

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suedeen G. Kelly.

San Diego Gas & Electric Company,
Complainant,

Docket No. EL00-95-000

v.

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

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

Docket No. EL00-98-000

ORDER ON CLARIFICATION

(Issued September 2, 2005)

1. In this order, the Commission clarifies that, for purposes of return on investment, marketers are allowed to include in their cost filings the product of ten percent times their investment in plant-in-service and/or cash prepayments.

Background

2. On August 8, 2005, the Commission issued an order establishing the framework for the evidence sellers must submit to demonstrate that the refund methodology results in an overall revenue shortfall for their relevant California spot market transactions from October 2, 2000, through June 20, 2001.¹ The August 8 Order also established a

¹ *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services*, 112 FERC ¶ 61,176 (2005) (August 8 Order).

technical conference to finalize the template for submission of these cost filings.² Following the August 25 Technical Conference, staff provided a suggested template for sellers to use in submitting their cost filings.³

Filings

3. On August 19, 2005, the California Parties⁴ filed a motion for expedited clarification requesting that the Commission clarify, among other things, how the ten percent return permitted for marketers should be computed. California Parties submit that the August 8 Order was unclear as to whether the Commission intended return to be based on: (1) actual out of pocket cash investment; (2) some proxy for allocated capital investment; or (3) a ten percent adder to incremental costs for each transaction. California Parties argue that *AEP Marketing, Inc.*,⁵ cited in the August 8 Order, only explicitly supports the latter option.

4. On August 31, 2005, Indicated Marketers⁶ filed a cross motion for limited and expedited clarification of the August 8 Order. Indicated Marketers assert that the “non-binding” guidance provided by staff at the August 25 Technical Conference indicated that marketers should compute a return based solely on capital investment or working capital requirements. Indicated Marketers argue, based on the August 8 Order’s citation to *AEP*, that the Commission intended the ten percent adder to be applied to all purchased power costs incurred by marketers. Indicated Marketers further assert that there is no rational basis for excluding purchased power costs from the ten percent adder. They argue that, as such exclusion would produce demonstrably lower returns than returns allowed for substantially less risky investment, staff’s suggested method is not likely to be just and reasonable.

² See *Notice of Technical Conference*, in Docket Nos. EL00-95-000 and EL00-98-000 (August 16, 2005).

³ See *Staff Suggested Template*, in Docket Nos. EL00-95-000 and EL00-98-000 (August 26, 2005).

⁴ “California Parties” are: the People of the State of California *ex rel.* Bill Lockyer, Attorney General; the California Electricity Oversight Board; the California Public Utilities Commission; Southern California Edison Company and Pacific Gas and Electric Company.

⁵ 108 FERC ¶ 61,026 (2004) (*AEP*).

⁶ Indicated Marketers are: Avista Energy, Inc.; BP Energy Company; Coral Power, L.L.C.; IDACORP Energy LP; NEGTEnergy Trading-Power; Sempra Energy Trading Corporation; TransAlta Energy Marketing (CA) Inc.; and TransAlta Energy Marketing (US) Inc.

Commission Determination

5. In the August 8 Order we stated:

For purposes of this proceeding, we are simply providing an opportunity for sellers to show that the refund methodology results in an overall revenue shortfall for their transactions in the ISO and PX spot markets, not to put them in the same revenue position or better. As such, we will allow marketers a return on investment (*e.g.*, cash requirements) of ten percent [footnote omitted]. Use of ten percent is consistent with the Commission's recent orders in which the Commission found that incremental cost plus ten percent represents a conservative proxy for a reasonable margin available in a competitive market [footnote omitted].⁷

6. The August 8 Order reaffirmed our prior determination, which stated: "Consistent with Commission precedent, the Commission's methodology is designed to allow sellers an opportunity to recoup their costs and receive a fair return on investment based on their total net sales in the relevant markets during the refund period."⁸ The Commission has always defined return on investment in a cost-of-service environment as the product of weighted cost of capital percentage and investment. The Commission's intent in the August 8 Order was to establish a weighted cost of capital return percentage as a substitute for a rate of return established by traditional discounted cash flow analysis. Marketers in general would have difficulty reconciling their circumstances to the Commission's long-standing practices of calculating a rate of return percentage based upon a discounted cash flow analysis. Accordingly, the Commission determined in the August 8 Order that it was reasonable, in light of the marketers' circumstances, to substitute a ten percent rate of return for the conventional calculated rate of return percentage. Our citation to *AEP* in the August 8 Order was only used to support the use of that ten percent amount as a reasonable substitute. It was not, however, our intent to determine the substituted ten percent would then be applied, as it was in *AEP*, to

⁷ August 8 Order, 112 FERC P 61,176 at P 81 (2005).

⁸ *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services*, 99 FERC ¶ 61,160 at 61,652 (2002) (May 15 Order).

incremental cost.⁹ Rather, the imputed ten percent return should be applied to *investment*, as discussed in our May 15 Order.¹⁰ We reiterate that investment in a cost-of-service world is defined in the filing requirements for electric and natural gas utilities as long term investment in plant, or cash prepayments (cash equivalents). For the cost filings, marketers may only include long-term investment: (1) Prepayments, as set forth in 18 C.F.R. § 35.13h (12)(i)(C) (2005) or 18 C.F.R. § 154.312e (2) (2005); (2) Plant, as set forth in 18 C.F.R. § 35.13(h)(4) or 154.312(c)(1).

7. Finally, return should be allocated based on revenues in the relevant markets during the refund period.

The Commission orders:

Further clarification is hereby given on certain aspects of the cost filing methodology, consistent with the body of this order.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.

⁹ The context of *AEP* and the cost filings are distinctively different. In *AEP*, the Commission established a 10 percent adder as a default price for short-term generation (one week), in other words, an MMCP. The Commission explicitly stated in the *AEP* order that this default price was not a cost-of service rate, but, rather, a substitute for a fair reimbursement in a market environment for incremental short-term generation plus costs, and no further cost support was required. Here, the Commission is providing marketers an opportunity to demonstrate that total actual costs incurred, including a return on investment, exceed the MMCP, thus converting a market environment to a cost-of-service based justification.

¹⁰ May 15 Order, 99 FERC ¶ 61,160 at 61,652.