \$74/MWh figure could not provide a basis for evaluating whether PacifiCorp’s contracts were unjust and unreasonable. *Id.* Further, the December 15 Order never mandated the

application of the just and reasonable standard to review forward contracts as the Commission could not, and did not attempt to, trump *Mobile-Sierra*.

PacifiCorp and Snohomish complain that application of *Mobile-Sierra* here is contrary to certain language in FERC's orders granting the sellers market-based rate authority.⁹ PB 42-43; IB 25-28. As the Commission found, however, that language "makes the obvious point that we do not specifically approve the service or rate, *etc.*" Rehearing n. 40, ER 1579. The quoted language is used in both market-based and cost-based settings, to reiterate the general proposition that a FERC order "permit[ting] a rate schedule or any part thereof . . . to become effective shall not constitute approval by the Commission of such rate schedule or part thereof" 18 C.F.R. § 35.4. The quoted language does not, however, specify what particular standard will be used to review contracts entered into under market-based rate authority that are challenged by complaint, and therefore the quoted language does not advance PacifiCorp's and Snohomish's arguments that

⁹ The orders relied upon state as follows:

This action does not constitute approval of any service, rate, charge, classification, or any ... contract ... affecting such rate or service ... nor shall such action be deemed as recognition of any claimed contractual right or obligation affecting or relating to such service or rate; and such action is without prejudice to any findings or orders which have been or may hereafter be made by the Commission in any proceeding

NorAm Energy Servs., Inc., Letter Order, Docket No. ER94-1247-000 (1994) (quoted at PB 42).

the language requires application of the just and reasonable standard. Indeed, the orders accepting the contracts challenged in *Mobile* and *Sierra* contained substantively identical language. See *Pacific Gas & Elec. Co.*, 7 FPC 832 (1948) (accepting contract challenged in *Sierra* for filing and stating that “[n]othing contained in this order shall be construed as constituting approval by the Commission of any service, rate, charge, classification, or any rule, regulation, contract or practice”); *United Gas Pipe Line Co.*, 5 FPC 770 (1946) (accepting the contract challenged in *Mobile* for filing and stating that “[n]othing contained . . . shall [] be construed as constituting approval by this Commission of any service, rate, charge, classification, or any rule, regulation, contract or practice”).

PacifiCorp claims the decision here is inconsistent with the refund obligation imposed in the spot markets. PB 41-42 (citing December 19 Order, 97 FERC at 62,217-18). There is no inconsistency. FERC’s November 1 Order determined that the spot market rates were unjust and unreasonable, and may continue to be unjust and unreasonable until remedied. November 1 Order, 93 FERC at 61,370. As a market mitigation measure, the Commission *prospectively* conditioned market-based rate authorizations of sellers in the CAISO and CalPX spot markets with a continuing refund obligation until longer-term remedies were in place. *Id.* Any refunds ordered with respect to these spot market sales would be “pursuant to the sellers’ continuing market-based rate authorizations, not Section 206(b).”

December 19 Order, 97 FERC at 62,220. In contrast, here, the Commission made no finding that forward market rates were unjust and unreasonable, and, therefore, no market mitigation measures, including imposing a refund condition on market-based rate authority, were imposed. *See id.* at 62,245.

PacifiCorp alternatively faults the Commission's consideration of the three-prong *Sierra* test in applying *Mobile-Sierra*, and contends that a "more flexible" version of the public interest test under *Northeast Utils.*, 66 FERC ¶ 61,332, should apply. PB 55-57. However, courts have determined that the three-prong *Sierra* test is appropriately applied in assessing a buyer's claim that its rate are too high, *PEPCO*, 210 F.3d at 409, 412, or in assessing the interest of nonparties under a contract filed for the first time, *Northeast Utils. II*, 55 F.3d at 691 (citing *Northeast Utils. I*, 993 F.2d at 961-62). Further, the Commission did not consider just the three-prong test, but looked at the totality of the circumstances surrounding these contracts, to determine if modification was required in the public interest. Rehearing ¶ 33, ER 1583.

