

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

San Diego Gas & Electric Company,
Complainant,

v.

Sellers of Energy and Ancillary Services
Into Markets Operated by the California
Independent System Operator and the
California Power Exchange,
Respondents

Docket Nos. EL00-95-045
EL00-95-083
EL00-95-087

Investigation of Practices of the California
Independent System Operator and the
California Power Exchange

Docket Nos. EL00-98-042
EL00-98-071
EL00-98-074

ERRATA NOTICE

(Issued May 27, 2004)

On May 12, 2004, the Commission issued an “Order Addressing Fuel Cost Allowance Issues” in the above-captioned proceedings.

Some of the paragraph numbers in this order were incorrectly numbered. The paragraphs following paragraph 25 should be numbered sequentially beginning with paragraph 26 and ending with paragraph 80.

A corrected version of the May 14, 2004 Order is attached.

Magalie R. Salas
Secretary

2. This order benefits customers by clarifying certain aspects of the fuel cost allowance methodology and bringing closure to this proceeding, which will permit final settlements to be calculated and refunds to be made for purchases made in the organized spot markets in California during the period from October 2, 2000 through June 20, 2001 (the Refund Period).

I. Background

3. On March 26, 2003, the Commission issued an order⁴ (March 26 Refund Order) on the initial decision in the California refund proceeding in Docket No. EL00-95, et al.⁵ The March 26 Refund Order, among other things, changed the methodology for calculating the mitigated market clearing prices (MMCP) for the Refund Period. In recognition of the fact that the revised methodology would tend to reduce the MMCP and could potentially reduce it below sellers' actual fuel costs, the Commission provided sellers with the opportunity to make claims for a fuel cost allowance to recover the difference between their actual fuel costs for mitigated sales and the proxy for gas prices used in calculating the MMCP.

4. The March 26 Refund Order also provided guidance as to how to assign actual fuel costs to the mitigated transaction. In recognition that this methodology required an after-the-fact assignment of gas costs to the mitigated transaction, the Commission established a pragmatic approach. In order to verify that generators paid spot gas prices, each generator was required to base its additional fuel cost allowance on its actual daily cost of gas incurred to make spot power sales in the PX and CAISO spot markets. Under this approach, a generator was required to determine what portion of its daily gas supply portfolio it used for spot power sales versus longer-term bilateral sales. Sellers were instructed to assign their shortest-term gas supplies to spot power sales, proceeding sequentially to the next shortest term supply, until a generator's spot power demand for gas is met. The average cost of this portion of the generator's gas supply portfolio would serve as the cost of gas for the additional fuel cost allowance.⁶

5. In addition, the March 26 Refund Order directed parties to file their actual daily cost of gas information, using the prescribed methodology and established a technical conference to address issues concerning the information submitted on generators' fuel cost allowances.

⁴ See San Diego Gas & Electric Co., et al., 102 FERC ¶ 61,317 (March 26 Refund Order), order on reh'g, 105 FERC ¶ 61,066 (2003).

⁵ See San Diego Gas & Electric Co., et al., 101 FERC ¶ 63,026 (2002).

⁶ See March 26 Refund Order at 62,071.

6. A motion for expedited clarification of certain aspects of the March 26 Refund Order relating to the fuel cost allowance was filed by CA Parties on April 2, 2003. In response to that motion, the Commission issued the April 22 Order, which further clarified the method for calculating the fuel cost allowance.

7. Subsequently, 22 sellers⁷ submitted fuel cost allowance claims and the CA Parties filed a motion to reject those claims. On May 22, 2003, the Commission's Staff held a technical conference to, among other things, permit parties to discuss the issues arising from the fuel cost allowance filings and the CA Parties' motion to reject those filings. Those issues together with additional issues raised on rehearing of the April 22 Order are addressed below.

8. The following parties filed requests for rehearing of the April 22 Order: CA Parties, CA Generators,⁸ and NCPA. Several parties filed answers to the requests for rehearing. Rule 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713, prohibits answers to rehearing. Accordingly, we will reject all answers to the requests for rehearing of the April 22 Order.

9. On October 16, 2003, the Commission issued the Refund Rehearing Order, which addressed requests for rehearing of the March 26 Refund Order. The Refund Rehearing Order further clarified the method for calculating refunds for electricity purchases made in the spot market of California. That order also established the gas proxy data series to be used as an input into the calculation of the MMCP. In particular, the Refund

⁷ Reliant Energy Services, Inc./Reliant Energy Coolwater, Inc./Reliant Energy Ellwood, Inc./Reliant Energy Etiwanda, Inc./Reliant Energy Mandalay, Inc./Reliant Energy Ormond Beach, Inc. (Reliant); Dynegy Power & Marketing, Inc./El Segundo Power LLC/Long Beach Generation LLC/Cabildo Power I LLC/Cabrillo Power II LLC (Dynegy); Williams Energy Marketing and Trading Company (Williams); Mirant Americas Energy Marketing, LP/Mirant California, LLC/Mirant Delta, LLC/Mirant Potrero, LLC (Mirant); Duke Energy North America, LLC/Duke Energy Trading & Marketing, LLC (Duke); AES Placerita, Inc.; Midway Sunset Cogeneration Company; Los Angeles Department of Water and Power (LADWP), the City of Pasadena; the City of Anaheim (Anaheim); the City of Burbank (Burbank)/the City of Glendale (Glendale)/Turlock Irrigation District (TID); Sacramento Municipality Utility District; the City of Redding (Redding); the City of Santa Clara (Santa Clara); Modesto Irrigation District (MID); Northern California Power Agency (NCPA); University of California Davis Medical Center; Tucson Electric Power Company; Puget Sound Energy, Inc. (Puget); Nevada Power Company/Sierra Pacific Company; Arizona Electric Power Cooperative, Inc.; Sempra Energy Trading Corp. (Sempra).

⁸ CA Generators are subsidiaries of Duke, Dynegy, Mirant, Reliant, and Williams.

