

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 Corporation,
Respondents.

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

Docket No. EL00-98-000

ORDER ON COST RECOVERY, REVISING PROCEDURAL
SCHEDULE FOR REFUNDS, AND ESTABLISHING TECHNICAL CONFERENCE

(Issued August 8, 2005)

1. In this order, the Commission establishes the framework for the evidence sellers must submit if they wish to demonstrate that the refund methodology results in an overall revenue shortfall for their transactions in the relevant markets from October 2, 2000 through June 20, 2001 (Refund Period). Specifically, this order determines the scope, substance, necessary data support, and timing for resolution of cost filings.¹ In addition, we also establish a technical conference to be held in August to finalize the template for submission of cost filings. The Commission is mindful that four years have elapsed since the inception of this refund proceeding, and we intend to resolve it as expeditiously as possible. In that vein, the Commission will require these cost filings to reflect fully-supported actual costs. In addition to setting out the parameters of cost filings, this order

¹ For purposes of convenience, we will refer to the filings sellers make to demonstrate an overall revenue shortfall as “cost filings.”

shortens several previously-established deadlines and alters the compliance filing phase of the refund proceeding. We strongly encourage parties who are considering settlement to reach and finalize any outstanding settlements within the next two months.

I. Background

2. Early on in the refund proceeding, the Commission stated it would provide an opportunity at the end of the refund hearing for sellers to submit evidence demonstrating that the refund methodology creates an overall revenue shortfall for their transactions made during the Refund Period.² The purpose of this cost filing procedure was to ensure that no seller's mitigated revenue falls below the cost the seller incurred to serve the relevant California markets.³ A number of times, over a several-year period, the Commission alluded to this cost filing mechanism as a buffer against confiscatory rates.⁴ However, aside from a few general guidelines, *e.g.*, that a seller must demonstrate that rates for mitigated transactions were inadequate based on consideration of all costs and revenues, not just certain cherry-picked transactions,⁵ the specific parameters for these filings remained undefined.

3. On October 21, 2004, IDACORP Energy, LP (Idacorp) and Idaho Power Company (together, Idaho) and the California Parties⁶ filed a joint motion (Joint Motion) stating that they had reached an impasse in settlement negotiations due to a disagreement concerning the appropriate range of costs and revenues a seller must take into account when making a cost filing.⁷ Specifically, California Parties maintained that cost filings

² See *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Service*, 97 FERC ¶ 61,275 (2001) (December 19 Order).

³ See *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 105 FERC ¶ 61,065 at P 20 (2003) (October 23 Order).

⁴ See, *e.g.*, December 19 Order; *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 99 FERC ¶ 61,160 (2002) (May 15 Order); October 23 Order; *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 107 FERC ¶ 61,166 (2004).

⁵ December 19 Order at 62,193-94.

⁶ California Parties are the People of the State of California *ex rel.* Bill Lockyer, Attorney General, the California Electricity Oversight Board, the Public Utilities Commission of the State of California, Pacific Gas and Electric Company, and Southern California Edison Company.

⁷ Joint Motion at 1-2.

must encompass all costs and all revenues related to a seller's entire Western Electricity Coordinating Council (WECC)⁸ portfolio for the entire refund period. Idaho asserted that such costs and revenues are limited to transactions into the California Independent System Operator (CAISO or ISO) and the California Power Exchange (PX or CalPX) markets.⁹ California Parties added that they have encountered this same issue in settlement negotiations with other sellers.¹⁰ The movants asked the Commission to allow interested parties to comment on the issue and, thereafter, for the Commission to clarify the scope of transactions eligible for inclusion in the cost filings.¹¹

4. On October 22, 2004, the Commission issued a Notice Shortening Answer Period for answers to the Joint Motion, requiring answers by October 28, 2004. The Competitive Suppliers Group (CSG)¹² filed a timely response, arguing that the Commission decided over two years ago that the universe of sales each seller must take into account when making a cost filing is limited to sales into the ISO/PX markets, and any attempt to change that determination constitutes an impermissible collateral attack on a prior Commission order.¹³ California Parties and Idaho each responded to the CSG's

⁸ Several parties note that the WECC was formed after the Refund Period on April 18, 2002, and is the successor to what was the Western Systems Coordinating Council (WSCC). For the purposes of discussion, this order will refer to the regional reliability council as the WECC.

⁹ *Id.* at 2-3.

¹⁰ *Id.* at n.3.

¹¹ *Id.* at 3-4.

¹² In its answer to the Joint Motion, the CSG is comprised of: Avista Energy, Inc. (Avista); Constellation Power Source, Inc. (Constellation); Coral Power Company (Coral); NEG Energy Trading-Power, L.P. (ET); Portland General Electric Company (Portland General); Public Service Company of New Mexico (PNM); Puget Sound Energy, Inc. (Puget); and Sempra Energy Trading Corporation (Sempra).

¹³ CSG Answer Opposing the Joint Motion at 3.

answer, California Parties arguing in favor of a WECC-wide approach, Idacorp in support of CSG's position.¹⁴

5. On December 10, 2004, the Commission granted the Joint Motion, noting that it faced a "novel challenge" in establishing a retrospective cost-based recovery scheme for transactions that occurred under existing market-based rates.¹⁵ The Commission stated its preference for "a standardized format applicable to all sellers that would present a pragmatic approach to sellers demonstrating that the refund methodology resulted in an overall revenue shortfall."¹⁶ To enhance its decision-making process, the Commission requested comments and reply comments on a limited number of specific issues: the scope of transactions for determining revenue shortfalls, the substance, format and support of the cost filings, as well as the timing of the resolution of the cost filings. The Commission also expressed hope that setting clear parameters for cost filings at this juncture would further the overarching goal of enhancing settlement.

II. Comments

6. On January 10, 2005, the following parties submitted timely comments in response to the December 10 Order: Arizona Electric Power Cooperative, Inc. (AEPCO); Automated Power Exchange, Inc. (APX); Avista; the CAISO; California Parties; Californians for Renewable Energy (CARE); City of Anaheim, California (Anaheim); Edison Mission Energy (Edison Mission); El Paso Marketing, L.P. (El Paso); ET; Hafslund Energy Trading, LLC (Hafslund); Idacorp; Indicated Sellers;¹⁷ Merrill Lynch Capital Services, Inc. (Merrill Lynch); Nevada Power Company and Sierra Pacific Power Company (Nevada Companies); PNM; Portland General; Puget; Sacramento Municipal Utility District (SMUD); Stand-Alone Marketers;¹⁸ Tractabel Energy Marketing Inc. (Tractabel); and Turlock Irrigation District (Turlock).

¹⁴ Reply of the California Parties to Competitive Supplier Group Answer in Opposition to the Joint Motion of IDACORP Energy, LP, Idaho Power Company and the California Parties for Issuance of Expedited Procedural Schedule to Clarify Cost Filing Issue; Supplemental Statement of IDACORP Energy, LP and Idaho Power Company Respecting Joint Motion.

¹⁵ December 10 Order at P 6.

¹⁶ *Id.* at P 7.

¹⁷ Indicated Sellers are: BP Energy Company (BP); Portland General; Idacorp; PNM; and Puget.

¹⁸ Stand-Alone Marketers are Constellation; Coral; and TransAlta Energy Marketing (US), Inc. and TransAlta Energy Marketing (CA), Inc. (TransAlta).

7. On January 19, 2005, the following parties submitted timely reply comments: AEPSCO; Anaheim; Avista; the CAISO; California Parties; CSG;¹⁹ ET; Powerex Corp. (Powerex); Puget; Sempra; SMUD; and Stand-Alone Marketers. On January 20, 2005, Portland General filed reply comments one day late, and on January 21, 2005, Portland General filed a motion for leave to file reply comments one day out-of-time.

8. On March 14, 2005, the Public Utility Commission of Oregon and the Washington Utilities and Transportation Commission (State Commissions) moved to submit late comments. On March 23, 2005, the California Parties answered in opposition to the State Commissions' motion. On March 30, 2005, Portland General replied to the California Parties' opposition to the State Commissions' motion. On March 31, 2005, Puget filed a similar reply.

III. Discussion

A. Procedural

9. Pursuant to 18 C.F.R. § 385.213 (2004), we will accept the comments Portland General filed late due to technical difficulties. In addition, we will also accept the late-filed comments submitted by the State Commissions, which are already parties to this proceeding. As the state agencies responsible for establishing retail utility rates in Oregon and Washington, we find that the State Commissions have shown good cause why their comments should be accepted.

B. Scope of Transactions

10. The December 10 Order solicited comments on the issue of whether sellers' demonstration of costs and revenues should be limited to sales into only the ISO and PX markets, or be WECC-wide. The December 10 Order asked commenters to justify their positions, and expressly stated that such justifications were not limited to what the Commission has declared in prior orders.²⁰

¹⁹ In its reply comments to the December 10 Order, CSG consists of Avista; BP; Coral; Constellation; Idacorp; Portland General; PNM; Puget; Sempra; and TransAlta.

²⁰ December 10 Order at P 7.

1. Initial Comments

11. A number of parties argue that cost filings should be based on the costs and revenues related only to transactions in the ISO and PX spot markets during the Refund Period, and should not include unrelated transactions throughout the WECC: Avista, Anaheim, Edison Mission, El Paso, ET, Idacorp, Indicated Sellers, Merrill Lynch, Nevada Companies, PNM, Portland General, SMUD, Stand-Alone Marketers, the State Commissions, Tractabel and Turlock. In contrast, AEPCO, California Parties and CARE assert that a WECC-wide approach would be more appropriate. APX, the CAISO and Hafslund take no position on this issue.

12. Parties that support limiting cost filings to an ISO/PX scope argue that the Commission's prior orders have definitively resolved this issue. Citing the Commission's December 19 Order,²¹ Indicated Sellers assert that, since the earliest orders in the refund proceeding, the Commission has justified refund liability on sellers' opportunity to make revenue shortfall filings if their post-mitigation revenues fall below the costs incurred to serve the California and PX markets. Similarly, Turlock and Anaheim emphasize that the Commission's January 19 Order demonstrates that the Commission intended to limit cost recovery to ISO and PX spot market transactions. ET cites to the Commission's December 19 and May 15 Orders to support its view that the underlying purpose of the overall cost portfolio recovery opportunity was to prevent application of the MMCP refund methodology to sales in the ISO and PX market from causing confiscatory rates. Relying on the May 15 Order and the order issued on October 16, 2003,²² Merrill Lynch states that the Commission has already said several times that it is extending to all sellers an opportunity at the end of the refund proceeding to submit evidence that the refund methodology produces an overall revenue shortfall for transactions into the ISO and PX markets during the refund period. El Paso argues that the Commission's May 15 Order was "proper and well-reasoned." Portland General, Stand-Alone Marketers, Avista, and El Paso state that the Commission's May 15 Order expressly held that cost filings are to be confined to an examination of costs and revenues in the ISO and PX markets during the refund period. These parties point out that the CSG asked the Commission for such clarification on rehearing of the January 19 Order, which the Commission expressly granted in the May 15 Order. These parties further highlight that California Parties failed to seek rehearing on that determination in the May 15 Order, and argue that California Parties' attempt to relitigate this issue at this late juncture is tantamount to a late request for rehearing of the May 15 Order, which the

²¹ Indicated Sellers at 1 (citing December 19 Order at 62,193).