In any event, *Northeast Utils.*, 66 FERC ¶ 61,332, did not purport to modify the public interest standard, but rather simply explained that utility attempts to increase rates rarely benefit the public interest as opposed to the private interests of the utility, and therefore the public interest test may in that context be regarded as "practically insurmountable." *Northeast Utils. II*, 55 F.3d at 692 (quoting

Northeast Utils., 66 FERC at 62,076). The doctrine was not “practically insurmountable” in *Northeast Utils.*, however, as that case involved a contract *between affiliated companies* which required closer scrutiny for the protection of third parties. *Northeast Utils.*, 66 FERC at 62,090. *See also Southern Power Co.*, 104 FERC ¶ 61,041 (2003) and *Entergy Servs., Inc.*, 103 FERC ¶ 61,256 (2003) (cited at IB 31 & n. 75, involving contracts between affiliated companies). Closer scrutiny of affiliate contracts is required because, while in an arms-length transaction the buyer can be expected to protect itself and thus consumers against excessive charges, in affiliate transactions the buyer has less incentive to bargain for the lowest possible rates because ultimately all provisions will benefit the common parent. *Northeast Utils.*, 66 FERC at 62,090. Thus, the Commission rejected contract provisions that provided a “blank check” allowing the affiliated parties to set future rates at will due to the potential detriment to third party ratepayers. *Id.* at 62,090-91 (rejecting provisions for adjusting return on equity and setting decommissioning costs without FERC review of resulting rate); *Northeast Utils. II*, 55 F.3d at 692.

Here, in contrast, no transaction provided a “blank check” to affiliated parties: these were brokered, fixed-rate contracts voluntarily entered into between sophisticated participants in the energy markets, with PacifiCorp having the option of turning to other suppliers. OI ¶¶ 47, 70-71, ER 1502, 1505; Rehearing ¶ 67,

ER 1585. As discussed in Section III, *supra*, there was no showing that the sellers exercised market power while selling under their market-based rate authority, Rehearing ¶¶ 30, 54, ER 1579, 1583, there was no showing of fraud or duress in the formation of the contract, Rehearing ¶ 55, ER 1584, nor was there evidence of market manipulation specific to negotiation of these contracts. OID ¶ 72, ER 1506. In those circumstances, the purchaser may be held to bargains that later prove improvident. “In our view, the policies enunciated by Congress are in no way demeaned by requiring primary energy distributors and their wholesale customers alike to exercise reasonable self-interested vigilance and to act promptly to protect their respective positions.” *Boston Edison*, 856 F.2d at 372.

Further, there is no basis for applying a more flexible public interest standard here because, as discussed in Section IV, *supra*, the record did not show that third-parties, *i.e.* the ratepayers, were adversely affected by the contracts at issue. OID ¶ 64, ER 1504; Rehearing ¶ 57, ER 1584. Nor was this an initial review, as the contracts were previously approved as lawful under FPA § 205 pursuant to market-based rate authorization awarded the sellers. OID ¶ 32, ER 1500. Absent demonstrable harm to third parties and initial rate review, the prerequisites for applying the “more flexible” public interest test have not been met, and the Court need not address it. *See PEPCO*, 210 F.3d at 409 and n. 2 (finding no need to address the more flexible public interest standard where

PEPCO failed to demonstrate burden on its ratepayers or that the contract was newly filed or previously unapproved).

B. The Commission Properly Found the Parties Intended *Mobile-Sierra* to Apply to the Challenged Contracts.

The Commission properly concluded that the parties intended *Mobile-Sierra* to apply to their contracts. As an initial matter, PacifiCorp and Snohomish contend that the Commission’s construction of the contract language is not entitled to deference because FERC purportedly did not rely on its expertise. PB 45; IB 41. However, the issue of the applicable standard was not resolved merely by construction of contract language, but was based upon evaluation of the complete evidentiary record. OI 28, ER 1498. Further, FERC’s expertise aids it in interpreting contracts, even where it is not necessary to go beyond the plain language. *City of Seattle*, 923 F.2d at 716 (“FERC’s special expertise in this area helps it to perceive the plain meaning of the language used, and that is still another reason for us to show deference to its interpretations”). *See also National Fuel Gas Supply Corp. v. FERC*, 811 F.2d 1563, 1570 (D.C. Cir. 1987); *Muratore v. OPM*, 222 F.3d 918, 922 (11th Cir. 2000).