Rehearing Order directed suppliers to use this data series as the baseline over which their fuel cost allowance claims will be calculated. Several parties filed requests for rehearing of the Refund Rehearing Order. In this order, we will address only rehearing requests raising issues pertaining to allocating fuel cost allowances.

II. Discussion

A. Should a fuel cost allowance be permitted for CAISO/PX sales made by a marketer?

10. In the April 22 Order, we clarified that:

...the additional fuel cost allowance should be based upon the MWh actually sold into the CAISO and PX markets, and the gas used to fuel that generation. The additional fuel cost allowance is meant to reimburse generators for any unrecovered cost of gas incurred to make spot power sales beyond that recovered under the MMCP calculation.⁹

11. CA Parties argue that marketers should not be eligible to receive the fuel cost allowance for the transactions they made in the CAISO and PX markets because marketers do not buy fuel; they buy and sell power. To the extent that marketers have presented fuel costs of the generation entities from whom they purchased power, CA Parties argue that these bilateral power sales are not subject to refund and the fuel costs associated with these bilateral sales should not be recoverable as an offset to the marketer's refund liability associated with its power sales into the CAISO and PX markets. As an example of this type of situation, CA Parties point to the gas cost allowance filing of marketer Sempra, in which it allegedly requested an allowance for gas costs actually incurred by the entity, El Dorado Energy, LLC (El Dorado), from whom it purchased the energy that it then resold to the CAISO or PX. In its fuel cost allowance claim, Sempra states that the El Dorado unit is owned in equal shares by Reliant Energy Power Generation, Inc. and Sempra Energy Resources, an affiliate of Sempra. Sempra further states that for two months during the Refund Period, it bought and supplied the gas and acted as the principal scheduling coordinator for El Dorado's sales to the CAISO. For two other months during the Refund Period, Reliant supplied the gas and acted as principal scheduling coordinator for El Dorado's sales to the CAISO. However, during the latter period, Reliant sold Sempra part of the energy output from the El Dorado unit.

12. CA Parties also object to filings by generators for fuel cost allowances associated with bilateral sales outside the CAISO/PX markets. CA Parties point to Burbank's filing in which Burbank sought a fuel cost allowance for a sale it allegedly made to Sempra.

⁹ See April 22 Order at 61,259.

Burbank argues that Sempra was merely the Scheduling Coordinator for its sales into the CAISO and PX markets.

13. Finally, in its petition for relief from refund reliability, Hafslund Energy Trading (Hafslund) argues that, according to its analysis, the revenue it is owed under the original, unmitigated market clearing price is consistent with revenue it would have gotten under a just and reasonable rate. Hafslund, therefore, requests an exemption from the MMCP.

Commission Determination

14. We agree, in general, with CA Parties' position on the ability of marketers to recover fuel costs for sales made in the CAISO/PX markets. The Commission created the fuel cost allowance to ensure that price-mitigated sellers who actually paid more than the MMCP for fuel used to serve California are not prevented from recovering their actual fuel costs. Normally marketers have no fuel costs. They do not generate electricity and thus do not purchase fuel. Rather, power marketers generally purchase electricity for resale and, thus, could not make a fuel cost allowance claim without first engaging in a complicated attempt to "back into" a fuel cost component the market-based rate they paid. This would require tracing back through a series of bilateral transactions that are not subject to refund in an attempt to identify the generating entity.¹⁰

15. Furthermore, for resellers of purchased power including marketers, the Commission has already established a portfolio-wide cost-based backstop. Our December 19, 2001 Order¹¹ permits a marketer to justify prices in excess of the MMCP based on the marketer's entire portfolio of transactions during the refund period. No subsequent Commission action has changed that right and, therefore, the Commission believes that marketers already have an appropriate forum for seeking to recover costs in excess of the MMCP. Accordingly, the Commission finds that marketers, with one exception discussed below, may not seek a fuel cost allowance. We also note that Hafslund has the option to file a cost and revenue study and therefore reject Hafslund's petition for exemption from the MMCP.

¹⁰ Adding to this complicated set of assumptions is the difficulty of verifying actual generation and fuel costs used through the chain of transactions. Any such attempt would require a variety of assumptions as to the fuel costs faced by the ultimate generating entity from whom they purchased power, and those individual assumptions could vary widely and would certainly be open to interpretation and dispute.

¹¹ See San Diego Gas & Electric Co., et al., 97 FERC ¶ 61,275 (2001).

16. The exception involves so-called tolling agreements such as the agreement between AES Southland, Inc. (AES) and Williams. Under this long-term agreement, Williams purchased all of the output of certain AES units at a fixed rate of \$60/MWh plus the cost of all needed fuel, which was in fact procured by Williams. In other words, Williams essentially rented the units for \$60/MWh, supplied its own fuel, and marketed the electrical output generated with its fuel. Under this arrangement, Williams took on the key characteristics of a generator by purchasing the fuel required to make its sales directly to the ISO/PX. Where these unique circumstances exist, the Commission finds that the marketer should be eligible to make a fuel cost claim because the marketer itself directly procured and paid for the fuel and has clearly identifiable fuel costs directly tied to its sales to the ISO/PX.

17. Regarding the case of El Dorado, we reiterate that in order to be eligible for a fuel cost allowance, the entity which both purchased fuel and then sold the power it generated from that fuel directly to the ISO/PX is eligible for a fuel cost allowance. We therefore direct Sempra and any similarly situated entity to file their fuel cost allowance claim accordingly.

18. Regarding a generator's bilateral sales, since bilateral sales that do not involve the ISO or PX are not mitigated, the Commission generally sees no reason why fuel costs associated with bilateral sales should be eligible for inclusion in the fuel cost allowance claims of generators. With regard to the Burbank example that the CA Parties raise, we note that Burbank may not file for a fuel cost allowance for its purchases that used Sempra as the Scheduling Coordinator. The fuel cost allowance is an offset to allow a generator to recover its cost of fuel for transactions for which it has refund liability. Since the Commission has generally held that refund liability in this proceeding attaches to the Scheduling Coordinator of the transaction, Burbank may not receive a fuel cost allowance offset for purchases for which it would not have been held refund liable because Sempra was the Scheduling Coordinator for the transactions.

