

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

PacifiCorp,)	
Complainant,)	
)	
v.)	
)	
Reliant Energy Services, Inc.)	Docket No. EL02-80-000
Morgan Stanley Capital Group Inc.)	EL02-81-000
Williams Energy Marketing & Trading Co.)	EL02-82-000
El Paso Merchant Energy, L.P.,)	EL02-83-000
)	
Respondents.)	(consolidated)

PREPARED REBUTTAL TESTIMONY OF
STAN K. WATTERS
ON BEHALF OF PACIFICORP

1 I. INTRODUCTION

2 Q. Please state your name and title.

3 A. My name is Stan K. Watters. My business address is 825 NE Multnomah,
4 Portland, Oregon, 97232. My present position is Vice President of Trading and
5 Origination.

6
7 Q. Did you submit direct testimony in this proceeding?

8 A. Yes, I did.

9

10 Q. What is the purpose of your rebuttal testimony?

11 A. The purpose of my rebuttal testimony generally is to address the assertions
12 made in the direct testimonies of witnesses for the Respondents and
13 Commission Staff filed in this proceeding. I specifically address comments by
14 Respondents' "in-house" witnesses, namely Messrs. Funk and Greenshields
15 (Morgan Stanley), Mr. Pratt (Williams), as well as Commission Staff witness
16 Poffenberger.

17

18 II. TESTIMONY OF WILLIAMS WITNESS PRATT

19 Q. At pages 12-13 of Exhibit No. WIL-1, Williams witness Pratt states that if
20 PacifiCorp's complaint against Williams is granted, "Williams will have
21 effectively been punished for doing nothing more than facilitating trades in
22 the market." Mr. Pratt's testimony goes on to state that PacifiCorp did not
23 complain to Williams about the prices contained in the contracts at the time
24 they were negotiated or thereafter, but rather entered into the contracts

1 without being coerced, in the course of normal business. See Exhibit No.
2 WIL-1 at 13. Do you agree with the position set out in Mr. Pratt's
3 testimony?

4 A. No.

5
6 Q. Why not?

7 A. Well, first of all, PacifiCorp is not really sure why Williams would put itself at risk
8 and utilize Williams' assets, such as working capital and credit exposure without
9 some substantial gain. So, PacifiCorp questions somewhat the contention that
10 Williams entered into the contracts in question merely to facilitate trades for the
11 sole benefit of other parties. Additionally, whether Williams exercised
12 oligopolistic market power or otherwise helped to maintain excessive market
13 prices, it is plain to me that Williams collected substantially more revenue under
14 the contracts at issue than it would have had the markets been functioning
15 competitively and effectively at the point we entered into the contracts. These
16 prices were clearly much higher than prices before and after the period Spring
17 2000 through June 19, 2001, and in my view, do not constitute just and
18 reasonable prices. Finally, I reject the implication of Mr. Pratt's testimony that
19 PacifiCorp has somehow taken undue advantage of Williams. Both Williams and
20 PacifiCorp are sophisticated parties who have long known that wholesale
21 electricity sales are subject to FERC regulation under the Federal Power Act
22 ("FPA"). The implication that PacifiCorp might have acted improperly, because it

1 entered into the Williams contracts at issue, and later asserted its rights under
2 the FPA, should impress no one.

3
4 **Q. Does the substance of your preceding answer also apply to the other**
5 **contracts at issue in this proceeding?**

6 A. Yes, it does. So far as I can tell, all the Respondents are telling the same basic
7 story. According to them, there never was a dysfunctional market of any kind, let
8 alone a dysfunctional electricity market in the West during the period Spring 2000
9 through June 19, 2001, that could have had any effect on the contracts at issue
10 here. In my opinion, their position in this case is simply not credible.

11
12 **Q. Mr. Watters, do you believe that PacifiCorp should have entered into the**
13 **contracts at issue here?**

14 A. PacifiCorp is a load serving entity. As such, it must at all times remain capable of
15 meeting the electricity needs of its wholesale and retail customers. We entered
16 into the contracts at issue knowing that the prices were excessive, but there
17 really were no alternatives that served our needs. So, given the situation we
18 were faced with, I feel we did the right thing by entering into the contracts at
19 issue.

1 **III. TESTIMONY OF MSCG WITNESS GREENSHIELDS**

2 **Q. What do you take to be the primary thrust of Mr. Greenshields' testimony**
3 **contained in Exhibit No. MSC-13?**

4 A. That testimony seems to amount overall to an assertion that unless the
5 Respondents, individually or together, can be found to have exercised market
6 power, or otherwise manipulated the market, they are entitled to keep any
7 revenues that they may have collected above just and reasonable levels.