1. The Commission Properly Interpreted WSPPA § 6.1.

The Commission properly interpreted WSPPA § 6.1 as invoking *Mobile-Sierra* protections. Rehearing Order ¶ 41, ER 1581. WSPPA § 6.1 provides that:

Nothing contained herein shall be construed as affecting in any way the rights of the Parties to jointly make application to FERC for a change in the rates and charges, classification, service, terms, or conditions affecting SWPP transactions under Section 205 of the Federal Power Act and pursuant to FERC rules and regulations promulgated thereunder. . . .

While WSPPA § 6.1 allows parties to seek jointly modification of the rates, terms, and conditions of the contracts under FPA § 205, it does not expressly address parties' FPA § 206 rights. *Id.* Upon consideration of the evidence of the parties' intent, the Commission concluded that the reference to a "joint" § 205 filing evidences an intent that neither seller nor buyer could seek any other changes under § 205 or § 206, and thus any change would be under the "public interest" standard. *Id.*; OID ¶ 29, ER 1498. As the statute does not prohibit joint filings, an alternative reading would make § 6.1 unnecessary or redundant. Rehearing ¶ 41, ER 1581.

Although the parties could have used specific language disallowing a unilateral filing by the seller under § 205, or the unilateral filing of a complaint by the buyer under § 206, the most reasonable reading of § 6.1 is that they intended to exclude any unilateral filings at the Commission. *Id.*; OID ¶ 29, ER 1498-99. "[U]nder the maxim '*expressio unius est exclusion alterius*,' (the expression of

one thing is the exclusion of the other), the only interpretation of Section 6.1 of the [WSPP Agreement] is that the parties thought about, contemplated, and provided for applications to FERC, excluding all applications not specifically provided for in the contracts.” OID ¶ 29, ER 1499 (quoting *Nevada Power Co. v. Enron Power Marketing*, 101 FERC ¶ 63,031 at 65,276 (2002)); Rehearing ¶ 42, ER 1581.

PacifiCorp contends that the maxim is inapplicable here because there is no “associated group or series.” PB 51 (citing *Barnhart v. Peabody Coal Co.*, 537 U.S. 149 (2003)). *See also* IB 48-49. FPA §§ 205 and 206 constitute an associated group or series as “[i]n the context of both the *Mobile-Sierra* doctrine and the FPA, Section 205 and Section 206 comprise the category or ‘group’ of filing rights relevant to contracting parties.” Rehearing ¶ 42, ER 1581. Therefore, the parties to the challenged contracts did not intend that PacifiCorp could seek unilaterally changes to its contracts, leaving the public interest standard as the only means for allowing modification. *Id.*; Rehearing ¶ 41, ER 1581.

Snohomish contends that § 6.1 applies only to the rights of parties to add or remove Service Schedules under the WSPPA, not to challenges to individual Confirmation Agreements under § 206. IB 42-48. The Commission reasonably rejected this argument because the relevant language in § 6.1 explicitly refers to possible changes in the rates, charges, classification, service, terms or conditions “affecting WSPP transactions,” rather than being limited to those affecting Service

Schedules appearing in the last part of the WSPP Agreement. Rehearing ¶ 45, ER 1582. The actual language of § 6.1, which encompasses all possible changes “affecting WSPP transactions” is certainly much broader in scope than “amendments to ‘this Agreement,’” *i.e.* the WSPPA itself, which Snohomish urges as the proper interpretation of § 6.1. IB 47.