B. How, if at all, should an affiliate's gas costs be reflected in the fuel cost allowance?

19. In the April 22 Order, we declined to impose a blanket prohibition on the consideration of gas purchases from affiliates. On balance, we found that generators need to be given the opportunity to support the appropriateness of any affiliate gas transactions included in their additional fuel cost allowance claims and that parties may challenge the appropriateness of including such transactions on a case-by-case basis.¹²

¹² See April 22 Order at 61,259.

20. Certain generators (Dynergy, Reliant, and Williams) included gas costs of their parent companies or other gas marketing affiliates in their fuel cost allowance claims. Duke, on the other hand, did not use actual fuel cost, but rather relied on intra-corporate valuation at the spot price. While CA Parties agree that generators affiliated with gas marketers should “pierce the corporate veil” and attempt to arrive at “actual” fuel costs, CA Parties argue that even the generators who did so did not delve deeply enough into the gas marketing activities of their affiliates, including the net effect of all of their gas purchases, sales, and hedging activities.

Commission Determination

21. We agree that intra-corporate transfer prices do not necessarily reflect “actual” fuel prices. The fuel price originally paid by a marketer may not be the same as the resale price offered to the affiliated generator. Accordingly, as a threshold matter, we direct all claimants who purchased fuel from marketing affiliates to ignore the intra-corporate valuation at spot prices, and instead to “pierce the corporate veil” and present the actual cost of fuel incurred by the affiliate who first obtained ownership of the fuel for the combined corporate entity.

22. Regarding whether all activities of the fuel marketing affiliate (purchases, sales, and hedging) must be scrutinized to arrive at an appropriate cost of fuel for mitigated power sales, we address that question in the next two sections below.

C. How, if at all, should other uses of gas be reflected in the fuel cost allowance calculations?

23. In the April 22 Order, we stated that the additional fuel cost allowance should be based upon the gas used to fuel the generation sold into the CAISO and PX markets.¹³

24. CA Parties argue that generators (or, as noted above, their marketing affiliates) could have purchased short-term gas for reasons other than to support sales to the ISO or PX. Primarily, CA Parties focus on the ideas that gas could have also been purchased: (a) to serve generation sales other than the mitigated sales to the ISO and PX; (b) for resale to others; (c) to address gas imbalances; or (d) for injection into storage. CA Parties contend that gas purchased for these other uses should be netted against the short-term gas purchases that would otherwise be incorporated into the fuel cost allowance. In connection with this, CA Parties argue that a fuel cost allowance can only be granted if it is supported with information on the generator's entire gas portfolio.

¹³ See April 22 Order at 61,259.

Commission Determination

25. CA Parties wish to introduce an unmanageable amount of complexity into an already complicated refund calculation. The Commission realized that the fuel cost allowance would be extremely difficult to reconstruct and would assign gas costs for refund calculation in a way that is not normally recorded. It was for this reason that the March 26 Refund Order assigned spot gas purchases to spot power sales first based on the principle of marginal purchase, which follows that: (1) spot power sales were made at the margin after the generators' longer-term power obligations were served, and (2) spot gas was bought to serve the spot power sales. If the generator has sold one less MW of spot power in the ISO and PX markets, it would have bought one less unit of the shortest-term gas available. Given that framework, it follows that all other uses of gas must be viewed as having been served using only the gas supplies that remained after these mitigated spot power sales were served. Accordingly, there is no need to reflect other uses of gas in the fuel cost allowance claims. The CA Parties' proposal is thus rejected.

D. How, if at all, should hedging transactions be reflected in the fuel cost allowance calculations?

26. In the April 22 Order, we stated that:

... generators must base their claims for additional fuel cost allowances on their actual daily cost of gas incurred to make spot power sales. To the extent that any financial and contractual arrangements these generators may have had in place for the purchase of gas impacted their actual cost of gas incurred to make spot power sales, generators must take into account any such arrangements in making their claims.¹⁴

27. CA Parties contend that many generators ignored the impact of hedging arrangements and other financial derivatives or contractual arrangements in their fuel cost allowance calculations. CA Parties also point to a specific type of hedge in which spot gas is purchased and a separate payment for the difference between the spot purchase and the hedged price is later received. As a result, CA Parties believe that the generators' fuel cost allowances are overstated. CA Parties' witness, Dr. Berry, asserts that a reasonable and equitable method for adjusting gas purchase costs for such financial hedges is to allocate the financial flows associated with all hedging instruments to all gas purchases on a pro rata basis.

¹⁴ See April 22 Order at 61,258.

28. At the May 22 technical conference, generators essentially argued that financial hedging activities are not associated with spot gas purchases, only with longer-term gas purchases. Their written answers to the CA Parties' motion to reject fuel cost allowance submittals reflect much the same argument. Addressing the CA Parties' hedging example, they argue that this is only a narrow circumstance and that they treat such gas purchases as longer term gas instead of spot gas. In addition, Duke points out that the Commission has recently approved certain accounting standards for hedging that contradict Dr. Berry's proposal for pro rata allocation.

Commission Determination

29. We clarify that any hedging instruments or other financial transactions should be reflected in the fuel cost allowance claims only if they are tied to the gas purchases attributed to spot power sales under our methodology. As noted, generators contend that such financial transactions were never relevant to the spot gas purchases that the Commission has assigned to serve spot power sales. According to generators, only longer-term gas purchases were tied to hedging or other financial instruments. The CA Parties do not specifically dispute this contention. Rather, their arguments revolve around the concept that all hedging or other financial instruments should be assigned or allocated to all gas purchases irrespective of term. This concept is fundamentally at odds with our prior orders and the primary reason for entering into such financial instruments.

