114 FERC ¶61,223
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, Docket Nos. EL00-95-129

v.

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

Investigation of Practices of the California Independent System Operator and the California Power Exchange Docket Nos. EL00-98-116

ORDER DENYING REHEARING

(Issued February 28, 2006)

1. In this order, we deny the California Parties'[1] request for rehearing of our March 18, 2005 Order[2] in which we addressed issues pertaining to the fuel cost allowance (FCA) claims.

Background

2. The March 18 Order provided clarification on issues pertaining to the FCA calculation and the template for FCA submissions. In that order, we also denied the California Parties' motion to lodge in this proceeding various Commodity Futures Trading Commission (CFTC) settlement orders and related consent agreements

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[1] The 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.

[2] *San Diego Gas & Electricity Co. v. Sellers of Energy and Ancillary Services*, 110 FERC ¶ 61,293 (2005) (March 18 Order).

documenting gas price and index manipulation. In addition, the March 18 Order addressed audit-related issues and audit costs, and adjusted timelines for the audit completion for certain claimants.

Discussion

Motion to Lodge

3. On rehearing, the California Parties argue that the Commission erred in denying its motion to lodge in this proceeding CFTC settlement orders and a criminal plea agreement relating to gas price reporting. The California Parties state that over the course of this proceeding it has submitted four motions to lodge and that the Commission denied all four of them. According to the California Parties, the Commission's rejection of one of these motions to lodge is not final, since in the March 18 Order it was addressed for the first time and thus the Commission's decision to deny the motion is not ripe for judicial review. Accordingly, the California Parties seek rehearing of the Commission's denial of that motion to lodge and in support reiterate all arguments presented on rehearing of the Commission' previous denials of the motions to lodge.

4. The California Parties filed a motion to lodge on September 24, 2003. On December 4, 2003, the California Parties supplemented its motion to lodge by filing an additional motion to lodge. The second supplemental motion to lodge was filed on February 6, 2004. The original September 24, 2003 motion to lodge and the December 4, 2003 supplemental motion were addressed in a May 12, 2004 Order[3] and again on rehearing in a September 24, 2004 Order.[4] In that order, the Commission also addressed for the first time the third supplemental motion to lodge filed on August 16, 2004. The Commission, however, overlooked the second supplemental motion to lodge, dated February 6, 2004, and addressed it for the first time in the March 18 Order. Specifically, the Commission stated that "it intended to deny the February 6, 2004 [m]otion to [l]odge in its September 24 Order."[5]

5. In this order, we deny the California Parties' request for rehearing challenging the Commission's denial of the second supplemental motion to lodge for the same reasons we denied three other motions to lodge. As we stated in the March 18 Order:

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[3] *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services,* 107 FERC ¶ 61,166 at P 73-76 (2004) (May 12 Order).

[4] *San Diego Gas & Electricity Co. v. Sellers of Energy and Ancillary Services,* 108 FERC ¶ 61,311 at P 65-75 (2004) (September 24 Order).

[5] March 18 Order at P 69.

> The arguments on rehearing do not justify supplementing the record. Regardless whether an entity manipulated gas price indices, an entity may receive an FCA if it is able to demonstrate that its actual fuel costs for mitigated sales exceed the proxy for gas prices used in calculating the [mitigated market clearing price]. This proceeding concerns the establishment of a just and reasonable rate. There are separate proceedings looking into allegations of manipulation. This is consistent with the Commission's policy of ensuring that a refund obligation does not penalize a seller from recovering its variable costs (*footnotes omitted*). [6]

Parties' Participation in Development of FCA Templates

6. The March 18 Order denied the California Parties' request for the Commission to clarify that the California Parties are allowed to participate in the development of additional templates. Instead, the Commission ruled that there is no reason for other parties to participate and that only the California Independent System Operator Corporation (CAISO), individual claimants, and, to the extent necessary, the auditor, Ernst & Young (E&Y), should be involved in the development of any additional FCA templates.[7] The Commission also rejected the California Parties' alternative suggestion that any additional templates should be filed with the Commission for comment and approval.[8]

7. On rehearing, the California Parties challenge this Commission decision and argue that the Commission's continued refusal to allow parties' participation in the development of templates violates basic principles of due process. In the California Parties' opinion, the templates may have substantive impacts that would go unreviewed by the Commission and to which adversely affected parties would have no direct recourse.