²² *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services*, 105 FERC ¶ 61,065 (2003) (October 16 Order).

Commission must deny under its rules and doctrines of repose. PNM, which joined the comments of Indicated Sellers, filed separately to indicate its concurrence with Indicated Sellers that the Commission has already expressly ruled in previous order that sellers' cost demonstrations should be limited to sales into the CAISO and PX, and there is no basis for the Commission to revisit its prior orders on that subject.

13. Also focusing on precedent, Indicated Sellers attempt to distinguish two types of remedies created by the Commission in the event that application of the MMCP to any individual seller produced a confiscatory result: (1) the revenue shortfall remedy (cost filings); and (2) the cost-of-service remedy. Indicated Sellers accuse the California Parties of blurring the distinction between these two remedies in their citation of precedent to support their position. Indicated Sellers argue that the Commission first permitted the filing of cost-of-service rates for each generator's entire portfolio of units in the WECC in a July 25, 2001 Order.²³ Indicated Sellers explain that this remedy was initially adopted in the context of prospective mitigation, which was required for all spot transactions throughout the WECC during periods of reserve deficiency. Indicated Sellers assert that inclusion of all units in a generators WECC portfolio was considered necessary to prevent the gaming opportunities prevalent in hybrid (cost-based/market-based) markets. Indicated Sellers highlight that, the December 19 and May 15 Orders together allowed all sellers to submit evidence demonstrating the impact of the refund methodology on a marketer's overall revenues during the Refund Period by making cost filings. Indicated Sellers point out that the October 16 Order reiterates this determination, and argue that the Commission has no discretion at this late juncture to grant California Parties request to reconsider the scope of transactions issue.

14. Other parties also favor an ISO/PX scope. Sellers, including SMUD, ET and Stand-Alone Marketers, essentially argue that, since the refund methodology relates entirely to transactions in the CAISO's and PX's spot markets, cost filings must necessarily focus exclusively on costs and revenues related to transactions in the ISO/PX spot markets during the refund period. Anaheim states the cost filings' purpose is to ensure that the refund methodology does not result in a confiscatory taking from sellers in the California markets and that a seller's transactions elsewhere, *e.g.*, in Nevada, "do not logically relate" to the question whether a reduction of its sales prices in California below costs is confiscatory. Similarly, Merrill Lynch argues that whether a power marketer profited from sales in any other markets, including in the West outside of California, is irrelevant to whether a power marketer should be allowed to offset refunds for sales in the CAISO and PX that would result in a confiscatory rate. SMUD asserts that the inclusion of revenues and costs that have no bearing on the refund calculation would

²³ *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 96 FERC ¶ 61,120 at 62,564 (2001) (July 25 Order).

unreasonably understate sellers' costs and the deficiency in refund methodology. SMUD argues that inclusion of WECC-wide transactions would be unreasonable for entities like SMUD that were both purchasers and sellers during the Refund period because revenues outside California would reduce costs without any corresponding ability to receive refunds for these transactions. SMUD states that it should not have its cost recovery reduced for revenues it received outside the California spot markets when it cannot recover for high-priced energy it purchases outside the ISO and PX markets. Edison argues that it would be illogical and unfair to require entities that can match sales to the ISO/PX with purchases to include WECC-wide sales in their cost filings.

15. Also commenting that WECC-wide scope would be unreasonable, El Paso asserts that at all times its decision whether to sell power to the CAISO and PX was based on an expectation of recovering its costs and a reasonable return from those sales in the CAISO and PX markets, and not based on a presumption that bilateral sales elsewhere would cover losses on ISO and PX sales. El Paso argues that consideration of the profitability of sales outside the CAISO and PX markets is only relevant for showing the opportunity costs incurred by a marketer electing to forego sales in other markets, and otherwise is not rationally related to the regulatory principle that sellers are guaranteed an opportunity to make a profit. Similarly, Stand-Alone Marketers state that their participation in the ISO/PX spot markets during the refund period was based on an "evaluation of those markets and the wholly reasonable expectation of recovering their costs and revenues plus a reasonable return on those sales unaffected by other transactions outside the ISO and PX spot markets."²⁴

16. Sellers also insist that economic theory and business practices require limiting the scope of transactions to the ISO/PX. Puget states that cost-recovery filings should measure a seller's revenue shortfall using the costs and revenues associated with making mitigated sales into the ISO and PX markets because this is consistent with its approach to serving retail load and with basic economic principles. Avista and Idacorp provide an expert affidavit from Dr. Charles Cicchetti (Cicchetti Affidavit) and in comments accompanying, Avista asserts that measuring revenue shortfalls in any way other than based on incremental cost of making mitigated sales in the CAISO/CalPex would unfairly compare revenues from sales of dissimilar electricity products and would require that participants in unrelated markets subsidize purchases in the CAISO and CalPex markets. Avista highlights Dr. Cicchetti's explanation in his affidavit that sellers organize their trading activities based on the type of products they sell, which, for electricity trading, is defined in part by contract duration. Dr. Cicchetti states that the best hedge for each product is contracts of a similar duration, so marketers establish different portfolios for each of their distinct products and try to offset trades within each portfolio against

²⁴ Comments of Stand-Alone Marketers at 8-9.

contracts of the same duration. As such and given the different types of electricity products and the risk management efforts associated with selling into different markets, it would be unfair for the Commission to require sellers in the California refund proceeding to measure revenue shortfalls using costs and revenues associated with sales outside the CAISO/CalPX markets. Idacorp also submits the affidavit of David Churchman, which confirms that Dr. Cicchetti's "statements about the distinctions in trading between term trades and spot market trades with the California organized markets are consistent with the manner in which [Idacorp] conducted its business."²⁵ The Churchman affidavit states that Idacorp's term traders entered into purchases or sales of monthly or greater duration, whereas spot market traders entered into transactions of less than 30 days. Churchman states that "term traders operated with substantial independence from the spot market traders."²⁶

17. In addition, sellers invoke the cost causation principle to support their position that cost filing should focus on transactions in the ISO/PX. Indicated Sellers argue that including all sales across the WECC region would give California the benefit of a west-wide blending of gains and losses, and incorporate transactions that did not have anything to do with sales into the mitigated ISO and PX spot markets. Indicated Sellers assert that Commission precedent states that rate design should produce rates which match, as closely as practicable, the costs to serve each individual customer. They and Puget also assert that taking into account the costs and revenues associated with all WECC transactions in calculating the effect of refund methodology on ISO/PX revenues would grant California buyers an undue preference by giving them the benefit of transactions undertaken in entirely different markets. According to Indicated Sellers, courts have rejected attempts to cross subsidize customers.²⁷ The State Commissions also argue that a WECC-wide scope would result in subsidization of California refunds.

18. In general, parties favoring an ISO/PX scope also argue that the scope of transactions should be limited to mitigated transactions only. Avista argues that the use of non-mitigated sales in the shortfall analysis would effectively require that market participants outside of CAISO/CalPx subsidize transactions in those markets. Avista asserts that this would be unfair and would contravene the Commission's rubric that customers bear only the costs incurred to serve them. Puget argues that the use of non-mitigated sales in the shortfall analysis would effectively require market participants outside of the ISO and PX spot markets to subsidize transactions in those markets.

²⁵ Churchman Affidavit at 1.

²⁶ *Id.*

²⁷ *Id.* at 5 (citing *Electricity Consumers Resource Council v. FERC*, 747 F.2d 1152, 1516 (D.C. Cir. 1984)).

19. In contrast, California Parties contend that the WECC-wide all costs/all revenues approach they advocate is one that the Commission introduced at the outset of the refund proceeding, and repeatedly reaffirmed throughout subsequent orders, most recently in the order issued December 20, 2004, resolving issues related to the fuel cost allowance (FCA). California Parties state that, whereas the Commission created the “cost-based backstop” as a safety-valve in the event refunds result in confiscation, sellers now seek inappropriately to convert the safety valve into a floodgate. California Parties urge the Commission to adhere to what they consider the Commission’s original plan for cost-based filings, *i.e.*, that they are intended to provide the Commission with the financial data necessary to discern whether seller would experience confiscation upon full payment of refunds and, if so, to devise a cost-based rate to cure the deficit. California Parties argue that the purpose of the cost-based backstop is not to replace the MMCP cap with a new cap equal to the highest cost-based rate for opportunity sales a seller may wish to justify, but rather, to ensure that the rates resulting from application of the MMCP do not fall below this just and reasonable floor for any individual sellers. California Parties warn that if the sellers get their way, stacking costs in a way that ignores reality and allows sellers to avoid paying refunds for charges above the MMCP, even where there is no showing of confiscation, they will eviscerate the estimated \$2.6 billion in refunds the Commission has ordered in the refund case. California Parties assert that regulatory theory, as explained in the declaration of Dr. Carolyn Berry that accompanies their comments, strongly supports the WECC-wide all costs/all revenues approach. California Parties highlight Dr. Berry’s explanation that the confiscation standard embodied in the cost-based backstop requires the seller to demonstrate “deep financial hardship,” which is difficult to meet and, in this context, requires an expansive examination of the impact of refunds a seller must pay on that seller’s overall financial integrity. California Parties state that Dr. Berry’s analysis reveals that most sellers reaped enormous profits throughout the WECC (most of them not subject to refund), and those profits are far in excess of refunds the seller will be required to pay for sales into the ISO/PX spot markets. California Parties also point out that Dr. Berry’s analysis of Portland General reveals that, if the Commission endorses the FCA-style cost based approach which stacked power purchase costs highest to lowest, this will virtually eliminate the refunds the Commission has found California deserves. California Parties assert that typical portfolios of sellers involve a huge variety of purchases and sales at different prices throughout the region, and the ISO/PX stacking approach would yield a cost filing that ignores the bulk of the seller’s trading activity, artificially allocates only the seller’s highest costs to ISO and PX sales, and thereby produces the illusion that the seller experienced a revenue shortfall. California Parties assert that importing the FCA approach into the cost-based backstop would mandate cherry picking as the cost-based methodology, contrary to Commission precedent.

20. CARE urges the Commission to order refunds for all rates above the cost of service retroactive to orders granting such entities market-based rates and halt all settlement

proceedings and reject previously settled agreements because, according to CARE, they were based on a vast under-calculation of refunds and California consumers are not adequately represented in these settlement discussions. Finally, CARE asserts that broad political support exists for complete refunds.