8
9 **Q. Do you agree with that position?**

10 A. No. The forward market for the Summer 2002 commodity contracts at issue in
11 this proceeding was obviously influenced directly by the dysfunctional California
12 spot market. Respondents should be ordered to refund the difference between
13 just and reasonable levels and the dysfunctional levels charged in the contracts
14 at issue in this proceeding.

15
16 **Q. On page 11 of Exhibit No. MSC-13, at lines 9 through 14, Mr. Greenshields**
17 **discusses the California ISO and PX markets. Do you agree with that**
18 **testimony?**

19 A. When I read this testimony, it became clear to me that MSCG, and by implication
20 the other Respondents in this proceeding, do not acknowledge any dysfunction in
21 wholesale electricity markets in this country; not even in the California spot
22 market already found to be dysfunctional. From where I stand, they may feel
23 they need to take that position, despite its credibility problems, in order to

1 maintain their position in this case. I really cannot think of any other reason for
2 their position.

3

4 **Q. What do you mean?**

5 A. In the wholesale electricity business in the West, it is simply not credible that
6 market fundamentals uninfluenced by exercise of market power, or other market
7 manipulation or dysfunction tied to the California spot market, could account for
8 the totality of the difference between the prices prevailing at Palo Verde and the
9 marginal cost of electricity production plus a reasonable profit from the Spring
10 2000 through June 19, 2001. With that in mind, I guess it makes some kind of
11 sense for Respondents to attempt to avoid refund or contract reformation by
12 taking the position that almost everyone knowledgeable about the situation,
13 including FERC, is simply wrong in believing that there was any dysfunction in
14 California or any other western markets from Spring 2000 onward. See
15 Deposition of Simon T.W. Greenshields, lines 10-16. On this very point, in a
16 recent deposition, Mr. Greenshields was quite clear.

17

18 Q. In your opinion, during the period April 2000 through
19 June 19, 2001, was the spot electricity market in California
20 dysfunctional? Do you have an opinion about that?

21

22 A. My personal opinion is I do not believe it was
23 dysfunctional. It is not what I would describe as a
24 dysfunctional market.
25

1
2 **Q. At page 12 of Exhibit No. MSC-13, lines 10-12, Mr. Greenshields speaks of**
3 **MSCG being “forced, among other things, to charge an additional premium**
4 **for forward sales to protect it and Morgan Stanley’s shareholders from**
5 **increased regulatory and legal risk.” Do you agree?**

6 A. No.

7

8 **Q. Please explain.**

9 A. To fully understand my reaction to this testimony, perhaps one has to first
10 understand that from PacifiCorp’s perspective MSCG has already included a
11 substantial premium above just and reasonable price levels in the contracts at
12 issue. One could call this premium by different names, but it represents the
13 premium above levels that would have prevailed if the Palo Verde market was
14 functional and competitive during the period Spring 2000 through June 19, 2001.
15 So, given that, what might be thought of as a dysfunctional market premium is
16 already reflected in the contract prices. It borders on the absurd, therefore, to
17 even begin considering the further premium addressed by the referenced
18 testimony.

19

20 **IV. PACIFICORP’S RIGHTS UNDER SECTION 206 OF THE FPA**

21 **Q. Does MSCG Witness Funk make any statements bearing on PacifiCorp’s**
22 **rights under Section 206 of the Federal Power Act?**

23 A. Yes. Mr. Funk states that a certain named broker “conveyed the product, price,
24 quantity, delivery point, and delivery terms between the parties.” (Exhibit No.

1 MSC-14 at 5:21-5:22.) Mr. Funk also states that “[u]nless the broker bid varied
2 from convention, or if we came to learn that the transaction involved a counter-
3 party that was not on MSCG’s approved list, normally we would not engage in
4 any formal or detailed analysis.” (Exhibit No. MSC-14 at 7:4-7:7.) Mr. Funk
5 furthermore answered “No,” when asked, “[w]hen you entered into the
6 confirmations with PacifiCorp memorializing the May 15, 2001, May 22, 2001,
7 and June 5, 2001 transactions, to the best of your knowledge, did you discuss
8 with PacifiCorp any terms or conditions other than those memorialized in the
9 confirm?” (Exhibit No. MSC-14 at 7:15-7:20)

10
11 **Q. Please explain how these sections of Mr. Funk’s testimony bear on**
12 **PacifiCorp’s rights under Section 206 of the Federal Power Act.**

13 A. At Exhibit No. PAC-20, pages 4 and 19-26, I explain that the Respondents have
14 presented no evidence indicating that PacifiCorp intended to waive its Section
15 206 rights. The testimony cited above from pages 5-7 of Exhibit No. MSC-14
16 strongly supports the proposition that PacifiCorp did not waive its Section 206
17 rights. It points out that such rights were not even discussed prior to execution of
18 the contracts between PacifiCorp and Morgan Stanley at issue in this
19 proceeding, let alone waived.