PacifiCorp argues that FERC’s precedent requires that the just and reasonable standard apply unless parties specifically waive that right. PB 52-54 (citing Order No. 888-A¹⁰; *Sithe Independence Power Partners, L.P. v. Niagara Mohawk Power Corp.*, 76 FERC ¶ 61,285 at 62,458 (1996), *remanded*, *Sithe/Independence Power Parts., L.P. v. FERC*, 165 F.3d 944 (D.C. Cir. 1999), and *Southern California Edison Co.*, Opinion No. 289, 41 FERC ¶ 61,188 at 61,491 (1987), *reh’g denied*, 52 FERC ¶ 61,299 (1990), *vacated in part*, 55 FERC ¶ 61,258 (1991)). The Commission rejected this argument, finding that the *Sithe* and *Southern California* finding of no waiver was based on the lack of any language susceptible to the interpretation that the parties intended to waive their rights. Rehearing, ¶ 44, ER 1582. Here, in contrast, the language of the WSPPA,

¹⁰*Promoting Wholesale Competition Through Open-Access Non-Discriminatory Transmission Service by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. ¶ 31,036 (1996), *order on reh’g*, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048 (1997), *order on reh’g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh’g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff’d in relevant part sub nom.*, *TAPS*, 225 F.3d 667, *aff’d sub nom. New York v. FERC*, 535 U.S. 1 (2002).

albeit not the most direct or most obvious manner of waiving rights to a just and reasonable determination, was sufficient to demonstrate waiver. *Id.* ER 1581-82. Further, although PacifiCorp suggests that the contract language in *Sithe* is comparable to that here, PB 53, the provision at issue in *Sithe*, rather than addressing parties' rights to make § 205 filings, concerned only their right to challenge a rate. Rehearing ¶ 46, ER 1582. Thus, in contrast to *Sithe*, here the fact that joint applications were specifically allowed by § 6.1 demonstrates that the parties considered what filings were allowed. *Id.* Also, *Sithe* did not interpret the contract language in isolation, but contrasted the lack of waiver therein with seller's contracts with other parties where the right was reserved. *Id.* (citing *Sithe*, 76 FERC at 62,458). Here, none of PacifiCorp's contracts reserve the right to seek a just and reasonable rate determination.

Further, the Commission's interpretation is consistent with the interpretation of functionally identical contract language in *Texaco*, 148 F.3d 1091 (concerning the equivalent provisions, §§ 4 and 5, of the Natural Gas Act). *See* OID n.42, ER 1499. In *Texaco*, the service agreement provided that the pipeline "shall not exercise [its] rights under Section 4 of the [Natural Gas Act] to change the rates to be paid by the Shipper." *Id.*, ER 1499 (quoting *Texaco*, 148 F.3d at 1095). The Court held that, even though parties' rights under § 5 of the Natural Gas Act (the equivalent of FPA § 206) were not mentioned, the language did not allow a just

and reasonable review, but invoked the *Mobile-Sierra* standard. *Texaco*, 148 F.3d at 1096. The Supreme Court's *Memphis* decision places parties on notice that they can negate *Mobile-Sierra* protections by expressly providing that the contract rate can be overridden by FERC at any time under the just and reasonable standard. *Boston Edison*, 233 F.3d at 66 (citing *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103 at 112 (1958)). Given this notice, the failure to include a *Memphis* clause in a contract reasonably leads to an inference that *Mobile-Sierra* was intended to apply.

The Commission's interpretation here is not undermined by its proposed policy statement, applying the public interest standard to market-based rate contracts only where the parties expressly state that intent. PB 54 (citing *Standard of Review for Proposed Changes of Market-Based Rate Contracts*, 100 FERC ¶ 61,145, 67 Fed. Reg. 51,516 at 51,517 (2002)). As this proposed policy statement had not yet been adopted, but remained under review, it had no precedential value for the challenged orders. Rehearing ¶ 36, ER 1581. Moreover, even if it had been adopted, it would apply only prospectively to contracts entered into 30 days or more after the date of issuance, and therefore would be inapplicable here. *Id.*

2. The Commission Properly Interpreted the EEIA.

The Commission properly concluded that *Mobile-Sierra* applied to the contracts entered into under the EEIA. Rehearing Order ¶ 48, ER 1582.

PacifiCorp contends that, because the EEIA is silent on the issue of the applicable standard of review, there was no mutual intent with regard to the applicable standard of review, and, therefore, the just and reasonable standard must apply. PB 45-46. However, the Commission's finding that the contracts were intended to restrict a party's FPA § 206 rights was based, not on contractual silence, but on related contract language, as well as evidence in the record regarding the parties' intentions. Rehearing ¶ 38, ER 1581.