21. AEPCO states that, although sellers, especially marketers, should probably have the option of limiting their cost filings to just their sales into the ISO and PX markets, sellers should also be allowed to make a WECC-wide demonstration that takes into consideration their total revenues. AEPCO asserts that this broad approach is necessary in light of the June 19 Order's finding of interdependence among the prices in the ISO's centralized spot markets, the prices in the bilateral spot markets in California and the rest of the West and the prices in forward markets. AEPCO states that the need for WECC-wide presentation is "particularly acute" for AEPCO because it operates essentially on a cost pass-through basis, and was, therefore, adversely impacted by the prices it paid for fuel, especially natural gas, and electricity during the energy crisis. AEPCO insists that its refunds should be reduced to the extent it failed to cover its own costs during the California power crises.

22. AEPCO asserts that making a WECC-wide determination eliminates the need to allocate various costs, such as general and administrative costs, between California and non-California sales. AEPCO also argues that it is inappropriate to consider the harm experienced by the CAISO and PX customers during the California power crisis, while ignoring the harm experienced by sellers into the CAISO and PX with respect to their own load-serving responsibilities. AEPCO asserts that, even though sellers may not receive refunds for their non-ISO and non-PX electricity purchases and fuel purchases, the high prices they paid should not be ignored in allocating burdens between California and the West, particularly considering California's role in adopting a highly flawed market structure and failing to acquire enough resources to meet its loads. AEPCO states that, while the Commission's *May 15 Order* appears to preclude a WECC-wide demonstration and to require an ISO and PX-specific showing, "much has changed" since issuance of that order, including the use of lower gas prices in the MMCPs, which substantially increase the refund exposure of sellers such as AEPCO. AEPCO argues further that there is substantial recognition of how some entities' conduct tainted power and fuel prices throughout the WECC, and not just in California. AEPCO states that it would be inherently confiscatory for sellers to be required to disgorge more than they made during the refund period.

2. Reply Comments

23. In significant part, the reply comments reiterate the position in earlier comments. We will not repeat substantially similar arguments here. Puget, Portland General and Stand-Alone Marketers take issue with California Parties witness' representation of their profits, risk management and business activities. Puget argues that Dr. Berry's

calculation of Puget's WECC profits during the refund period on behalf of California Parties is "clearly and demonstrably wrong." Puget asserts that Dr. Berry erred by excluding Puget's costs of acquiring monthly and long-term power, and the costs associated with Puget's peaking generation. Puget further points out that Dr. Berry erred by basing her calculations on transactions throughout the refund period, despite the fact that Puget stopped selling into California spot markets in mid-December 2000. Puget also states that Dr. Berry understates Puget's refund liability because she bases the refund numbers on an exhibit that was based on the refund methodology in place before the Commission changed the gas price proxy in the MMCP.

24. Portland General reiterates that there is no justification for California Parties' proposal to wipe out the only remedy given to sellers by using revenues from unrelated transactions in unrelated markets, and for unrelated products to subsidize electricity sales in the ISO/PX markets. Portland General also submits the declarations of Kristin Strathis and Alan Heintz to explain flaws in Dr. Berry's analysis. The Strathis Declaration demonstrates how Dr. Berry's estimates of Portland's net revenues are inflated. The Strathis Declaration also refutes the California Parties' contention that "the payment of refunds to California ratepayers will have no adverse effect on Portland General's retail customers" by pointing out that Portland General's ratepayers are currently funding part of the refunds to the California Parties and will benefit from any reduction in those refunds that ensue from Portland General's cost filing. Strathis also states that Dr. Berry's assertion that traders throughout the WECC considered the entire region to be a single market for purposes of managing their portfolio is erroneous. She explains that, while large traders such as Powerex may have viewed their portfolios broadly, Portland General participated in wholesale markets principally to balance its power supply to meet the needs of its retail customers, manage price risk and administer its long-term wholesale contracts. Alan Heintz's declaration explains why Dr. Berry's proposal to consider transactions throughout the entire WECC is not appropriate based on Commission ratemaking policies and precedents.

25. Avista submits an affidavit of David M. Dickson, Avista's Vice-President of Electric Marketing and Trading. Mr. Dickson explains that calculating revenue shortfalls on a WECC-wide basis is "fundamentally at odds" with the manner in which Avista managed its risks during the refund period.²⁸ In addition, he asserts that WECC-wide calculation of revenue shortfalls would improperly reallocate the results of the company's risk management actions for market activities during that period. In particular, Mr. Dickson states that Avista does not enter into long-term transactions with the intent of offsetting those transactions in the short-term markets, due to differences in the products'

²⁸ Dickson Affidavit at P 2.

risk profiles. He explains that Avista enters into term transactions based on “macro long-term fundamental assumptions,” such as snow-pack levels and load growth, whereas Avista enters into short-term transactions based on “known short-term fundamentals,” such as today’s temperatures by region, tomorrow’s forecasts and today’s outages.²⁹ In conclusion, Mr. Dickson states that revenue shortfall calculations should not include costs and revenues of all WECC-wide transactions because doing so would be “tantamount to revising the [sellers’] risk management process” solely to benefit the California Parties.

26. The CSG states that marketers purchased power from other sources to supply transactions in the ISO/PX markets, paying high prices for their purchases just like California consumers paid, and the cost filing process is vital to ensuring sellers’ recovery of those high costs. They argue that it would be novel, artificial, unprincipled and unwise to attribute revenues earned from distinct geographical regions, unrelated markets and different products to services to which they are irrelevant, as California Parties propose. The CSG states that California Parties “west-wide blender” approach seeks a subsidy by drawing on revenues from other regions and markets in which the California Parties made no investment or assumed risk.

27. Powerex argues that the California Parties ignore the Commission’s orders specifically addressing the cost filings and misconstrue the orders to suit their purposes. Powerex states that the cost filings’ purpose is to give marketers an opportunity to justify their sales above the MMCPs and present evidence that would show the true impact of the refund formula on their costs, to demonstrate that refunds may be confiscatory. Sempra endorses the CSG’s reply arguments.

28. Stand-Alone Marketers assert that neither California Parties nor Dr. Berry is informed as to how each marketer managed its portfolio or maintained records during the refund period. They further assert that the costs relevant to a confiscatory rate analysis depend on the manner in which the rate was developed. They argue that the California Parties’ confiscatory rate analysis is fundamentally flawed because it confuses cost-of-service ratemaking under section 205 with the marginal cost inquiry relevant to cost filings. They argue that the proper test for confiscation in connection with these cost filings is whether the generic rate cap causes an under-recovery of actual margin costs related to the relevant transaction, analogous to *Permian Basin Area Rate Cases*, 390 U.S. 747, 770-733 (1968), and not on the company’s overall costs and revenues, as in *Jersey Central Power & Light Co. v. FERC*, 810 F.2d 1168 (D.C. Cir. 1987).

29. Anaheim states that the California Parties’ characterization of the May 15 Order’s

²⁹ *Id.* at P 4.

clarification of the scope of cost filings as a diversion from the Commission's more comprehensive statements is disingenuous. Anaheim argues that neither the cases cited by California Parties nor any identified Commission or Court precedent stands for the proposition that a regulatory body can force sellers to pay refunds below costs. Anaheim asserts that the California Parties' approach would result in de facto West-wide price mitigation, in contravention of numerous Commission orders. They state that this will also result in LSEs who sold into the ISO/PX markets at costs above the MMCPs subsidizing the refunds of California ratepayers.

30. California Parties characterize the FCA as an "adjunct to the Commission's market-based MMCP formula" that differs from the cost filing backstop because the two methodologies are based on opposing regulatory paradigms. California Parties highlight Dr. Berry's testimony, which explains that the MMCP, of which the FCA is a part, is a market-based mechanism based on marginal cost pricing, whereas the cost filing opportunity is based on cost-of-service principles. California Parties state that sellers' interpretation of prior Commission orders as prohibiting the WECC-wide approach comprise a "novel and implausible" reinterpretation of the Commission's orders that assumes the Commission intended to treat generators differently from other sellers and ignores the basic principles underlying the cost filing. The California Parties state that, while the Commission has never delineated the cost filing requirements, it has never wavered from its basic approach, which is that sellers are to be treated alike and "are entitled to demonstrate, through a filing that focuses on all costs and all revenues WECC-wide, that the payment of refunds will result in 'deep financial hardship' such that the seller will experience confiscation." California Parties also assert that sellers' argument that a WECC-wide approach creates an illegal subsidy is overreaching. They point out that the Commission has already rejected the cross-subsidy argument for LSEs, finding that LSEs primarily incurred their power purchase costs to serve native load customers, and that those customers are benefited by the sales their utilities made to the ISO/PX from surplus power. According to California Parties, notions of subsidy, improper cost causation and undue preference have no application to cost filings.

31. California Parties also submit the reply declaration of Dr. Carolyn Berry. Dr. Berry further asserts that the MMCP methodology, including the FCA, is based on a theory of markets, whereas the cost filings fall under a regulatory cost-of-service paradigm. Dr. Berry states that a seller making a cost filing is choosing a cost-of-service framework which, by definition, examines rates charged to all customer groups to determine if the overall rate level is sufficient to cover costs. She opines that it would be inappropriate to allow a seller to choose a cost-based regulatory framework for ISO and PX sales, but retain a market-based regulatory framework for sales into the rest of the WECC. She states that, since WECC is an interconnected electricity market, a seller's ability to pay refunds must be assessed at the corporate level for all operations in the WECC.

Commission Determination

32. Recognizing the significant impact the scope of revenue included in the cost filings could have on refunds, we invited parties to comment on this issue, without limiting those justifications to what the Commission had said in prior orders. Having reviewed these comments, we are not persuaded to depart from our prior determination that the cost filing analysis should focus on costs and revenues derived from transactions in the ISO and PX single price auction spot markets and the costs related to those transactions.³⁰ None of our subsequent orders expressly rescinded this determination, nor have circumstances changed since the issuance of that order in a manner that would justify expanding the scope of transactions to include WECC-wide revenues/costs. Prior Commission precedent, logic and business practices support limiting the scope of cost filings to all transactions -- mitigated and non-mitigated -- into the ISO/PX markets during the Refund Period.

33. The establishment of the MMCP reflects the Commission's primary concern throughout this proceeding that buyers may have paid rates above the zone of reasonableness.³¹ The MMCP was established to emulate competitive market prices in California markets during the Refund Period, but does not take into account the effect of the MMCP on any individual seller's recovery of the costs of providing that service into California. Consequently, in the December 19 Order, we gave individual generators the opportunity through this cost filing process "to submit evidence as to whether the refund methodology results in an overall revenue shortfall for their transactions in the ISO and PX spot markets during the refund period."³² The May 15 Order extended this opportunity to all sellers, not just generators.³³

³⁰ January 19 Order at 62,254 (allowing marketers to "submit evidence as to whether the refund methodology results in an overall revenue shortfall for their transactions into the ISO and PX markets."), *clarified*, May 15 Order at 61, 653 ("the cost justification showing relates to the revenue shortfalls in the ISO and PX single price auction spot markets.").