30. Regarding the specific example raised by CA Parties, we note that despite the presence of a spot market price as part of the transaction, the hedge itself is longer term and has no direct relationship to the purchase of daily spot gas for spot electricity sales. However, in order to properly account for such transactions, and consistent with assigning short-term gas supplies to spot power sales and proceeding sequentially to the next shortest term supply, we direct generators to allocate gas purchases by the term associated with the underlying hedge.

E. Can the cost of fuels other than gas be recovered through the fuel cost allowance?

31. Certain parties included non-gas fuel costs in their allowance claim filings. For example, Puget, Duke, and Dynegy burned fuel oil in order to make some of their sales to the CAISO or PX.

32. CA Parties argue against any fuel cost allowance for fuels other than gas because the Commission's MMCP methodology is based on gas costs.

Commission Determination

33. The Commission sees no basis to exclude the cost of any alternative fuel from the fuel cost allowance. It is irrelevant whether the MMCP is based on gas costs because the MMCP is meant to serve as a proxy for a competitively-set single market clearing price based on the bid of the marginal unit which is most likely to be a gas-fired unit. In contrast, the fuel cost allowance was meant to ensure that generators could recover their actual cost of fuel for all units associated with mitigated sales, not just the marginal unit. The two keys then are that: (1) fuel was burned to make mitigated sales; and (2) the cost of the fuel exceeded the proxy for gas prices used in computing the MMCP. It does not matter what fuel a generator used. Accordingly, the Commission will permit the cost of fuel other than gas to be recovered through the fuel cost allowance, provided that the criteria above are met.¹⁵

F. Should pumped-storage hydro generators be able to claim the fuel cost associated with their ultimate thermal generation source?

34. LADWP made certain sales to the CAISO and PX from pumped-storage hydro generation. All pumped-storage facilities work by taking advantage of the fact that peak prices for electricity are generally higher than off-peak electricity prices. Accordingly, a pumped-storage facility will purchase electricity off-peak in order to run its electric-powered pumps. Those pumps then increase the potential energy of the facility's working fluid; most commonly water but sometimes air. In a pumped-storage hydro facility like LADWP's, the water is simply moved from a lower-altitude reservoir to a higher-altitude reservoir. Then, during peak demand hours when electricity is more valuable, the higher reservoir is opened so that gravity will draw the water back through the pumps in the other direction. The pumps then work in reverse and act as turbines attached to generators. The electricity produced is sold at the higher peak price.

35. LADWP's fuel cost allowance filing includes certain fuel costs for thermal generation, owned by LADWP, and which it claims was run in order to power the pumps in its pumped-storage hydro facility. CA Parties oppose this claim for basically the same reasons that they oppose a fuel cost allowance for marketer sales to the ISO/PX. CA Parties argue that any bilateral power sales to the pumped-storage facility are not subject to refund so the fuel costs associated with those bilateral sales should not be recoverable as an offset to the pumped-storage facility's refund liability associated with its power sales to the ISO/PX. At the May 22 technical conference, CA Parties noted that there are no thermal generation facilities located at the pumped-storage facilities in question.

¹⁵ We note that the April 22 Order frequently discusses "gas" instead of "fuel" because it responds to questions framed that way (i.e., the question was about gas). This was an oversight that we hereby correct.

Commission Determination

36. As a general matter, the input electricity used by a pumped storage facility can come from owned generation or purchased power. In LADWP's case, it comes from LADWP-owned generation which is located elsewhere on LADWP's system. Here, there actually is only a single entity, LADWP, both generating the input electricity and making the sale to the ISO or PX. Accordingly, the Commission will permit LADWP to recover fuel costs associated with its pumped-storage sales to the ISO or PX.

37. In contrast, if a pumped-storage facility had purchased third-party power as input electricity, the Commission would see no relevant difference from the situation of a more traditional power marketer. In both cases the marketer would be reselling energy it purchased from someone else. A pumped-storage facility is merely able to delay its resale until the most favorable circumstances prevail. Accordingly, for instances where third-party purchased power was used as input electricity, the Commission will prohibit pumped-storage facilities from making a fuel cost allowance claim for the same reasons that power marketers are prohibited. Any attempt to "back into" a fuel cost from the market-based price paid by the facility for input power would require the facility to make a variety of assumptions as to the fuel costs faced by the seller from whom they purchased power, and those individual assumptions could vary widely and would certainly be open to interpretation and dispute. Also, as with other marketers, the Commission has already established a portfolio-wide cost-based backstop.

G. Are out-of-state generators eligible to receive a fuel cost allowance?

38. Certain out-of-state generators have made fuel cost allowance filings. CA Parties oppose these filings arguing that the Final Staff Report¹⁶ and the March 26 Refund Order only permit fuel cost allowances for generators who actually paid California delivery point spot gas prices. CA Parties interpret this to mean that only generators actually located in California can qualify. CA Parties also argue that there is no way to verify that fuel costs claimed by out-of-state generators were actually incurred for sales to the CAISO or PX.

Commission Determination

39. The Commission's intent in the Final Staff Report and the March 26 Refund Order was broader than the CA Parties contend. The March 26 Refund Order adopted the Final Staff Report recommendation to use producing-area prices plus transportation as a proxy for gas prices in computing the MMCP.¹⁷ The Commission's modification of Staff's

¹⁶ The Commission Staff's Final Report on Price Manipulation in Western Markets in Docket No. PA02-2-000.

¹⁷ See March 26 Refund Order at 62,071.

recommendation to rely on actual daily costs did not preclude out-of-state generators who bought gas outside of California from making fuel cost allowance claims.¹⁸

40. As noted earlier, the key questions are whether the fuel was burned to effectuate a mitigated sale to the ISO or PX and whether that fuel was more or less expensive than the MMCP. Accordingly, the Commission will permit out-of-state generators to make fuel cost allowance claims provided that they can adequately support their filings in the same way that all other claimants must.