8. In the May 12 Order, the Commission established a procedure for processing FCA claims with an objective to "resolve the FCA proceeding in an efficient and equitable manner."[9] Specifically, the Commission directed parties to submit their individually audited FCA claims in a prescribed format directly to the CAISO. The Commission also identified the information required to be included in FCA claims. Subsequently, the

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[6] *See Id*.

[7] *See Id*. at P 64.

[8] *Id*.

[9] *See* May 12 Order at P 27.

CAISO proposed a more detailed template for FCA submissions.[10] The proposed template was discussed by parties during the Commission Staff-led technical conference on October 7, 2004,[11] following which the parties had an opportunity to comment on the template-related issues. In a December 20, 2004 Order, the Commission accepted for filing the CAISO's proposed template for FCA submissions with modifications reflecting the consensus reached at the October 7, 2004 technical conference[12] and directed the CAISO to work with individual claimants to adjust the general template to reflect their specific circumstances.[13]

9. In this order, we reiterate that there is no need for parties' participation in the development of individual templates. In the March 18 Order we stated that:

> [t]he templates merely serve to present the FCA data so that the CAISO can adequately and efficiently process FCA claims. We remind all parties that the Commission has set the methodology to calculate and allocate the FCAs, and that the templates themselves raise no merits issues. To ensure that the relevant template exists for each transaction in which a seller claims an FCA, we have directed the CAISO to work with the sellers.[14]

Accordingly, the California Parties' request for rehearing on this issue is hereby denied.

Audit-Related Issue

10. The California Parties further challenge the Commission's clarification provided in the March 18 Order in response to E&Y's request to clarify the method for determining the term of the purchase contract used in stacking gas purchases from shortest to longest term. Specifically, we clarified that:

> …if prices vary within a contract's term, the duration of the price level should be used as the contract term. To do otherwise would require

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[10] *See* the CAISO's Motion for Leave to File Answer and Answer to Comments and Protests on Compliance Filings, Docket Nos. EL00-95-109 and EL00-98-096, September 14, 2004.

[11] *See* Notice of Technical Conference, Docket No. EL00-95-000, September 27, 2004; Notice of Agenda of Staff Technical Conference, Docket No. EL00-95-000, October 4, 2004.

[12] *San Diego Gas & Electricity Co. v. Sellers of Energy and Ancillary Services*, 109 FERC ¶ 61,297 at P 79 (2004).

[13] *Id*. at Ordering Paragraph (C).

[14] March 18 Order at P 64.

> averaging of costs of the term (by month, for example) and the resulting average monthly cost would not reflect the incremental cost at the time of use. We clarify that price duration and/or requested volume changes should define the placement of the contract within an appropriate like-term tranche.[15]

11. On rehearing, the California Parties argue that this amounts to a transformation of monthly contracts into individual spot sales contracts and is inconsistent with the Commission's prior determination that gas supplies be ranked by contract term.[16] The California Parties further state that to the extent the Commission's ruling in the March 18 Order concerns monthly contracts associated with hedges, it contradicts the Commission's prior directive to allocate gas purchases by the term associated with the underlying hedge.[17] In support, the California Parties quote the Commission's finding that "despite the presence of a spot market price as part of the transaction, the hedge itself is longer term and has no direct relationship to the purchase of daily spot gas for spot electricity sales."[18] The California Parties further argue that the same rationale applies to monthly contracts not associated with hedges.

12. The California Parties further contend that the Commission's clarification in the March 18 Order violates principles of contract law, which dictate that freely negotiated gas supply contracts should be enforced and accounted for in accordance with their specific terms. In the California Parties' opinion, the Commission's ruling disregards the durational term of the gas purchase contracts without a sufficient justification, while the actual time period set out in a gas supply agreement is no less important than the pricing mechanism for determining the seller's actual fuel costs.

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[15] March 18 Order at P 84.