³¹ October 23 Order at P 17 ("The May 15 order explained that the [MMCP] approach is consistent with the Commission's primary concern throughout the EL00-95 et al. proceeding – that buyers may have paid rates above just and reasonable levels.") (citing May 15 Order, 99 FERC ¶ 61,160 at 61,655 and n. 36).

³² December 19 Order at 62,254.

³³ May 15 Order at 61,656.

34. The December 19 Order, when discussing the cost filing sellers must submit to demonstrate overall revenue shortfalls, referred to the relevant portfolio as “all transactions from all sources”³⁴ and, at another point referred to “transactions in the ISO and PX spot markets.”³⁵ CSG, therefore, sought clarification that, when the Commission used the phrase “all transactions,” it intended to refer to only those transactions in the ISO and PX spot markets.³⁶ We granted the CSG’s request in our May 15 Order: “Finally we grant CSG’s request for clarification that the cost justification showing relates to the revenue shortfalls in the ISO and PX single price auction spot markets, and not to ‘all transactions from all sources.’”³⁷ No party sought rehearing of this determination, and it is, therefore, final.³⁸ The October 16, 2003 Order reaffirmed this approach,³⁹ and the Commission has never wavered from this determination, despite the contention of California Parties.

35. Notwithstanding the position of intervenors that would have us expand the scope to include WECC-wide transactions, the Commission finds no compelling rational basis to extend the scope of transactions to the WECC, a region that spans fourteen states, two Canadian provinces, and portions of one Mexican state. The ISO and PX markets are the only markets subject to refund during the Refund Period. The purpose of the cost filing procedure is to assess whether the MMCP “refund methodology results in an overall shortfall for [a seller’s] transactions into the ISO and PX spot markets during the refund

³⁴ *Id.* at 62,193-94.

³⁵ *Id.* at 62,254.

³⁶ *See* CSG’s Request for Clarification at 24, Docket No. EL00-95-053, *et al.* (January 18, 2002):

While it is clear from a thorough reading of the Commission’s order that the Commission intended to limit its discussion of cost justification and revenue shortfalls to the PX and ISO single price auction markets, out of an abundance of caution, given the potential significance of the issue and the absence of this qualifying language from previous passages, the undersigned members of the CSG request that the Commission clarify that the cost justification showing will relate only to the revenue shortfalls in transactions in the ISO and PX single price auction spot markets.

³⁷ May 15 Order at 61,653.

³⁸ *See, e.g., City of Tacoma v. Taxpayers*, 357 U.S. 320, 340-41 (1958).

³⁹ *See San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 105 FERC ¶ 61,065 at P 20 (2003) (October 16 Order).

period.”⁴⁰ Consequently, the logical scope of transactions to consider in analyzing whether application of the MMCP causes a seller to experience a revenue shortfall for its transactions in the California spot markets is the revenues from sales into the ISO/PX during the refund period, and the costs incurred to serve those California markets and generate those revenues.⁴¹

36. Equally compelling, limiting cost filings to an analysis of costs and revenues in ISO/PX markets is consistent with record evidence concerning how sellers bid and managed risk for their trading portfolios. In their submitted testimony, sellers indicate that they organize trading activities around portfolios of like products, and the products relevant to this proceeding are real-time contracts.⁴² They add that they manage risk by hedging with like products.⁴³ So, for example, sellers claim they generally would not use a long-term contract with a wholesale customer in Oregon to hedge a real-time sale into the ISO or PX. Sellers state that they did not sell into ISO/PX spot market sales with the expectation of profiting from long term-contracts elsewhere in the West.⁴⁴ LSEs that indicate that they traded generally to balance electricity supply to meet retail customers’

⁴⁰ December 19 Order at 62,254.

⁴¹ Indeed, the MMCP formula is based on natural gas prices and the heat rate of the least efficient gas-fired generator that sold power into the ISO in 10-minute intervals during the Refund Period. It does not take into account the cost of generating power from units WECC-wide. Since we established the cost filing backstop in recognition of the fact that MMCP may not allow an individual seller to recover its actual costs of providing electricity to the ISO/PX, the only rational scope of transactions to include in this analysis are those into the ISO/PX during the Refund Period.

⁴² *See, e.g.*, Cicchetti Affidavit at 6; Churchman Affidavit at 1. *See also* Stand-Alone Marketers Reply Comments at 5 (“ . . . Dr Berry’s generic opinion as to the ‘way energy is traded in the WECC and elsewhere’ fails to take into account the fact that traders often maintain more than one book of transactions to ensure that sales made from a particular book will match purchases and sales with common cost and margin characteristics – such as long-term purchases with long-term sales.”).

⁴³ Cicchetti Affidavit at 7.

⁴⁴ *See id.* (“Purchases of long term contracts are rarely entered into with the intent of holding for offset in the real time markets.”). In El Paso’s Reply Comments at 9, the company states that: “At all times, El Paso Marketing determined whether to sell power in the CAISO and CalPx based on an expectation of recovering its costs and a reasonable return from those sales.”

needs, manage price risk and administer long-term wholesale contracts, also state in testimony that they did not consider markets throughout the WECC as equivalent for trading purposes.⁴⁵ Rather, they state that they focused on markets to which they had transmission access. Consequently, including WECC-wide transactions into the cost filing analysis would be contrary to the way sellers have stated they operated their business during the Refund Period.⁴⁶

37. Consistent with our intention to preclude a seller from having unfettered discretion to pick and choose among the transactions for which it seeks cost recovery,⁴⁷ the relevant scope of transactions is further defined to include all transactions for all hours, mitigated and non-mitigated in the relevant ISO/PX markets. We find that it is reasonable to include non-mitigated as well as mitigated transactions in the analysis because the MMCP set the ceiling price for all transactions into the ISO/PX during the Refund Period. It is further necessary to include non-mitigated transactions in the analysis because sellers may have made substantial profits on non-mitigated sales that balance out losses from mitigated sales. Netting revenues from costs of all transactions, mitigated and non-mitigated, will ensure that there is no cherry-picking among transactions.⁴⁸ If revenues from non-mitigated as well as mitigated transactions are sufficient to cover an individual seller's costs for serving the ISO/PX markets during the Refund Period, then the MMCP is reasonable with respect to that seller. This is consistent with the Commission's policy of not setting a refund so high as to prevent a seller from recovering its costs.⁴⁹

38. The California Parties' contention that WECC-wide scope is mandated because California prices influenced prices in the West misses the point.⁵⁰ The cost filings do not address prices or whether prices were influenced, but rather whether the MMCP

⁴⁵ Strathis Declaration at ¶ 20.

⁴⁶ *See id.*

⁴⁷ *See, e.g.*, May 15 Order at 61,652.

⁴⁸ *See id.* As we previously noted, the Commission has discouraged cherry-picking in other contexts. *See id.* at n.20 (citing *Questar Pipeline Co.*, 62 FERC ¶ 61,192 (1993); *French Broad Elec. Membership Corp. v. CP&L*, 92 FERC ¶ 61,283 (2000)).

⁴⁹ *See, e.g.*, *Carolina Power & Light Co.*, 87 FERC ¶ 61,083 (1999); *Coastal Oil & Gas Corp. v. FERC*, 782 F.2d 1249, 1253 (5th Cir. 1986).

⁵⁰ *See Berry Declaration* at ¶ 3-5.

precluded a seller from recovering its costs to serve the ISO and PX markets. Accordingly, we are not persuaded by the California Parties' argument that the Commission must take WECC-wide revenues into account in assessing whether the MMCP produces a confiscatory rate.⁵¹ The issue here is whether a seller's refunds for sales into the ISO and PX markets should be limited, and focusing only on ISO and PX sales is more reasonable than considering sales from a much broader region.⁵² In this proceeding, the Commission set a refund rate, the MMCP, for transactions into the ISO/PX during the Refund Period. Since this rate was not applied on a WECC-wide basis during the Refund Period, revenues in the WECC and the costs incurred to produce those revenues are irrelevant to the analysis of whether the MMCP prevents an individual seller from recovering its costs to serve the ISO and PX markets during that time frame.

C. Determination of Energy Costs

39. The December 10 Order invited comments from parties on how the costs for sales into the ISO and PX spot markets should be determined. Specifically, the December 10 Order asked parties to comment on whether a seller's costs should be based on: (1) an incremental basis or (2) an average system basis. In terms of incremental cost, we invited additional comments on the feasibility of matching (or "tagging") a particular sale with a particular resource, and the most recent power purchase with the incremental sale most proximate in time. In terms of average system cost, we also requested comments on how a portfolio-wide cost of energy should be calculated.

1. Incremental Cost

40. In general, sellers support cost recovery on an incremental basis, arguing that an incremental approach better reflects the principles of cost causation and the manner in which they operated their business, and is more consistent with the refund methodology.

⁵¹ The California Parties assert that "the confiscation standard embodied in the cost-based backstop, which requires the seller to demonstrate 'deep financial hardship,' is difficult to meet, and, in this context, necessarily requires an expansive examination of the impact of refunds that a seller must pay on the seller's overall financial integrity." California Parties' Initial Comments at 4 (citing Berry Declaration at ¶ 3-13).

⁵² Cf. *CP&L*, 87 FERC at 61,355 (granting rehearing in part because the refund the Commission ordered may have prevented CP&L from recovering its variable costs associated with one of its sales, and directing CP&L to submit cost data for that contract showing that the amount refunded to its customer prevented it from recovering its variable costs).

(a) **Cost Causation and Operational Practices**

41. All sellers argue that the Commission should permit sellers to use a method in filing for cost recovery that is consistent with the manner in which each seller operated during the Refund Period. Most sellers state that their sales in the California spot markets were an incremental use of their resources, and, therefore, the identification of costs associated with those transactions cannot be made on an all-average basis. These sellers argue that average costs would understate the costs associated with making these mitigated sales and contravene the Commission's ratemaking principles that customers bear only the costs incurred to serve them, and not incurred for the benefit of other classes of customers.

42. The LSEs emphasize that they are obligated to satisfy their native load requirements with their lowest-cost resources, after which they then can sell higher-cost, marginal resources into the market. They argue that an average cost approach would unjustly disregard this obligation, would be contrary to FERC precedent, and inconsistent with the manner in which they purchase and resell energy. Nevada Companies add that their sales to the mitigated spot markets were made on an opportunity basis from marginal or incremental resources available after application of economic dispatch principles, and that the cost basis for opportunity sales should thus be incremental.

