

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell and Joseph T. Kelliher.

San Diego Gas & Electric Company,

Complainant

Docket Nos. EL00-95-098
EL00-95-114
EL00-95-117
EL00-95-124

v.

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

Respondents

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

Docket Nos. EL00-98-086
EL00-98-101
EL00-98-104
EL00-98-111

ORDER ADDRESSING FUEL COST ALLOWANCE CALCULATION

(Issued June 27, 2005)

1. In this order, we address a motion of Puget Sound Energy, Inc. (Puget) for expedited determination. Puget seeks the Commission's permission to use, in calculating its fuel cost allowance (FCA), the higher of cost or market prices at which Puget's gas function transferred gas to its electric function pursuant to state regulatory requirements. In this order, we deny Puget's request for the reasons stated below.

2. This order benefits customers by allowing the audit of Puget's FCA claim to proceed in accordance with previously established timelines, which will facilitate calculation of refunds for electricity purchases made in organized spot markets in California during the period from October 2, 2000 through June 20, 2001.

Puget's Filing

3. In an order issued on May 12, 2004,¹ the Commission held that intra-corporate transfer prices may not reflect “actual” fuel costs and that claimants who purchased fuel from marketing affiliates must present the actual cost of fuel incurred by the affiliate who first obtained the fuel.² In the September 24 Order, the Commission clarified that the purpose of this requirement was “to best determine each claimant’s actual fuel costs by eliminating any issues of potential affiliate abuse.”³

4. On May 11, 2005, Puget filed a motion for expedited determination that the Commission’s rulings on the treatment of natural gas transactions between affiliates does not apply to instances where a load-serving utility such as Puget prices its gas purchases in accordance with state regulatory requirements. Puget seeks expedited treatment of its motion to ensure that the audit of its FCA claim can be completed by the August 9, 2005 deadline.

5. Puget states that in approving the 1997 merger between Puget Sound Power & Light Company and Washington Natural Gas, the Washington Utilities and Transportation Commission (WUTC) expressly established requirements governing the pricing of gas transfers or sales from Puget’s gas distribution division to the electric utility to ensure against cross-subsidization by the ratepayers. As a condition of the merger, the WUTC required that the assets of the natural gas division and the assets of the electric division be separately accounted for, and operated for the benefit of their respective retail customers. Puget states that as part of this determination, the WUTC ordered that intra-company transfers of natural gas shall be priced at the higher of market or the cost of incremental supplies with flexible take provisions.

6. According to Puget, the rule requiring intra-company transfers at the higher of cost or market price ensures that Puget’s natural gas operating division will be able to recover the cost of replacement gas, a cost recovery that allows the gas division to remain whole, and that the rates of Puget’s captive retail gas ratepayers will not be adversely impacted by intra-company sales of gas to the electric operating division. In accordance with these provisions, Puget’s FCA submission to the auditor Ernst & Young (E&Y) reflected that

¹ *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 107 FERC ¶ 61,166 (May 12 Order), *reh’g denied*, 108 FERC ¶ 61,311 (2004) (September 24 Order).

² See May 12 Order, 107 FERC ¶ 61,166 at P 21.

³ September 24 Order, 108 FERC ¶ 61,311 at P 25.

transfer of gas between Puget's gas function and Puget's electric function at applicable market prices, which are reflected in the accounting records of both Puget's natural gas operating division and its electric operating division.

7. Puget states that if it is required to use the purchase price to calculate its FCA claim, it would have to adopt a post hoc matching or allocation process to connect its gas division's purchases with the sales to the electric division. It claims that this process would involve the use of artificial assumptions and could result in a higher FCA claim.

The California Parties' Answer

8. In their answer to Puget's filing, the California Parties⁴ argue that Puget's filing amounts to a collateral attack on previous Commission orders directing the use of actual fuel costs for pricing intra-affiliate transactions. The California Parties contend that Puget did not raise the present issue in any rehearing request of those previous Commission orders, and thus Puget's motion should be summarily rejected.

9. The California Parties argue that Puget does not define or describe the calculation of the terms "cost" or "market" in its request to price gas at the "higher of cost or market." Nonetheless, regardless of how the market price is calculated, the California Parties state that virtually any market price based on spot price indices would be unreliable and unusable because of the widespread price misreporting that occurred during the period.

10. The California Parties argue that WUTC's requirements should not be controlling in the Commission's determination of the appropriate measure of gas cost for calculating the FCA. The California Parties contend that the Commission is not bound by the actions of a state regulatory commission with regard to setting rates.

11. The California Parties argue that Puget's proposal to use market prices in its FCA calculations constitutes a form of opportunity cost pricing, which the Commission has rejected in FCA calculations. According to the California Parties, Puget justifies the use of market prices by referring to the "cost of replacement gas" that its gas subsidiary would have to pay in order to obtain gas from the spot market. The California Parties argue that this reasoning is an opportunity gas concept that provides no basis for determining actual gas costs.

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

12. The California Parties also argue that Puget's claim that it would have to adopt a post hoc matching or allocation process in order to use purchase price in its FCA calculations is not a justification for using a "fundamentally flawed" alternative. Further, the California Parties claim that Puget does not explain why it must undertake a separate calculation to compute actual costs, since; presumably, there is already cost information available to Puget.

13. Finally, the California Parties argue that it would be inconsistent to require the FCA to reflect actual costs and then to permit Puget to use market-based prices to calculate its FCA, as this would exacerbate the unlawful mixing of market-based and cost-based rate mechanisms.

Discussion

14. Puget's proposal to use the higher of cost or market prices to calculate its FCA claim would rely on gas spot price indices to value the market prices. The Commission has determined that spot gas price indices are not a reliable indicator of generators' actual gas costs.⁵ We reiterate that all sellers must ignore the intra-corporate valuation at spot prices, and instead pierce the corporate veil and present the actual cost of fuel incurred by the affiliate who first obtained ownership of the fuel for the combined corporate entity.⁶

15. Accordingly, we will reject Puget's motion to value its gas purchases at the higher of cost or market price. Since Puget was required to track actual costs under the WUTC requirement, Puget must have the actual cost data on an on-going basis. Thus, reporting actual costs should not be as burdensome as Puget claims.

16. Puget will not be harmed by the use of actual costs for intra-company sales of gas to the electricity operating division. The gas division may lose the opportunity cost pricing in instances where the market price is higher than the actual cost, but they cannot be considered harmed because they are exposed only to costs actually incurred to provide gas service.

⁵ *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 102 FERC ¶ 61,317 at P 59 (2003).

⁶ *Id.*

The Commission orders:

Puget's request is hereby denied for the reasons stated in the body of this order.

By the Commission. Commissioner Kelly not participating.

(S E A L)

Linda Mitry,
Deputy Secretary.