20
21 **Q. Does the substance of your preceding answer also apply to the other**
22 **contracts at issue in this proceeding?**

23 A. Yes, it does.

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Q. At Exhibit S-1, page 12, lines 11 through 18, Staff Witness Poffenberger states that the “EEI Agreement (General Exhibit 1) does not contain a specific provision addressing the parties rights under Section 205 or 206 of the FPA,” referencing Exhibits PAC-28 through 30 and concludes that the EEI Agreement contains no specific provision that sets forth the parties’ rights to modify rates, terms and conditions under the FPA. Are you familiar with that testimony?

A. Yes, I am. What Staff witness Poffenberger actually says in that regard is the following:

The Commission's June 28 Order noted that the EEI Agreement (General Exhibit 1) does not contain a specific provision addressing the parties' rights under Sections 205 or 206 of the FPA. 99 FERC at 62,614. I have reviewed the EEI confirmation agreements and found no additional language or special provisions relating to the parties rights to seek modifications to the contracts. See PacifiCorp's EEI transaction confirmations in Exhibits PAC-28 (two confirmations with Reliant), PAC-29 (three confirmations with MSCG), and PAC-30, page 3 (one confirmation with Williams).

Q. Do you agree with that testimony?

A. Yes, I do.

Q. What about the WSPP Agreement and the six contracts at issue here that are governed by the provisions of that agreement?

A. At Exhibit S-1, page 16, Mr. Poffenberger testifies as follows “the WSPPA signatories (including PacifiCorp) expressly omitted a provision allowing a party to unilaterally file with this Commission to effect such changes.” This seems to

1 plainly mean that the WSPP Agreement and conforming confirmation
2 agreements do not contain specific provisions addressing the parties' rights
3 under Section 206 of the FPA.

4
5 **Q. At Exhibit S-1, page 17, line 16 through the end of the sentence that ends**
6 **on page 18, line 2, Mr. Poffenberger discusses certain factors and**
7 **implications that, in his opinion, pertain to trades made under the EEI**
8 **Agreement. Do you agree with that testimony?**

9 A. No, I do not. But I nevertheless find the referenced testimony to be very
10 interesting.

11
12 **Q. What in the referenced testimony did you find interesting?**

13 A. The referenced testimony up to its very last sentence appears to be laying a solid
14 predicate for granting PacifiCorp's complaints, and then, without explanation, in
15 its last sentence it seems to conclude that buyers should nonetheless be held to
16 an almost impossible standard in order to obtain a refund or other relief from the
17 contracts. In my book, the referenced testimony simply does not make good
18 sense.

19
20 **Q. From your perspective, why does the referenced testimony not make good**
21 **sense?**

22 A. First, Mr. Poffenberger goes to great length to distinguish between transactions
23 under the WSPP Agreement and conforming confirmation agreements, on the

1 one hand and transactions under the EEI Agreement and conforming
2 confirmation agreements on the other (Exhibit S-1, page 17, lines 16 through 20,
3 and page 18, lines 1-2.) What he actually says in this regard is the following:

4 *In my opinion, the burden required to alter a contract, or form*
5 *of contract, that the Commission has reviewed and accepted*
6 *is much greater than the burden required to alter a contract,*
7 *or form of contract, that the Commission has not previously*
8 *reviewed and accepted. Florida Power & Light Company, 67*
9 *FERC 61,141 (1994); Northeast Utilities v. FERC, 55 F.3d*
10 *686 (D.C. Circuit 1995). Therefore, in the case of*
11 *confirmation agreements reached under the WSPPA, a*
12 *presumption of justness and reasonableness attaches to*
13 *transactions that contain rates, terms and conditions*
14 *unchanged from those in the pro forma Exhibits or Service*
15 *Schedules appended to or included in the WSPPA as*
16 *accepted by the Commission. This would include those*
17 *confirmation agreements in which all the parties did was to*
18 *fill in the blanks on the pro forma agreement. Therefore,*
19 *PacifiCorp's burden of proof should be the public interest*
20 *standard for those transactions entered into pursuant to the*
21 *confirmation agreements under the WSPPA.*

22
23 Exhibit S-1, page 17, lines 1 through 13. After going through the trouble to make
24 these distinctions, and stating that they should make a great deal of difference in
25 determining whether the just and reasonable, or more onerous public interest,
26 standard should be used, Mr. Poffenberger then proceeds to ignore his own
27 position in this regard as described above, inexplicitly concluding that both
28 PacifiCorp's six WSPP contracts and its six EEI contracts should all be judged by
29 the same onerous standard. This conclusion makes little sense, in light of Mr.
30 Poffenberger's analysis.