43. The State Commissions and several LSEs argue that the California Parties' proposal to incorporate all costs would unfairly raise rates to their consumers, effectively resulting in a subsidy for California consumers at the expense of their own retail customers. Portland General and State Commissions note that Oregon's retail customers are currently paying for a retail rate increase, as approved by the Oregon Public Utility Commission, which includes an estimate of potential refund liability.

44. Responding to California Parties' arguments against reserving LSEs' least cost resources for native load (see below), Anaheim notes that the Commission orders cited by California Parties respond to arguments that are not related to the context of the instant proceeding. Anaheim argues that, although it incurred purchased power costs prior to its ISO and PX spot market sales, it could have chosen to sell this energy into other Western markets not subject to mitigation. Additionally, Anaheim argues that LSEs place a value on their ability to resell excess energy in Western spot markets when they negotiate longer-term purchase agreements. Anaheim asserts that if it had considered excess energy essentially valueless, this consideration would have affected the price it would have been willing to pay originally.

45. Indicated Sellers argue that because ISO and PX sales were an incremental use of their resources, sellers should rank their supply stack by price in order to assign their highest cost, unassigned supplies to their ISO and PX sales. They argue that this

approach is consistent with, if not required by, long-standing ratemaking precedent whereby utilities routinely price off-system sales at their incremental costs in order to ensure that lower cost resources are reserved for native load. In support, Portland General cites another proceeding⁵³ where the Commission directed a seller to calculate actual refunds due based on the difference between the market-based rates the seller charged and its incremental costs.

46. According to many marketers, an average cost approach would disregard the way in which they conducted business. Marketers argue that the use of an average system cost would incorporate the costs from unrelated purchases and erase the important distinctions between real-time products and term products, and between geographic markets. These marketers assert that an incremental approach would properly reflect the fact that sellers move up a bid curve selling least cost products first, and that as the real time approaches, sellers offer their more expensive products.

47. Citing the Cicchetti Affidavit, Avista argues that, in general, traders strongly attempt to offset comparable products, *i.e.*, they conduct their business by hedging a term purchase against a term sale and separately engaging in spot purchase matched against a spot sale. Idacorp indicates that its term traders entered into purchases and sales of monthly or greater durations while its spot market traders entered into transactions of less than 30 days. Avista argues that at the end of any trading month, it would offset all of its term contracts before entering into the spot market, and, consequently, the ISO and PX markets were not being served by Avista's term portfolio. ET adds that it would meet its sales obligations to the ISO and PX with incremental energy purchased within any given month.

(b) Consistency with the Refund Methodology

48. Many sellers argue that the cost filings must reflect an incremental approach in order to be consistent with the Commission's refund methodology. They argue that the Commission has affirmed its "policy to ensure that the established refund liability does not prevent a seller from recovering its variable costs."⁵⁴ Many sellers note that the calculation of the MMCP reflects the marginal cost of the last unit dispatched to serve load in California and thus attempts to replicate the marginal cost that would have been incurred in each interval had the ISO and PX markets not been dysfunctional during the Refund Period. Stand-Alone Marketers assert that the MMCP formula does not consider

⁵³ See Portland General Reply Comments at 8 (citing *Southern California Water Co.*, 106 FERC ¶ 61,305 (2004), *reh'g denied*, 108 FERC ¶61,168 (2004)).

⁵⁴ December 10 Order at P 2.

other average system costs incurred by a generator unrelated to the MMCP formula and unrelated to their actual sales into the ISO and PX spot markets. Stand-Alone Marketers argue that a methodology that compares a marketer's actual marginal cost to the refund methodology's hypothetical marginal cost of the least efficient generator compares apples to apples and is consistent with the refund methodology.

49. Many sellers also argue for an incremental approach based on the methodology developed by the Commission in the FCA filing. They note in that case, the Commission found that sales in the ISO and PX mitigated spot markets were an incremental use of sellers' resources and directed the use of a stacking methodology. Puget adds that a similar approach to calculating both FCA claims and revenue shortfall claims for sellers will preclude double-recovery of costs and ensure that sellers do not suffer a loss for their ISO and PX mitigated spot market sales.

2. Total Costs and Total Revenues

50. California Parties submit that the cost filings should display all of a seller's costs within the entire WECC so as to match their proposal to include a seller's entire WECC-wide revenues. California Parties state that this would include all fixed costs and all variable costs. They add that similar data should be provided for affiliates and cite the Commission in stating that where one affiliate opts for cost-based treatment, all must do so.⁵⁵

51. California Parties assert that an all cost and all revenue approach does not violate regulatory cost causation principles and does not create a subsidy at the expense of other WECC customers. They argue that the rates of customers in the WECC outside the ISO and PX markets will not be higher as a result of the refund obligation because refunds are lump sum payments unrelated to future market prices and the price paid by customers. Instead, California Parties assert that refunds will simply reduce excess profits made by sellers.

52. According to California Parties, the WECC-wide all costs and all revenues approach they propose is the most appropriate given the refund methodology. They maintain that the cost-based backstop was designed as an alternative to the market-based refund methodology, and that the two methodologies are based on different regulatory paradigms. California Parties submit that the cost filing is concerned with revenue adequacy and thus it is appropriate to use total costs, while the FCA and MMCP calculations are based on incremental or marginal costs.

⁵⁵ California Parties' Comments at 26 (citing December 19 Order at 62,215).

53. California Parties also submit that the Commission has already rejected the argument that their proposal is inappropriate for LSEs that reserve their lowest cost resources for native load. They cite two prior Commission orders in which the Commission stated that, to the extent LSEs had excess capacity to sell, the proceeds of LSEs' sales to the ISO and PX mitigated spot markets served to reduce the sunk costs of the purchased power that their customers would otherwise have paid.⁵⁶ California Parties argue that consequently, even the revenues derived from the MMCP constitute recovery of costs that already had been incurred.

54. AEPCO agrees that a better approach would be to compare total costs and total revenues. AEPCO submits that an analysis that takes into account a seller's system-average cost, but then ignores its system-average revenues "ignores the LSE's role as an LSE." AEPCO suggests that a comparison of total costs to total revenues would also be desirable in comparison to average costs versus average revenues because of transactions (*e.g.*, closeouts) that did not result in any actual sales. AEPCO asserts that this also eliminates the need to attribute particular costs to particular sales in the first place.

3. Matching

55. Some sellers indicate that they are able to match their sales with specific purchases or generation while others state they can match none or only a portion of their resources. The Cicchetti Affidavit states that where marketers are able to trace specific purchases to specific sales, they will be able to directly match the costs and revenues for those sales and should be allowed to demonstrate revenue shortfalls on this basis. Stand-Alone Marketers submit that unlike other sellers who may have had generation or retail load, or perhaps sold out of a portfolio, they can demonstrate that a vast majority of their transactions in ISO and PX spot markets were conducted on a back-to-back basis, which lends itself to matching specific sales to corresponding purchases.

56. Several LSEs conclude that aligning their resources with sales most proximate in time would not be appropriate. Turlock argues that such an approach would not ensure that the Non-Public Utilities' incremental purchased power costs are properly allocated to the customers who caused these costs to be incurred. SMUD states that it did not make sales from its resources based on a first-in, first-out policy and argues that there is no correlation in timing between the contract and the incremental sale. AEPCO believes that attribution of sales to generation/power purchase on the basis of price is more appropriate than attribution based on proximity in time.

⁵⁶ California Parties' Comments at 16-17 (citing July 25 Order at 61,518 and December 19 Order at 62,214).

57. Stand-Alone Marketers also request the following two clarifications with regard to a tagging methodology. First, they submit that any tagging should not require marketers to produce NERC tags (or other scheduling tags issued by the ISO), as these tags would be difficult to produce. Second, they maintain that any tagging or matching method should not be intended to foreclose consideration of other incremental or marginal operating costs that were incurred to make subject sales to the ISO or PX counter-parties.

58. California Parties argue that any attempt to match purchases made in order to resell power into the ISO and PX spot markets would be arbitrary. Citing the statements of two Powerex traders, California Parties argue that, as a general matter, all sellers maintained a WECC-wide portfolio from which they made their sales and did not match specific purchases to specific sales. Stand-Alone Marketers respond that they did not operate their business in the same fashion as Powerex.

4. Average Portfolio Cost

59. Many sellers propose that an average portfolio cost be calculated only for sales that cannot be attributed to particular resources. As a LSE, SMUD submits that it cannot match any of its resources with its sales to the ISO and PX spot markets and suggests that its costs be based on an average cost of energy incremental to native load obligations. Another LSE, PNM, suggests that in addition to its native load obligation, it has other “primary obligations” that includes firm wholesale sales, long-term contract sales and resource-backed forward sales.

60. Stand-Alone Marketers submit that, for those transactions which cannot be attributed, they recommend that the associated costs be valued on a weighted average cost basis. If the Commission were to direct the use of an overall average approach, Stand-Alone Marketers argue that its portfolio costs should be the weighted average cost of all power the marketer received at a delivery point into California (COB, NOB, NP-15, SP-15, Mead, Palo Verde, and Four Corners) on that day.

61. ET cites limited resources in proposing that a weighted average cost of short-term power purchases by the seller from non-ISO and non-PX entities at the same delivery location for the given month should be calculated. Then ET states it could determine its net margin by comparing its revenues from its sales to the ISO and PX and its costs from purchased power associated with these sales.

62. California Parties argue that if the Commission were to utilize a variable cost approach instead of their proposed WECC-wide all costs/all revenues, it is critical to consider a seller’s entire portfolio to produce an average variable cost, so that a seller is not permitted to artificially attribute its most expensive resources to the ISO and PX spot market sales. They estimate that for at least one seller, using an FCA-style stacking

methodology as proposed by many sellers would likely double or triple average cost for ISO and PX sales.

Commission Determination

63. As discussed in the preceding section, we find that the relevant universe of sales to consider for the cost recovery is limited to ISO and PX sales, both mitigated and non-mitigated. Consistent with this finding, the corresponding costs to include in any showing for cost recovery should be limited to the costs incurred to make sales into the ISO and PX markets. Accordingly, we will reject the arguments raised by California Parties and AEPCO to include all of a seller's costs.

64. With the universe defined, we next turn to the determination of costs and the necessary supporting documentation. While several sellers indicate that they can clearly match specific resources from their portfolio of generation and purchased power with specific sales into the ISO and PX markets, others have indicated that a significant number of ISO and PX sales remain which cannot be clearly matched to specific resources. For these unmatched sales into the ISO and PX markets, we received three distinct proposals to calculate the associated cost of energy. First, as an alternative to their all costs all revenues methodology, California Parties argue that an average cost of energy should be calculated, based on a seller's entire resource portfolio. Second, Indicated Sellers argue for a top-of-the-stack approach using a stacking analysis that calculates an energy cost based on a seller's highest cost resources. Third, sellers such as SMUD and ET propose to calculate an average energy cost based on the subset of their resource portfolio that was available for sale into the ISO and PX markets.