H. How much information must generators provide as to their full range of electricity activities?

41. CA Parties contend that generators cannot support their fuel cost allowance claims unless they provide full information about the totality of both their electricity sales and purchases, including spot bilateral sales. Only in this way, CA Parties argue, can actual gas costs associated with mitigated ISO and PX sales be determined.

42. In CA Parties' view, electricity sales are important, because non-mitigated short-term "spot" sales should be allocated a pro-rata share of the generators' spot gas purchases. In CA Parties' opinion, this would reduce the amount of generally expensive spot gas available for serving mitigated spot electricity sales and, thus, reduce the average cost of gas incorporated into the fuel cost allowance claims. Electricity purchases are important, in CA Parties' view, because if the purchased power was actually used to serve mitigated sales to the ISO or PX, then the generator essentially acted as a marketer for such resales. Since CA Parties argue that marketers should never be eligible for a fuel cost allowance, there should be no allowance associated with those ISO/PX sales and, thus, the average cost of gas incorporated into the fuel cost allowance claims should again be reduced.

43. NCPA seeks clarification that its methodology should not include the "sell" component of buy-sell transactions as spot power sales over which gas costs would be allocated.

Commission Determination

44. The Commission disagrees that the generators' non-mitigated short-term bilateral power sales are equivalent, for purposes of the fuel cost allowance calculations, to spot power sales made through the organized and mitigated spot markets. The CA Parties argue that the term "spot power sales" from the March 26 Refund Order includes spot bilateral sales. In the March 26 Refund Order, the Commission outlined a process to identify the cost of gas used to make spot power sales in the PX and CAISO spot

¹⁸ Id.

markets. We thus disagree with CA Parties and clarify that the discussion of allocating gas purchases to “spot power sales” refers only to sales in the PX and the CAISO spot markets, not to spot bilateral sales. This treatment is consistent with the principle of marginal purchase as discussed in section C and our finding that marginal heat rates should be used to determine the MMCP. We find that spot power sales in the PX and CAISO markets were an incremental or marginal use of sellers’ generation assets. Accordingly, the allocation of gas purchases should assign the shortest-term gas supplies first to the ISO/PX sales ahead of bilateral spot and spot gas sales. For these reasons, we deny clarification.

45. Regarding the generators' power purchases and NCPA's related clarification request, the Commission agrees with CA Parties that at times when generators made mitigated sales from purchased-power, they acted as marketers. Accordingly, no fuel cost allowance will be permitted for those periods or transactions. However, we also agree with NCPA that spot power sales made using purchased power, for which no fuel cost allowance will be permitted, should not be included in the total spot power sales amount over which spot fuel costs are allocated. Since there was no relevant fuel cost associated with these sales, it would make no sense to allocate fuel costs to these sales.

I. Should discovery be granted to permit buyers to check the accuracy of the fuel cost allowance claims?

46. CA Parties argue that discovery should be granted and buyers should have the opportunity to present adverse evidence and arguments to counter the sellers' fuel cost allowance claims. More specifically, CA Parties argue that the Commission should: (1) direct claimants to submit additional data within 30 days; (2) provide that failure to adequately support claims with the additional data will result in rejection; and (3) allow 40 days for answers to the claims following the submission of additional data.

Commission Determination

47. The Commission finds that the clarifications adopted herein eliminate the need for discovery in the form of the pro forma data request as proposed by CA Parties. Instead, the Commission will require parties to support and, if necessary, revise their filings consistent with the clarifications recommended herein. Included with their support should be workpapers necessary to verify the fuel cost claims as discussed in the final section of this order.

J. Should the fuel cost allowances be capped such that they can never result in a refund level lower than what would have resulted from use of the original MMCP formula?

48. CA Parties argue that the change from California delivery point index pricing to basin plus transportation pricing in the MMCP calculation, less fuel cost allowance, should not be permitted to ever result in refunds less than those that would have resulted under the original MMCP formulation.

Commission Determination

49. The Commission's intent in changing the method of calculating the MMCP was neither to raise nor lower the refund amount. Rather, it was to establish a reasonable basis for calculating refunds. We continue to believe that the revised methodology is indeed a reasonable means of calculating refunds. Accordingly, we reject this aspect of CA Parties' arguments.

K. Should average or incremental heat rates be used to calculate the fuel cost allowances?

50. While the Commission has conclusively found in past orders that incremental heat rates should be used in the MMCP calculation,¹⁹ the first order to discuss whether average or incremental heat rates should be used to calculate the fuel cost allowances was the April 22 Order. The April 22 Order stated simply that the use of incremental heat rates in the determination of the additional fuel cost allowance would be consistent with the calculation of the MMCP.²⁰

51. CA Generators argue, both in their motion for expedited clarification and in their rehearing request, that average heat rates should be used to calculate the fuel cost allowances because, unlike the MMCP calculation, the fuel cost allowances are designed to permit recovery of actual fuel costs. According to CA Generators, use of the average heat rate better reflects actual fuel costs because average heat rates include minimum load fuel costs while the incremental heat rates used for the MMCP calculation do not.

52. In response to the CA Generators' motion for expedited clarification, CA Parties argue that incremental heat rates should be used for the fuel cost allowance. CA Parties point out that they presented evidence during the proceeding that 70 percent of CA Generators' sales during the Refund Period were made outside of the mitigated markets.

¹⁹ See March 26 Refund Order at 62,066; and Refund Rehearing Order at 61,367-68.

²⁰ See April 22 Order at 61,259.

Accordingly, CA Parties essentially argue that it is appropriate to view the mitigated ISO/PX sales as being an incremental use of the CA Generators' generation and, thus, that the use of average heat rates would inappropriately allocate to mitigated ISO/PX sales the fuel costs associated with unmitigated bilateral sales.