31 In any event, PacifiCorp does not agree with either Mr. Poffenberger's analysis or
32 his conclusion. From PacifiCorp's perspective, there is absolutely no difference
33 between the standard of review to be applied to contracts governed by the

1 WSPP Agreement and those governed by the EEI Agreement. Neither the
2 WSPP Agreement nor EEI Agreement contains any language that in any way
3 restricts or impedes FPA Section 206 rights.

4 **Q. At Exhibit S-1, page 13, lines 1 through 7, Mr. Poffenberger states that**
5 **“[w]hen a contract is silent regarding the parties rights to change rates, the**
6 **public interest standard must be applied.” Do you agree with that**
7 **testimony?**

8 A. No, I do not.

9
10 **Q. Please explain.**

11 A. It seems that Mr. Poffenberger is attempting to make it as hard as possible for a
12 load serving entity, like PacifiCorp, and its customers, to prevail even if the rates
13 involved are obviously excessive. If I read Staff witness Poffenberger right,
14 unless special hardship results, he recommends that it really should not matter to
15 the FERC how much market-based rates exceed just and reasonable levels,
16 unless truly drastic results have occurred as a consequence.

17
18 **Q. Please respond to Mr. Poffenberger’s analysis of the language of the WSPP**
19 **Agreement and the six contracts at issue here that are governed by the**
20 **provisions of that agreement contained in Exhibit No. S-6 at 14:10-17:13.**

21 A. Mr. Poffenberger’s analysis of the WSPP Agreement is flawed in my opinion. Mr.
22 Poffenberger points to the fact that Section 6.1 of the WSPP Agreement provides
23 for joint application to FERC for contract changes under Section 205 of the FPA

1 and concludes that the parties must have intended to curtail the parties rights
2 under *Section 206* of the FPA. This conclusion appears to be based upon a
3 complete failure of logic. Contract language addressing FPA Section 205 does
4 not imply anything whatsoever about Section 206. In fact, in his enthusiasm to
5 argue about what the parties must have intended about Section 206 based on
6 what they agreed to regarding Section 205, Mr. Poffenberger does not notice the
7 most glaring failure of his argument: that the drafters of the WSPP Agreement
8 could easily have included express language regarding Section 206, but did not.
9 Mr. Poffenberger tries to lend credibility to his theory about the parties' intentions
10 by describing the fact that the WSPP Agreement does not specifically provide for
11 unilateral Section 206 actions as an "express omission." (Exhibit No. S-6 at
12 16:7.) In addition to being a meaningless oxymoron, this phrase typifies Mr.
13 Poffenberger's presumptions about the parties' intentions regarding their Section
14 206 rights. No asserted inference arising from language appearing in the WSPP
15 Agreement addressed to FPA Section 205 – no matter how enthusiastic or
16 fanciful – will allow Mr. Poffenberger to escape the simple fact that Section 6.1 of
17 the WSPP Agreement is silent with respect to the Section 206 rights of the
18 parties.

19
20 **Q. Mr. Poffenberger also argues that the contracts entered into under the**
21 **WSPP Agreement are presumptively just and reasonable, and that**
22 **therefore any proposed changes thereto must be evaluated under the**
23 **public interest standard. Do you agree?**

1 A. No. Mr. Poffenberger may be saying that although the confirms at issue here
2 were never reviewed or accepted by the Commission, they are presumptively just
3 and reasonable anyway because they were entered into without any substantive
4 change, except, of course, for several specific details characterizing the
5 transaction's the term and prices of the transactions. Hence, Mr. Poffenberger
6 concludes that evaluation under the public interest standard is warranted. (See
7 Exhibit No. S-6 at 16:14-17:13.) To my understanding, the Commission seems
8 to have arrived at exactly the opposite conclusion in its Proposed Policy
9 Statement regarding the Standard of Review for Proposed Changes to Market-
10 Based Rate Contracts for Wholesale Sales of Electric Energy by Public Utilities.
11 See 67 Fed. Reg. 51,516 (Aug. 8, 2002) (FERC Docket No. PL02-7-000).