65. We will require that sellers first match specific sales to specific resources, provided that they can clearly demonstrate each sale with a specific resource, as discussed above. This demonstration must include: (1) the relevant North American Electric Reliability Council (NERC) tag or CAISO tag; and/or (2) a transaction-by-transaction accounting of resources matched with sales, together with corresponding documentation, *e.g.*, letter agreements, transaction confirmations. In the settlement proceedings we order below, parties may offer alternative types of documentation. We recognize that a transaction-by-transaction showing will likely be burdensome to make; however it should prevent the need for hearing.

66. For those sellers unable to match and document transactions to specific resources, we consider the three proposals offered in the comments. First, with regard to California Parties' recommendation that an average cost of energy should be calculated, based on a seller's entire resource portfolio, we believe that this approach is inconsistent not only with the way in which regulated and unregulated entities did business during the Refund Period, but is also inconsistent with the structure of the ISO and PX markets (based on marginal units setting a clearing price) and the MMCP established for the Refund Period.

LSEs are obliged to serve native load with their lowest cost resources and may have other “primary obligations,” as PNM notes. We find that resources serving these primary obligations are unavailable for sale into the ISO and PX markets and should thus be excluded from the cost filing. Similarly, marketers appeared to have generally bought and sold short-term energy separate from their long-term purchases and sales.⁵⁷ Accordingly, we will reject the proposal that the energy cost for unmatched sales be based on a seller’s entire resource portfolio.

67. Turning to Indicated Sellers’ proposal to base their cost of energy on their highest cost resources, we recognize that LSEs use their lowest cost resources to serve native load and make off-system sales with only the excess, as several LSEs, over the course of this proceeding dating back to August of 2001, have indicated. However, we find that Indicated Sellers’ proposal to use a top-of-the-stack approach is not appropriate where sellers are not able to match a resource with a sale.⁵⁸ As discussed below, we will require the costs to be averaged where a seller’s resources cannot be matched on a transaction-by-transaction basis.

68. We find that the proposal by SMUD and ET to calculate their average energy cost based on the subset of a resource portfolio that was available for sale into the ISO and PX markets to be generally consistent with our determination above. Any seller wishing to avail itself of the use of an average approach must submit fully-supported actual cost and transactions with testimony, as well as an attestation of a corporate officer, as required under section 35.13(d)(7) of the Commission’s regulations, verifying the claim and the fact that the company has not kept books and records that would allow it to match sales into the ISO/PX markets to specific resources.

69. Our approach of first requiring matching with documentation before turning to an averaging methodology should address California Parties’ concern that a seller not be permitted to artificially attribute its most expensive resources to the ISO and PX spot market sales, which would tend to overstate a seller’s associated cost of energy. We believe that this approach strikes the right balance between, on one hand, recognizing the incremental nature of a seller’s ISO and PX sales, and on the other hand, acknowledging that an unmatched sale by definition cannot be linked to a specific resource. It is also consistent with our determination to limit the scope of revenues subject to cost recovery to the portfolio of mitigated and non-mitigated ISO and PX sales. A seller’s total energy

⁵⁷ See, e.g., Cicchetti, Dickson and Churchman Affidavits.

⁵⁸ If, as LSEs claim, their off-system sales were made from the highest-cost resources, this should be clearly demonstrated on a transaction-by-transaction basis matching each sale with each resource in their cost filings.

cost will equal: (1) the aggregate cost of energy for matched sales; and (2) the product of the average portfolio cost of energy and the MW-hours of unmatched sales into the ISO and PX markets. Below we describe how each type of seller, marketer and LSE, should calculate its average portfolio cost of energy from unmatched sales.

70. We direct marketers to calculate an average cost of energy for their unmatched sales based on their portfolio of short-term purchases. According to the operational practices of many marketers (as discussed in comments), we find that a reasonable definition of short-term purchases includes all transactions of less than one month in term. This portfolio shall exclude any short-term purchases previously committed or unavailable for sale into the California spot markets.

71. Likewise, we direct LSEs to calculate an average cost of energy for their unmatched sales. As provided in the December 19 Order and May 15 Order, we stated that we would not allow LSEs to justify sales above the mitigated Market Clearing Prices based on their cost of purchased energy. We noted that LSEs purchase energy to serve their native load obligations and that to the extent they have excess capacity to sell, the proceeds of such sales would reduce the cost of power that their customers would otherwise pay. LSEs continue to argue that they should be given the opportunity to include purchased energy costs in their showings. To the extent a LSE can demonstrate that it sold energy initially purchased for native load that subsequently became available in real time, it may include this allowed energy in its filing.⁵⁹ We will not, however, allow an LSE to include in its filing any costs from purchase/resale transactions that were entered into on an opportunity basis. In entering such transactions, LSEs took on a risk that should not be borne by the ratepayers of California. Accordingly, a LSE's average cost of energy for unmatched sales must be based on its portfolio of generation and allowed purchased energy (as discussed above), to the extent this portfolio was not used to meet primary obligations. This portfolio shall exclude (1) resources, as determined from a stacking analysis, that were utilized to meet native load requirements; (2) resources previously committed or unavailable for sale into the California spot markets; and (3) purchased/resale transactions that were entered into on an opportunity basis.

⁵⁹ See *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888-A, 62 Fed. Reg. 12,274 (March 14, 1997), FERC Statutes and Regulations ¶ 31,048 at 30,253 (1997).

72. With respect to opportunity costs, consistent with our prior determinations, we will not allow sellers to include opportunity costs.⁶⁰ Opportunity costs are not appropriate because energy that is available in real time cannot be sold elsewhere.

D. Other Costs

73. Commenters raise a number of other costs, many of which were not contemplated in previous orders. These include: the cost of transmission service and losses; directly assigned (where possible) or allocated (when direct assignment is not possible) transmission expenses; operating expenses; and non-mitigated California expenses associated with a seller's transactions in the PX and CAISO markets. They identify non-mitigated California expenses to consist primarily of PX and CAISO fees, such as the CAISO's "Hour Ahead Inter-Zonal Congestion Charge" and the PX's "CAISO Fees Imposed by the PX Charge." Citing the ten percent creditworthiness adder incorporated into the refund methodology, Indicated Sellers would include risk premiums to compensate for capital risks associated with sales in the California spot markets. Indicated Sellers also submit that it would be appropriate to use a proxy for their operating and maintenance (O&M) expenses based on the 21.11 mills per kWh adder set forth in the Western Systems Power Pool Agreement, which they state is similar to the \$6/MWh O&M adder designed for generators in the refund methodology. Commenters also seek the inclusion of agent fees, such as those it incurred by using APX's services, broker or sleeving fees, and natural gas or emission costs that the marketer incurred when purchasing power.

74. Certain commenters also state that the practicality of how to include these costs depends on whether the required demonstration is based on incremental or average costs. AEPCO submits that an additional advantage of comparing total revenues to total costs is that there should be no, or at most, a limited need to separate transmission costs and losses from other costs. Another commenter offers that transmission expenses should be calculated by using an allocation factor derived from the percentage of a marketer's trading. Stand-Alone Marketers submit that whether a particular cost is marginal for the purposes of the cost filings is based on whether it is avoidable, but for a seller's participation in the ISO and PX spot markets. They assert that this determination of whether a particular cost is marginal or fixed will entail fact-specific determinations that will likely vary among the sellers and should thus be left to the sellers to decide.

⁶⁰ December 19 Order at 62,212.

Commission Determination

75. In the December 19 Order we stated:

We recognize that sellers have never had an opportunity to present evidence of their *marginal* costs, and also that the true impact of the refund formula on sellers' bottom lines will not be known until the conclusion of the refund hearing. Therefore, in order to assure adequate process, the Commission will provide an opportunity after the conclusion of the refund hearing for [sellers] to submit evidence as to whether the refund methodology results in an overall revenue shortfall for their transactions in the ISO and PX spot markets during the refund period.⁶¹

76. We reiterate that sellers' cost filings may reflect only their marginal costs related to sales into the ISO and PX spot markets. This is consistent with our finding in the preceding section that California spot market sales were incremental in nature and that recovery of energy costs is based on only the subset of a seller's resource portfolio available for sale into the ISO and PX markets.

77. Furthermore, we agree with Stand-Alone Marketers that, for the purposes of the cost filings, the relevant marginal costs are those costs that would have been avoided had no sales been made into the ISO and PX markets. We will use this principle to guide us in our determination of the types of costs sellers may include in cost filings to the extent there is a demonstration of direct relationship to the transactions into the ISO/PX. Accordingly, we will allow sellers to include marginal costs that are directly attributable to the incremental sales made into the ISO and PX markets. For matched transactions, we would expect these types of costs to be clearly linked with the resource and the sale, and easily verifiable by supporting evidence. Under the averaging approach, sellers must also be able to document how these types of costs attach to the related transactions.

78. We find that transmission costs and losses paid to make the sale into the ISO and PX markets may be included in the cost filing. These should include the marginal costs that were paid to deliver energy to the CAISO control area, but should not include costs associated with transmission reserved or acquired for other uses. We view such costs to have been "sunk", and thus not incrementally incurred for the sale. Sellers must clearly demonstrate the transmission costs associated with each ISO or PX sale, as well as document the Open Access Same Time Information System (OASIS) reservation and the approved tariff rates on file with the Commission. Within our definition of marginal costs, we will also allow APX fees and non-mitigated California expenses such as the

⁶¹ December 19 Order at 62,254 (emphasis added).

CAISO's "Hour Ahead Inter-Zonal Congestion Charge" and the PX's "CAISO Fees Imposed by the PX Charge." We will not allow emissions and natural gas costs (outside the emissions adder and FCA previously claimed by sellers), credit risk or O&M expenses.

E. Return

79. Although the December 10 Order did not request comments on capital costs and return on investment, many marketers noted that they should have the opportunity to include these items in the cost filings. Stand-Alone Marketers assert that capital costs have been long recognized as an integral component of the cost of doing business by jurisdictional service providers and the failure to provide for the recovery of capital costs has been recognized as regulatory taking. The Cicchetti Affidavit states that a reasonable return on their trading activities would be based on a split between bid and ask prices.

80. Merrill Lynch submits that, along with recovery of capital costs associated with buying and selling into the ISO and PX spot markets, the level of return on equity for power marketers must be commensurate with the level of risk that commodity trading businesses face. Merrill Lynch agrees with an earlier filing submitted by Hafslund,⁶² who argued that a return on equity of at least 14 percent is consistent with the level of return the Commission has approved for greenfield pipelines, and that a higher level is warranted for power marketers because of the inherent risk in trading commodities with volatile prices.