53. CAISO also responded adversely to this aspect of CA Generators' motion for expedited clarification. CAISO states that the Commission's orders never endorsed recovery of minimum load fuel costs through the fuel cost allowance and never endorsed the use of a different heat rate in the fuel cost allowance calculation. Rather, in CAISO's view, the Commission merely provided for the fuel cost allowance to use a different price for gas from that used in the MMCP calculation while the amount of gas, determined in large part by the heat rate data, would remain the same.

Commission Determination

54. We will deny the request for rehearing on this point but will grant clarification. To the extent that a generator must, for purposes of this fuel cost allowance calculation, use heat rate data to determine how much fuel was burned by a unit at a particular level of output, incremental heat rates should be used. The principle of the marginal purchase, as previously discussed in section C, applies here as well, whereby spot power sales were made at the margin after the generators' long-term power obligations were served. We, therefore, agree that the CAISO/PX sales made during this period were primarily a marginal or incremental use of the sellers' generation. We find that this predominantly incremental use of generation took place using predominantly the last MWhs produced by the unit. Given this and the fact that most of the sellers' generation was sold at non-mitigated rates, we find that incremental heat rates are most appropriate for use in the fuel cost allowance calculations. Additionally, as noted in the Refund Rehearing Order, after final MMCPs are calculated, sellers have the right to submit cost evidence, on a portfolio-wide basis, demonstrating that their overall costs would not be recovered.

L. How should generators assign heat rates to mitigated power sales that are not unit specific?

55. CA Parties point out that some mitigated power sales, such as sales to the PX, are not tied to a specific generating unit and could have been made from any unit within a seller's portfolio of generation. CA Parties argue that many sellers submitted fuel cost allowance claims that assign the heat rate from their least efficient generation to these types of power sales. CA Parties believe a pro rata allocation of each generating unit over all sales is a more reasonable allocation. CA Parties contend that even in the case of load-serving entities, all units not used to serve native load should be allocated pro rata to all non-native load power transactions.

Commission Determination

56. In general, it is reasonable to assume that a generator would have operated each of its units in order of higher to lower efficiency until all power sales are fulfilled. Consistent with our finding that mitigated power sales were the incremental or marginal generator sales, it follows that a mitigated, non-unit specific power sale would have been part of the very last amount of electricity produced. This power sale therefore would have been produced using the least efficient unit (i.e., the unit with the highest incremental heat rate) in operation at the time. We therefore reject CA Parties' proposal.

M. Is the fuel cost allowance available during all intervals in which a unit is mitigated (in particular during the soft-cap period)?

57. CA Generators seek clarification that excess fuel costs are recoverable during all instances in which a unit is mitigated, even if the MMCP is greater than the MCP. This issue arose from the following statement in the April 22 Order: “[i]n intervals where the MCP was lower than the MMCP, there is no need to provide an additional fuel cost allowance.”²¹ CA Generators point out that, due to the existence of soft-caps in the CAISO markets there are intervals in which a unit will be mitigated even though the MCP was lower than the MMCP.

58. On reply, CA Parties do not object to the requested clarification. They, however, request that the Commission condition its clarification on this issue by holding that for all intervals of the Refund Period, regardless of whether there was a soft cap in effect, the fuel cost allowance should not result in generators recovering more than the pre-mitigated amount.

Commission Determination

59. We will grant this clarification only in cases where the soft cap affected the MCP, and such effect must be tangibly demonstrated. We agree with the CA Parties' proposed condition.

N. Fuel Cost Allowance Recovery in Proportion to Gross Load

60. In the Refund Rehearing Order, we found that the fuel cost allowance will be allocated to customers as an offset to refunds in proportion to customers' Gross Control Area Load in the same manner as emissions costs offsets.²² Several parties filed request for rehearing of this ruling raising the issue of whether the Gross Control Area Load is

²¹ See id.

²² See Refund Rehearing Order at 61,386.

the proper allocation factor for the fuel allowance cost. We will now address this issue, as it is directly related to the subject matter of the instant proceeding.

61. Specifically, Redding and Santa Clara argue that allocation by Gross Control Area Load fails to match gas costs to the transaction for which they were incurred, and fails to match the costs with the beneficiaries of the costs. City of Vernon and Northern California Power Agency also argue that allocation of the additional fuel cost allowance based on customers' Gross Control Area Load would be inequitable: entities that met the bulk of their energy needs through scheduling of resources they arranged would have to share the costs caused by other market participants who used the CAISO to make up, through spot purchases, enormous shortfalls in their schedules.

Commission Determination

62. We will grant rehearing on this issue. The fuel cost allowance is not similar to the emission cost offset. The December 19 Order found that total gross load was the most appropriate method to assess emission costs because of the reliability function served by the ISO's markets. Due to the nature of the emissions costs and its direct relation to reliability of the ISO grid, we found it appropriate that the emissions costs be assessed against all in-state load served on the ISO's transmission system, on the basis of control area gross load.

63. We find that the nature and purpose of the fuel cost allowance is substantially different from the nature and purpose of the emission cost allowance. The fuel cost allowance applies to spot-market gas purchases made for spot-market energy sales. Accordingly, we find that the recovery of the fuel cost allowance should be assigned to those that relied on the energy sales spot market to serve load. We direct the CAISO to devise a method that follows this principle and note that NCPA has suggested two options that appear to achieve this result: fuel cost allowance allocated on an hourly basis to those entities receiving refunds as a result of their spot market purchases or offset against the refund liabilities of individual sellers.

O. Gas Proxy Data Series

64. CA Parties request clarification that the basin plus transportation price series developed by Dr. Michael J. Harris should be used in the MMCP calculation and in the additional fuel cost allowance calculations. The Commission provided the requested clarification in the Refund Rehearing Order at paragraph 44. In particular, we stated that:

... [t]he Commission finds this gas price proxy data series to be reasonable and accurate. Accordingly, the Commission directs that the CAISO and the PX use this gas price proxy data series as an input into the calculation of the MMCP and that

suppliers use this data series as the baseline over which their fuel cost allowance claims will be calculated.²³

65. In their request for rehearing of the Refund Rehearing Order, Redding and Santa Clara challenge the above quoted ruling to adopt the basin plus gas proxy data series proposed in the California refund proceeding and subsequently discussed at the May 22 technical conference.²⁴ Specifically, Redding and Santa Clara argue that before adopting the basin plus gas proxy data series, the Commission should have reopened the record before the Presiding Judge so that the new data series could be fully reviewed and analyzed.