12
13 **Q. Before discussing the Proposed Policy Statement, let us turn briefly to the**
14 **EEI Agreement. Please evaluate Mr. Poffenbergers's analysis of the EEI**
15 **Agreement.**

16 A. I agree with many of the factual statements made by Mr. Poffenberger with
17 respect to the EEI Agreement, but I disagree entirely with the conclusions that he
18 draws.

19

20 **Q. Please explain.**

21 A. Mr. Poffenberger states that:

22 [T]he Commission has never formally reviewed and approved the
23 EEI Agreement. It is also my understanding that none of the EEI
24 transactions at issue in this proceeding have been accepted for
25 filing by the Commission. The EEI Agreement itself does not

1 include any language regarding parties' rights under either Section
2 205 or 206 of the Federal Power Act. In addition, none of the
3 confirmation agreements based on the EEI Agreement include any
4 language regarding either Section 205 or 206 rights. (Exhibit S-6 at
5 17:16-18:2.)
6

7 I agree with these statements. However, Mr. Poffenberger then states that
8 because the EEI Agreements are silent with respect to the parties' rights to make
9 changes, the public interest standard should apply to proposed changes.

10 (Exhibit No. S-6 at 18:2-18:4.) I am not a lawyer, but I think this conclusion is
11 incorrect.
12

13 **Q. You have established that both the WSPP Agreement and the EEI**
14 **Agreement are silent regarding the Section 206 rights of the parties. Why**
15 **is Mr. Poffenberger incorrect in stating that the public interest standard**
16 **should apply in such cases?**

17 **A.** The Commission recently issued its Proposed Policy Statement regarding the
18 Standard of Review for Proposed Changes to Market-Based Rate Contracts for
19 Wholesale Sales of Electric Energy by Public Utilities. As I discussed in my
20 Prepared Direct Testimony, this Policy Statement would require the inclusion of
21 specific language in market-based power sales contracts for the contracting
22 parties to express their intent that the public interest standard be used to review
23 subsequently-proposed changes to the contract. If the specific language
24 provided by the Commission is not included in a contract, then subsequent
25 proposed changes to that contract would be reviewed under the just and
26 reasonable standard. This design, advanced by the Commission itself, rejects

1 the notion that contractual silence can amount to a party's waiver of its rights
2 under the FPA to have contracts reviewed under the just and reasonable
3 standard. Although the Proposed Policy Statement would apply prospectively, it
4 is very relevant to the present dispute.

5
6 **Q. But Mr. Poffenberger invokes the very same Proposed Policy Statement to**
7 **support his argument that the public interest standard applies where**
8 **contracts are silent regarding the parties' rights to change rates, correct?**

9 A. Mr. Poffenberger does indeed cite to the Proposed Policy Statement for support
10 of that argument (see Exhibit No. S-6 at 13:8-13:24), but Mr. Poffenberger's
11 reading of the Proposed Policy Statement is dramatically selective: he ignores
12 the body of the Proposed Policy Statement, indeed, he ignores the very heart of
13 the Proposed Policy, and instead fixes on a small portion of a concurrence that
14 suggests that the Commission could have made a different proposal. This
15 argument is not compelling in my opinion. Despite the fact that Commissioners
16 Brownell and Breathitt, (who is no longer with the Commission) may have
17 suggested a different result, the Commission's Proposed Policy Statement
18 champions the proposition that, "the omission of, or any deviation from, the
19 language quoted below [specifically invoking the public interest standard] would
20 result in the use of a just and reasonable standard of review." 67 Fed. Reg. at
21 51,517. In other words, in the market-based rate context, contractual silence
22 does not constitute waiver of a party's right to have proposed changes reviewed
23 under the just and reasonable standard. Mr. Poffeneberger's arguments are off

1 point, and I believe that the instant case should be evaluated consistent with the
2 Proposed Policy Statement.

3

4 **Q. Does that conclude your Rebuttal Testimony?**


5 **A. Yes, it does.**

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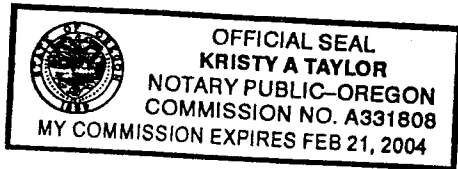
**AFFIDAVIT
OF
STAN WATTERS**


Stan Watters, on oath, deposes and states that the foregoing Affidavit and Exhibits, on behalf of PacifiCorp were prepared by him or at his direction and under his supervision, and that if asked the questions herein, he would give the answers as shown, and that the facts stated herein are true to the best of his knowledge, information and belief.



Stan Watters

Subscribed and sworn to before me on this 22 day of November, 2002





NOTARY PUBLIC
My Commission Expires: **2-21-04**