In the face of contractual silence, PacifiCorp had the burden of proof to show the parties' intent. Rehearing ¶ 48, ER 1582. PacifiCorp failed, however, to offer evidence on the issue, instead, it made only conclusory allegations. *Id.* No testimony identified either communications between parties regarding an intent to adopt one or the other standard, or PacifiCorp's unilateral intent as conveyed to its broker or a counterparty. OID n. 43, ER 1499; Rehearing ¶ 48, ER 1582.

In the absence of testimony from PacifiCorp, the Commission relied on other record evidence and the ALJ's analysis to determine the intent. Rehearing ¶ 48, ER 1582. The circumstances of contract execution reasonably suggested that the parties would not have expected that either party could modify the contract in the absence of unforeseen extraordinary circumstances. OID ¶ 30, ER 1499; Rehearing ¶ 48, ER 1582. The contracts had terms of 90 days or less and were brokered by a third-party who matched bids. *Id.* Those circumstances indicated

the parties would have expected the contractual obligations to be firm and not subject to modification. *Id.* Thus, while PacifiCorp asserts that the length of the transaction or the use of a broker has no bearing on the parties' intent, PB 48, the Commission and the ALJ reasonably found otherwise in the face of PacifiCorp's failure to introduce any evidence to the contrary. Rehearing ¶ 48, ER 1582.

PacifiCorp asserts that the regulated energy commodity market differs from unregulated commodity markets, PB 49, but the ALJ and the Commission specifically considered PacifiCorp's contracts in the context of the energy commodity market. *Id.* ¶ 50, ER 1583. Further, the regulatory overlay does not assist PacifiCorp because parties have been on notice since *Memphis* that they may negate *Mobile-Sierra* review by expressly providing for just and reasonable rate review. *Boston Edison*, 233 F.3d at 66 (citing *Memphis*, 358 U.S. at 112). Thus, to take advantage of the regulatory overlay, PacifiCorp should have included a *Memphis* clause in its contracts; its failure to do so reasonably leads to an inference that *Mobile-Sierra*, not the just and reasonable standard, was intended to apply.

Despite acknowledging that under New York law extrinsic evidence may be used to resolve ambiguity, PacifiCorp contends that contractual silence cannot create ambiguity permitting the use of extrinsic evidence, citing *Schmidt*, 97 A.D. 2d 151. PB 47. In *Schmidt*, the agreement did not provide procedures for electing successor directors, and the court refused to imply such a provision from

contractual silence. Rehearing ¶ 49, ER 1582. Here, an ambiguity exists as to whether Commission review should be under the just and reasonable standard or the *Mobile-Sierra* standard (assuming *arguendo* that New York law could control on determining the applicable standard of review). *Id.* Contract silence does not resolve the issue, as one or the other standard must be applied to PacifiCorp's efforts to modify the contracts. Accordingly, the Commission properly considered extrinsic evidence in evaluating the intent of the parties. *Id.*

CONCLUSION

For the reasons stated, the Commission's orders should be affirmed in all respects.

STATEMENT OF RELATED CASES

Respondent has no related cases to add to those listed by Petitioner.

Respectfully submitted,

Dennis Lane
Solicitor

Lona T. Perry
Attorney

Federal Energy Regulatory
Commission
Washington, DC 20426
TEL: (202) 502-6600
FAX: (202) 273-0901

January 14, 2005

CERTIFICATE OF COMPLIANCE

Case No. 03-72522
(Consolidated with Case No. 04-72781)

Pursuant to Ninth Circuit Rule 32-1, I hereby certify that the Brief of Respondent Federal Energy Regulatory Commission is proportionately spaced, has a typeface of 14 points or more and contains 13,861 words.

Dated this 14th day of January, 2005.

Lona T. Perry
Attorney

Federal Energy Regulatory
Commission
Washington, DC 20426
TEL: (202) 502-6600
FAX: (202) 273-0901