Commission Determination

66. The issue of the appropriate data series to use to calculate the MMCP was designated as one of the main topics for discussion at the May 22 technical conference.²⁵ This issue was fully discussed at the technical conference, and the conference participants agreed that the basin plus gas proxy data series should be used to calculate the MMCP.²⁶ In fact, a number of submittals of fuel cost allowance calculations are based on this basin plus gas proxy data series. We also note that a representative of Redding and Santa Clara attended the May 22 technical conference and did not participate in the discussion of the data series issue.²⁷ For these reasons, we reject Redding and Santa Clara's request for rehearing.

P. Relation of Generator's Fuel Cost to Gas Proxy Price

67. CA Parties raise two issues concerning a generator's cost of fuel relative to the gas proxy price (Dr. Harris' basin plus transportation price series). First, they continue to argue that the Commission should require sellers to net out fuel cost allowance amounts related to periods when their actual daily fuel costs were less than the gas proxy price. Second, CA Parties contend that some generators have excluded all fuel purchase transactions below the gas proxy price in calculating their daily average fuel costs. They argue that this results in average costs that are inaccurately high.

²³ See Refund Rehearing Order at 61,371.

²⁴ See id.

²⁵ Notice of Technical Conference Agenda, Docket No. Nos. EL00-95-045 and EL00-98-042 (May 16, 2003); and Transcript of May 22, 2003 Technical Conference, Docket Nos. EL00-95-045 and EL00-98-042, at 8-9 (June 6, 2003).

²⁶ See Transcript of May 22, 2003 Technical Conference at 8-23.

²⁷ See Transcript of May 22, 2003 Technical Conference at 6 and 8-23.

Commission Determination

68. Regarding the first issue about netting, we find that CA Parties raise no new arguments, and that the April 22 Order reached the correct conclusion on this issue. We reiterate that just as sellers may not net out from refunds the profits they would have received when their prices were less than the MMCP (because the MMCP is treated as a cap instead of a clearing price), they should not now have to net out of the fuel cost allowance amounts related to periods when their actual fuel costs were less than the gas proxy price.²⁸

69. Regarding the second issue about possible exclusion of below proxy fuel purchases in calculating average daily fuel costs, we agree with CA Parties. Accordingly, we direct generators to incorporate into their calculation all fuel purchases, whether above or below the gas proxy, that were transacted to make mitigated sales.

Q. Market Manipulation

70. CA Parties continue to request that the fuel cost allowance be prohibited for those found guilty of gas market manipulation. The issue of how entities found guilty of this type of activity will be dealt with was addressed in detail in the Refund Rehearing Order at paragraphs 200 through 206 and we see no justification for revisiting it here.

R. Settlement Agreement between Williams and the State of California

71. In this order, we will also address procedural issues relating to the Settlement Agreement filed by Williams in compliance with the Commission directive in the Refund Rehearing Order. This Settlement Agreement was concluded between Williams and the CPUC and CEOB in the Docket Nos. EL02-60-000 and EL02-62-000 proceeding. That proceeding involved a complaint by CPUC and CEOB against Williams, challenging a number of long-term contracts entered into with Williams by the California Department of Water Resources in early 2001. The Settlement Agreement resulted in the dismissal of the CPUC and CEOB's complaint against Williams.²⁹ Additionally, on the basis of the Settlement Agreement, William's case was partially dismissed from the California refund proceeding to the extent the proceeding directed the refunds for sales of electric power sold by Williams to the State of California.³⁰ The December 30 Order, however, did not

²⁸ See April 22 Order at 61, 259.

²⁹ The CPUC and CEOB's Notice of Withdrawal with prejudice of the complaint against Williams was filed on January 13, 2003 and became effective on January 28, 2003 pursuant to Rule 216(b)(1), 18 C.F.R. § 385.216(b)(1).

³⁰ San Diego Gas & Electric Co., et al., 101 FERC ¶ 61,391 (2002) (December 30 Order).

establish a methodology for implementing the Settlement Agreement in the California refund proceeding. Upon William's request for clarification concerning implementation of the Settlement Agreement, the Refund Rehearing Order directed Williams to file the Settlement Agreement for the Commission to assess its possible impact on refunds.³¹

72. On November 4, 2003, Williams submitted for filing the Settlement Agreement. Several parties, including PG&E, NCPA, and Californians for Renewable Energy, Inc., commented on the terms of the Settlement Agreement. We clarify in this order that the Settlement Agreement was not filed pursuant to Rule 602 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.602, governing submission of settlement offers. The filing was directed for informational purposes only. For this reason, we will not address comments challenging the terms of the Settlement Agreement. We direct Williams in its fuel cost allowance claim to reflect any adjustments resulting from the terms of the Settlement Agreement with CPUC and CEOB.

S. Motions to Lodge

73. On September 24, 2003, as supplemented on December 4, 2003, the CA Parties filed a motion to lodge eight orders by the Commodity Futures Trading Commission (CFTC). These orders address offers of settlement reached between the CFTC and eight different entities,³² which neither admitted nor denied the findings in the CFTC's orders. The CA Parties argue that the CFTC orders provide additional support for the CA Parties' position that the submitted fuel cost allowance calculations are based on inappropriate methodologies, are inadequately supported, and significantly overstate actual gas costs and thus should be rejected. The CA Parties believe that the CFTC orders will aid the Commission's understanding of the issues in the instant proceeding by explicating both the scope and severity of the misreporting by major gas marketers. In the CA Parties' opinion, the CFTC orders demonstrate how flawed the gas index pricing was during the Refund Period and how inappropriate it is to use these very same indices to calculate gas cost allowances.