[16] The California Parties cite to *San Diego Gas & Electricity Co. v. Sellers of Energy and Ancillary Services*, 103 FERC ¶ 61,078 at P 13 (2003), in which the Commission stated that "… generators must rank their gas supplies by term and allocate their shortest-term gas supplies to spot power sales, moving up in contract term only until the generator's spot power demand for gas is met. Accordingly, only the gas supplies actually allocated to spot power sales, as impacted by any financial or contractual arrangements that may apply, should be considered in generators' fuel cost claims… [T]he average cost of this entire portion of a generator's gas supply portfolio, *i.e.*, the portion allocated to spot power sales as described above, would serve as the cost of gas for the additional fuel cost allowance."

[17] The California Parties cite to May 12 Order at P 30.

[18] *Id.*

13. We disagree with California Parties. The Commission is not changing or modifying contracts but rather determining how to treat the costs resulting from existing contracts. The purpose of the term stacking requirement in the FCA methodology is to establish the marginal cost of fuel for ISO/California Power Exchange (PX) sales. This requirement is based on the assumption that the generator would use its shortest-term supplies first to fuel its ISO/PX sales. Monthly contracts with daily price variation typically allow a buyer to vary its daily purchases. Thus, it is appropriate to treat such contracts the same as daily spot contracts, because in each case the purchase decision is based on the generator's incremental ISO/PX sales level. Averaging over the term, as California Parties suggest, would fail to reflect incremental costs at the time of use, and would therefore be in conflict with the marginal approach approved by the Commission.

14. With regard to hedging, it was not our intention in the March 18 Order to address contracts associated with underlying hedges. The Commission already addressed this issue in the May 12 Order, so as to properly account for the costs of the transactions. As discussed in the May 12 Order, the hedged transactions are ultimately trued-up to reconcile the difference between the hedged price in the contract and the spot purchase price; thus, the contracts do not involve daily changes in price.[19] The intent of the March 18 Order was to clarify that, absent this type of hedging, term contracts with daily changes in the volumes and prices were to be treated on the basis of these changes.

15. Finally, California Parties are incorrect in suggesting that our decision is contrary to black letter contract law. We are not reinterpreting contract law, but rather clarifying the application of the term stacking requirement in a situation where term by itself does not equate to marginal cost determination. Accordingly, we deny California Parties' request for rehearing.

<u>Commission Orders</u>:

The California Parties' request for rehearing is hereby denied for the reasons stated in the body of this order.

By the Commission. Commissioner Kelly concurring with a separate statement attached.

(S E A L)

Magalie R. Salas,
Secretary.

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[19] May 12 Order at P 27-30 (2004).

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KELLY, Commissioner, *concurring*:

I am sympathetic to the California Parties' arguments seeking broader participation in the development of additional Fuel Cost Allowance templates for those sellers that need them. However, I am voting for this order because I believe that under the circumstances existing at this stage of the proceeding such broader participation would likely only increase the processing expenses of affected parties, including the California Parties, without resulting in a materially different outcome.

My decision turns primarily on two facts. First, most of the largest sellers are no longer subject to the Fuel Cost Allowance aspects of this proceeding. They have either already entered into settlements with the California Parties or been found by the Court of Appeals to be beyond this Commission's jurisdiction to order refunds. Accordingly, the resolution of issues associated with Fuel Cost Allowance templates primarily affects smaller sellers and relatively small amounts of sales. Furthermore, the additional templates at issue here apparently affect an even smaller subset of sellers representing approximately 10-20 percent of total sales. Broader participation in the development of these additional templates, then, seems unlikely to result in significant changes in overall Fuel Cost Allowances.

Second, the existence of a cost-based back-stop makes it likely that any dollar impact on the Fuel Cost Allowance of these remaining smaller sellers will largely be theoretical in any event. The lower the fuel cost offset from MMCP-derived refunds, the greater the chance that the cost-based back-stop will kick in for these remaining sellers.

In summary, while I see some theoretical merit to the California Parties' arguments on this issue, at this stage of the proceeding I do not believe that the potential benefits of their requested relief would outweigh the associated cost to all involved, including the California Parties themselves.

Suedeen G. Kelly