Commission Determination

81. In the May 15 Order we stated:

CSG is mistaken in rigidly applying cost-based principles to issues that are unique to sales made by marketers at market-based rates...consistent with 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.⁶³

⁶² See Hafslund's Petition for Relief from Refund Liability, Docket No. EL00-95-000 (March 20, 2003).

⁶³ May 15 Order at 61,652.

As indicated in our prior order, we will allow marketers the opportunity to receive a return. We disagree, however, with the proposition that marketers should receive a return on equity equivalent to or higher than a greenfield pipeline. 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.⁶⁴ 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.⁶⁵

F. Other Issues

1. Offsets to Refund Liability

82. The December 10 Order invited comments on how offsets to refund liability (*i.e.*, the FCA and emissions adder) should be treated for generators who file for both an offset and cost recovery.

83. Puget states that it intends to submit both a cost filing to recover its revenue shortfall and a FCA to recover its gas costs. Puget submits that if it will still incur a revenue shortfall for an interval even after its FCA claim for that interval is calculated and incorporated into the refund calculation, then it will make an additional revenue shortfall claim for that interval. AEPCO submits that any offset should be applied first and then the refund liability, as reduced, should be subject to application of the cost-based recovery.

84. California Parties propose that the cost filing should be based on net refund obligation as determined after it is reduced to reflect the adders. In their reply comments, California Parties add that the FCA and emission adder are part of the MMCP approach, and thus it is appropriate to look at the overall MMCP result for each seller (including any offsets) when analyzing the seller's cost and revenues.

⁶⁴ The resulting dollars must be allocated according to Commission precedent.

⁶⁵ *See, e.g., AEP Power Marketing, Inc.*, 108 FERC ¶ 61,026 (2004).

Commission Determination

85. Sellers should pursue cost recovery claims for any transactions in which the MMCP as adjusted by the FCA and emissions still result in a confiscatory rate.

2. California Spot Market Purchases

86. Many sellers argue that their revenues should reflect their sales both into the spot markets as well as on the purchases in those markets that were sold to third-parties on a bilateral basis. Indicated Sellers propose to value revenues generated from the resale of energy purchased in the ISO and PX markets at the California-Oregon border index for the relevant day. They believe this is a conservative approach which assumes the highest opportunity cost for that energy. Indicated Sellers note, however, that if a stacking methodology is not used to determine energy costs, pricing ISO and PX purchases at index prices may not be appropriate. The Cicchetti Affidavit suggests that, in order to determine the income a marketer earned from buying and selling from one organized market to another in California, the pre-mitigated cost of a marketer's California purchases should be subtracted from its California sales revenue.

87. Several suppliers also appear to implicitly support netting of ISO and PX sales and purchases in their proposals. On the other hand, Indicated Sellers argue that ISO and PX sales and purchases should not be netted, as consistent with the FCA, and instead propose that California spot market purchases should be treated like any other resource in the supply stack.

Commission Determination

88. We will reject various sellers' proposals to include the costs and revenues associated with the resale of energy purchased from the ISO and PX markets and sold into the bilateral markets. We find that that these proposals are inconsistent with our approach to determining the costs and revenues for sales into the ISO and PX markets. Just as the Commission's methodology does not include the direct costs for sales into the bilateral markets, nor should it include the revenues from any such sales.

89. We agree with Indicated Sellers that California spot market purchase should not be netted with sales. We find that netting is inappropriate in the context of our methodology which requires sellers first to match, where possible, their resources with ISO and PX sales.

3. Hydroelectric Power Sales

90. Some sellers argue that the replacement costs of energy unique to their hydroelectric generation must be included in any cost recovery methodology. SMUD

explains that replacement costs of SMUD's sales from its hydroelectric resources are based on actual costs of power purchased to serve SMUD's load to replace hydroelectric generation sold into mitigated spot markets. Powerex argues that as a result of a drought during the Refund Period, it had to purchase power in the mitigated spot markets to replace energy it had previously made available in these markets.

Commission Determination

91. SMUD and Powerex have failed to adequately support that they should be allowed a specific allowance for recovery of replacement costs related to the hydroelectric power they sold into the ISO and PX markets. Accordingly, we will not allow sellers to directly include replacement costs for hydroelectric power in their cost filings.

G. Methodology and Template

92. We stated in the December 10 Order that "we are interested in a standardized format applicable to all sellers that would represent a pragmatic approach to sellers demonstrating that the refund methodology resulted in an overall revenue shortfall."⁶⁶ The December 10 Order therefore requested comments on whether the same cost-based recovery methodology should apply to all sellers, both marketers and non-marketers. The order also encouraged parties to file any workable templates so as to illustrate how the cost filings should be determined and submitted.

93. Most sellers emphasize the need for flexibility, arguing that, given the wide disparity in operational practices and situations facing each seller, the same cost-based recovery methodology and template should not necessarily apply to all sellers. They believe that any process that does not reasonably accommodate the specifics of how they did business during the Refund Period is unduly confiscatory and that a uniform cost-based recovery would inherently contradict the purpose of the revenue shortfall filings. Hafslund adds that administrative convenience cannot justify imposing a cost-based recovery method that will not permit an accurate depiction of cost incurrence. Avista asserts that while an incremental cost-based recovery should apply to all sellers (generators, marketers, and LSEs), each classification of seller may face different sets of incremental costs.

94. California Parties submit that their proposed methodology should apply to all sellers and suggest that the approach proposed by some sellers would allow them to cherry-pick. According to California Parties, their WECC-wide all costs and all revenues methodology could easily be applied to all sellers in a uniform way and add that they are

⁶⁶ December 10 Order at P 7.

ready to work with the Commission to create a template for cost-based filings.

Commission Determination

95. Today we are establishing a framework that strives to reasonably account for the different business practices and cost structures that each type of seller operated under during the refund period. We have provided guidance in the types of costs the Commission will allow to include in their cost filing demonstrations, and how those costs should be accounted for, e.g., incremental, average. Further below we discuss the process by which parties are to develop a standardized template(s) by type of seller (if necessary) and further develop any details of the cost filings.

H. Verification of Costs

96. The December 10 Order invited parties to comment on the verification that sellers would need to provide in submitting their cost filings. We specifically asked whether or not cost support in accordance with 18 C.F.R § 35.13 (2004) would be appropriate, or whether some other form of verification would be adequate.

97. Many sellers point out that the requirements of section 35.13 relate to jurisdictional utilities seeking to change an existing cost-based rate schedule or otherwise justify an increase in rates under section 205 and consequently do not appear to be applicable to their situation. These sellers indicate that they were not required to keep their books and records in accordance with section 35.13 of the Commission's regulations and instead maintained them in accordance with Generally Accepted Accounting Principles (GAAP), subject to audit before the Securities and Exchange Commission. Avista states that the cost support outlined in 35.13 was waived for marketers at the time they were granted market-based rates, and that the required information cannot be replicated by parties that do not maintain cost-based rate schedules at the Commission. Sellers also point out that section 35.13 requires a test period, which, they assert, would not be appropriate for the Refund Period. Some sellers mention that Section 35.13 contemplates verification by a company's chief financial officer, but in some cases the chief financial officer may not be the appropriate officer to gather, prepare and attest to the information needed to submit a cost-based filing. CSG concludes that imposing these requirements under section 35.13 would unduly discriminate against certain suppliers and unnecessarily delay resolution of this proceeding.

98. Many sellers again stress the need for flexibility to accommodate each of their particular circumstances. AEPCO submits that GAAP treatment might cause some of the costs for rehabilitation of its turbines – which were utilized to make mitigated sales – to be incorrectly attributable to other periods after the Refund Period ended. AEPCO also notes that the Refund Period corresponds roughly to three calendar quarters and that various accounting/cost items which are regularly recorded on a quarterly or monthly

basis should rightly be included in its cost-based recovery filing. Stand-Alone Marketers note that, in the past, when marketers have submitted cost-based filings, such as in support of filings for reactive rates, those filings were supported by the sworn testimony and verifications of appropriate company personnel that the amounts included in the filing were accurate, and the Commission would grant waiver of the requirements of section 35.13.

99. Anaheim states that the cost support requirement should not be so onerous that it precludes smaller entities such as Anaheim from submitting a claim. Turlock echoes this sentiment in asserting that it should be subject neither to “the rigors” of section 35.13 nor to an Ernst & Young type audit, as the costs associated with either could far exceed the underlying claim and ultimately prevent sellers from filing for an offset.

100. In general, sellers argue that they should include in their filing cost support together with workpapers and the attestation of a corporate officer as required under section 35.13(d)(7) of the Commission’s regulations.

101. California Parties are in favor of the procedures provided in section 35.13, but they believe it may be appropriate for the Commission to investigate and implement shortened procedures to facilitate the Commission’s review of the filings. They submit that sellers miss the point when they argue that the rate schedule change and test year assumptions found in section 35.13 are inapplicable to them. California Parties assert that section 35.13 properly requires sellers to file for cost recovery in accordance with the Uniform System of Accounts and include data typically analyzed in cost-of-service filings. California Parties argue that if sellers do not maintain their records in accordance with the Uniform System of Accounts, they should restate them to supply the information the Commission needs in a consistent format. California Parties conclude that section 35.13 provides a uniform and useful set of principles for a cost based rate inquiry without having to master a new method in order to evaluate each new filing.

102. California Parties also highlight the activity of some sellers who purchased from affiliated entities. They submit that these transactions must be scrutinized to assure that the cost filings do not allow high priced sales from one affiliate to another to serve “as a sham basis for an inflated picture of a seller’s portfolio-wide costs.”⁶⁷

⁶⁷ California Parties’ Comments at 27.

Commission Determination

103. Given the cost recovery methodology established in this order, we conclude that the requirements of section 35.13 do not provide the appropriate format by which sellers must document their costs. Instead, we direct sellers to comply with the following requirements. Sellers must include in their cost filings detailed work papers supporting the costs for each transaction. This is irrespective of whether the seller uses the matching method or the average cost method, as described above. There must be a showing of the costs incurred to make each sale to the ISO/PX. In addition, the seller must show the revenues from all sales made into the ISO/PX. The total costs and total revenues will then be netted to justify any offset to the refund obligation. A seller's demonstration must include, but is not limited to:

- Complete tagging or line-by-line accounting for each transaction, backed by the power purchase contract and/or agreement.
- Stacking analysis for LSE resources demonstrating the top of the stack available for sales into the PX and CAISO markets.
- An accounting of purchased energy transactions by duration of contract and date of agreement. This should be accompanied by testimony that identifies the purpose for entering into the contract, *e.g.*, serve native load, opportunity sales.
- OASIS reservation, transmission service agreement, and effective tariff rate.
- Showing of the revenues credited back to retail customers as a result of the off-system sales into the ISO and PX markets.⁶⁸
- Company business plan or risk mitigation plan in effect during the Refund Period.
- Any allocation formulas with supporting detail.
- All calculations and supporting schedules.
- Relevant testimony with explanatory detail.