74. CA Generators, Burbank, Glendale, TID, Duke, Competitive Supplier Group, Anaheim, Redding, and MID filed answers in opposition to the CA Parties' motion to lodge. They argue that the CFTC's orders the CA Parties seek to lodge in the instant

³¹ See Refund Rehearing Order at 61,390.

³² These entities are Dynegy Marketing & Trade and West Coast Power LLC, El Paso Merchant Energy, L.P., WD Energy Services Inc., Williams Energy Marketing and Trading, Enserco Energy, Inc., Duke Energy Trading and Marketing, L.L.C., Reliant Energy Services, Inc., and CMS Marketing Services and Trading Company and CMS Field Services, Inc.,

proceeding are irrelevant to both the determination of the proxy gas price and the generators' fuel cost allowance filings. The opposing parties argue that the CA Parties challenges of the March 26 Refund Order's findings pertaining to gas indices are overbroad and that the movants have failed to establish the link between alleged misreporting of gas prices and the indices to be used in calculating fuel cost allowances.

75. On July 22, 2003, Duke filed a motion to lodge the Settlement Agreement concluded between El Paso Merchant Energy-Gas, L.P. and El Paso Merchant Energy Company on one side, and the CPUC, PG&E, SoCal Edison, and the City of Los Angeles, California on the other side (El Paso Agreement)³³ in the instant proceeding. In Duke's opinion, this would require vacating the portion of the March 26 Refund Order modifying the natural gas price indices in calculating the MMCP. Duke explains that because the El Paso Settlement Agreement has established the settlement fund, of which approximately 72.9 percent goes directly to compensate California retail electricity consumers, the use of the producer basin price indices to calculate the MMCP will result in duplicate recovery for the same injury, *i.e.*, artificially high electricity prices resulting from non-competitive basis differentials in the natural gas markets. El Paso filed an answer to Duke's motion to lodge stating that it mischaracterizes the conclusions reached in the Final Staff Report regarding the causes of higher natural gas prices at the California border.

76. CA Parties and Duke request that we reopen the evidentiary record and reconsider the methodology and process for calculating refunds and fuel cost allowances. The CA Parties and Duke, however, have failed to show good cause to reopen the record pursuant to Rule 716 of the Commission's Rules of Practice and Procedure, 18 C.F.R § 385.716. The documents that the CA Parties and Duke seek to lodge are irrelevant to the instant proceeding. The need for finality in the proceeding dictates the denial of CA Parties' and Duke's motions to lodge.

III. Process to Further Resolve Fuel Cost Allowance Issues

77. In order to resolve the fuel cost allowance proceeding in an efficient and equitable manner, we establish the following process. We direct that all fuel cost allowance claims

³³ The El Paso Settlement Agreement was accepted by the Commission on November 14, 2003. See Public Util. Com'n of the State of California v. El Paso Natural Gas Co., et al., 105 FERC ¶ 61,201 (2003).

be independently reviewed by an outside auditor,³⁴ and that a responsible company official attest to the independent auditor's findings. Specifically, the independent auditor will review and verify that the source data used in fuel cost calculations are correct and comprehensive, and that the calculations performed to determine a fuel cost allowance claim conform to the Commission's directives. In turn, the responsible company official will be required to attest to the following:

I have examined the facts on which the auditor's findings rest, and hereby declare under penalty of law, 18 U.S.C. § 1001, that all statements of fact contained therein are true, correct, and complete to the best of my knowledge, information, and belief, and are made in good faith.

78. CA Parties and generators must all agree on the choice of the independent auditor and inform the Commission of their choice within 30 days of issuance of this order. If parties are unable to agree, we direct them to submit a list of no more than three proposed auditors to the Commission within 30 days of issuance of this order, in which case the Commission will choose the auditor for the parties.

79. We direct sellers to clearly identify within their fuel cost allowance claims the following:

- i) Fuel purchases ranked by term from shortest to longest that indicates price, term, date and quantity for each transaction;
- ii) Marginal heat rate by unit (to be the same as that used by the ISO);
- iii) MW-hours by unit sold to the ISO/PX over the applicable interval (to be the same as that used by the ISO);
- iv) Average daily fuel cost per MMBtu, a demonstration of how this calculation was derived based on the fuel supply stack, and supporting workpapers; and

³⁴ We note that Reliant engaged an independent auditor to review and verify all data and calculations it used to determine a fuel cost allowance claim. The auditor states it employed three types of tests in its review. The auditor first verified that data inputs were correct by identifying source data and reconciling the inputs back to this source data. The auditor then ensured all data inputs used in calculation were complete and taken from the entire population of relevant data. The auditor reviewed all formulas to verify that they were working as intended. Finally, the auditor reviewed overall calculation methodology to ensure that it was in accordance with the Commission's direction.

- v) Overall fuel cost allowance amount, on a monthly basis, to offset the refund owed by each generator.

All calculations must be provided in a usable electronic spreadsheet format.

80. We also direct the CAISO to inform the Commission within 10 days of issuance of this order whether the prescribed format for the fuel cost allowance claims meets the CAISO's needs. The fuel cost allowance calculations must be submitted directly to the CAISO no later than August 30, 2004.

The Commission orders:

(A) Further clarification is hereby given on certain aspects of the methodology for allocating fuel cost allowances.

(B) The parties are hereby directed to inform the Commission of their choice of an independent auditor within 30 days of issuance of this order.

(C) Parties are directed to submit their fuel cost allowance claims verified by an independent auditor and attested to by a responsible company official directly to the CAISO no later than August 30, 2004.

(D) The CAISO is hereby directed to inform the Commission of any necessary changes to the format prescribed in this order for the fuel cost allowance claims within 10 days of the date of issuance of this order.

(E) CA Parties' and Duke's motions to lodge are hereby denied for the reasons stated in the body of this order.

By the Commission. Commissioner Kelly not participating.

(S E A L)

Magalie R. Salas,
Secretary.