104. Shown below is an example based on the direction in this order of the types of information sellers must include in their cost filings. We would expect the filing format to be developed to include separate identification of each of the following categories so that the Commission can easily verify, check and make ready use of the information provided. Parties must develop a standardized spreadsheet format that all sellers must use to submit their cost filings.⁶⁹ All schedules and worksheet reference numbers must be consistent among all filers (whether applicable or not applicable). This standardized

⁶⁸ Such a showing could help support a claim of the type of off-system sale contemplated in this order, but would not, on its own, be an adequate showing. Rather, it could help demonstrate business and management practices of an LSE.

⁶⁹ Sellers should use an electronic spreadsheet format where possible.

format will allow for clear reference through the discovery and hearing phases of the process.

I. Revenues:

MMCP-derived ISO and PX Sales

II. Offsets to the MMCP obligation:

- A. FCA
- B. Emissions

III. Costs:

- A. Energy Purchased
 - i) Affiliate
 - ii) Non-affiliate
- B. Energy Production

IV. Other Costs

- A. Transmission Costs, Transmission Losses and Ancillary Services on a Transaction Basis⁷⁰
- B. CAISO and PX Administrative Fees
- C. APX Fees

V. Return on Investment (Marketers Only)

- A. Product of Allocated Investment and Ten Percent

105. Finally, we will require the attestation of a corporate officer, as required under section 35.13(d)(7) of the Commission's regulations.

106. With regard to affiliate transactions, we find that for power sales, sellers are

⁷⁰ We envision that for each transmission and ancillary service transaction, the cost filer will list: (1) the provider; (2) the rate schedule and rate contained in the rate schedule; (3) the total costs paid under that rate schedule for the transaction; (4) the MW of transmission taken; (5) whether self-supplied (if applicable); and (6) whether customers and provider are affiliated. The seller will need to document any discounts, if applicable. The information provided should be of sufficient detail to confirm the costs.

required to seek approval for affiliate sales under section 205 of the FPA and are typically subject to codes of conduct.⁷¹ For transmission service, a provider must treat its affiliate like any other customers and should have entered into a service agreement for the provision of transmission services. We believe that a seller that makes a claim for costs associated with affiliate transactions must show that its transactions were in compliance with the Commission's rules and regulations, including codes of conduct and standards of conduct. This should satisfy any concerns about inappropriate behavior between a seller and its affiliate.

I. Timing of Cost Filings

107. The December 10 Order invited comments on what, if any, problems would arise if the Commission were to order refunds first by those sellers not seeking cost-based recovery, instead of waiting to issue refunds until all sellers' cost-based recovery filings have been filed and processed by the Commission.⁷² California Parties and CARE support this approach, in order to expedite receipt of refund dollars. A number of commenters, however, prefer resolution of the cost filings coterminous with the determination of "who owes what to whom."⁷³ Even those commenters who do not object to issuing refunds first from suppliers who elect not to make cost filings insist that, if some refunds are issued prior to resolution of cost filings, the Commission must ensure, by the establishment of escrow accounts or letters of credit, etc, that sufficient funds are available to cover the full extent of potential revenue shortfall/cost filing obligations.⁷⁴ The CAISO, which is the entity responsible for calculating refund amounts, strongly objects to the two-phased refund approach as an "administrative nightmare" for itself and its clients.

108. Specifically, the CAISO states that it has three categories of concerns: (1) this proposal would double the time-frame and quality checks associated with the financial adjustment phase and with the global settlement adjustment phases (2) the CAISO would need to modify its software or, even less desirable, perform a settlement production re-run; and (3) multiple financial clearing would be greatly complicated by the bankruptcies

⁷¹ See, e.g., *Aquila Inc.*, 101 FERC ¶ 61,331 (2002).

⁷² December 10 Order at P 7.

⁷³ See, e.g., Comments of Indicated Sellers at 33; Stand-Alone Marketers at 28; and Puget at 9.

⁷⁴ See, e.g., Comments of Indicated Sellers at 34-35; El Paso Comments at 16; Hafslund Comments at 5.

involved during the Refund Period. In its reply comments, the CAISO points out that there is not real support from any of the commenting parties that the CAISO conduct a two-phase financial clearing. The CAISO states that it strongly believes that the FERC refund rerun process should be completed so that Market Participants will know “who owes what to whom” prior to the Commission’s consideration of cost filings. The CAISO states that this would be the most efficient use of time and resources for all involved. According to the CAISO, the two-phase approach would increase its administrative costs and strain its limited computer and human resources.

109. SMUD argues that the CAISO’s estimate of a doubled time frame for calculations plus additional software modifications or another settlement production re-run eliminates any possible efficiency gains from a phased refund payment process. In addition, SMUD asserts that the possibility of costly software modifications and shortfalls that could result from phased refund payments likely outweigh the benefits from payment of a portion of refunds at an earlier date.

110. Avista objects to any process whereby the company must pay refunds calculated under the MMCP methodology prior to a formal review of its cost/revenue filing. Avista asserts that, if sellers not seeking cost-based recovery were to reconcile accounts prior to the time when cost filings are processed, the Commission must ensure that claims arising out of the cost/revenue filing are secure and fully enforceable with interest. Similarly, Turlock states that the Commission should not order refunds prior to a final determination on cost filings unless the Commission can guarantee that sellers making cost filings will be paid all net amount sellers are owed by the ISO and PX without any shortfall. Turlock suggests basing the guarantee on a pertinent affidavit by the ISO and PX. AEPCO and Hafslund also express the concern that if refunds are disbursed prior to resolution of cost filings, cost recovery must still be full and complete. El Paso states that early disposition of refunds to some is neither lawful nor equitable if those paid later receive less than the full amounts they are due.

111. Indicated Sellers, Stand-Alone Marketers and Puget urge the Commission to place the cost filings on an expeditious procedural track so that they may be resolved concurrently with the final determination of “who owes what to whom.” Puget says it does not object to the proposed two-phase process, but it does not support it. Indicated Sellers argue that, if the Commission does not resolve cost filings concurrently with refunds, then the Commission should refrain from requiring a marketer who has filed or intends to file a revenue analysis to make any refunds prior to a final determination on the marketer’s revenue filing. Indicated Sellers further state that the Commission should take “whatever steps necessary” to ensure that any shortage of funds at the ISO/PX does not fall more heavily on a seller that is owed funds simply because that seller is the last to be processed. Stand-Alone Marketers similarly insists that, if the Commission decides to follow the proposed two-phase disbursement approach, it should require the utilities to

establish escrow accounts or provide firm security, such as letters of credit, to guarantee the unpaid receivables of sellers who make cost filings.

112. Edison Mission asserts that all parties will benefit from sequencing events that will result in the “earliest, reliable and fixed” determination of each seller’s refund liability. In its reply comments, ET argues that requiring payment of refunds prior to netting losses against gains to determine whether a seller will suffer a net revenue shortfall as a result of the refund methodology would destroy the overall cost portfolio recovery opportunity for those who owe refunds. ET argues that this would constitute an unjust penalty, in violation of the FPA, because it would disgorge revenues and deny recovery of costs.

113. In contrast, California Parties argue that the Commission should take all steps possible to distribute refunds to buyers from all sellers at the earliest possible date, before sellers are permitted to make cost filings. California Parties explain that sellers cannot suffer financial distress if refunds are paid from existing escrows while cost filings are being processed. California Parties state that cost filings are not integral to the ISO’s refund calculation, and that the Commission has placed them on a separate track where they should remain. California Parties argue that the refund process should be completed by the ISO first, so sellers can evaluate whether their refund obligation will cause the “deep financial hardship” necessary to recover costs through the cost filing process.

114. CARE argues that refunds should be issued first by jurisdictional sellers, with sufficient time to allow non-jurisdictional sellers to issue refunds thereafter.

Commission Determination

115. After taking into account comments concerning the complications that might ensue from issuing refunds piecemeal, including the difficulty of ensuring adequate funds to cover cost filings, we will require the resolution of the cost filings prior to issuance of any refunds. In reaching this determination, we are particularly mindful of the CAISO’s “administrative nightmare” objections to our proposed two-phase approach, since the CAISO must perform the task of finalizing the refunds as well as settle and clear current ISO market activity and perform other vital daily functions. We further find that resolving cost filings prior to issuing refunds is consistent with our prior statement that refunds will be offset by amounts still owed as determined in this proceeding, and only the net result of this offset will flow to or from parties.⁷⁵ Parties are required to submit to the Commission their cost filings no later than September 10, 2005. The technical

⁷⁵ *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 105 FERC ¶ 61,066 at P 180 (2004).

conference we establish below should hasten resolution of the cost filings as expeditiously as practicable.

J. Establishment of Technical Conference

116. Parties have fourteen days from the date of issuance of this order to submit a proposed template and supporting comments. Parties are advised to limit their comments to the parameters of this order; in other words, the Commission is not calling for expedited rehearing requests, but rather seeks to decide the form of the template to implement this order and streamline resolution of cost filings. The Commission does not envision the need for evidentiary hearings to resolve the cost filings. The Commission views the cost filings as limited demonstrations of actual transactions and costs. The burden will be on the filer to present the actual data in a manner that supports its claim. As a consequence, the Commission will establish a technical conference in August to develop and iron out the details of a uniform filing format, or template, to be used for filing by the parties to receive the offset. The Commission envisions issuing an order on November 15, or sooner, finalizing the offsets. In addition, we urge parties with unresolved disputes concerning the re-run and/or cost filing process to file those disputes with this Commission as soon as possible, and not wait until the CAISO makes its compliance filing. To further expedite resolution of the proceeding, and consistent with due process, we announce a December 1, 2005 deadline for parties to file with this Commission any disputes with reruns and offsets, including fuel cost allowance claims and emissions cost offset claims.

The Commission orders:

(A) The scope of portfolio transactions for cost filing purposes is mitigated and non-mitigated sales to the ISO/PX for delivered electricity during the Refund Period, as discussed in the body of this order.

(B) Pertinent costs for cost filing purposes are as discussed within the body of this order.

(C) Parties may submit a proposed template and supporting comments within 14 days of the issuance of this order.

(D) Parties are hereby required to submit their cost filings no later than September 10, 2005.

(E) Subsequent to the comment deadline, the Commission will convene a Technical Conference to finalize the format of the uniform cost filing template. This Technical Conference will be held in August, on a date to be announced shortly.

(F) Parties shall file with the Commission any outstanding disputes concerning the refund re-run and/or offset process by December 1, 2005.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.