127 FERC ¶ 61,250
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Suedeen G. Kelly, and Philip D. Moeller.

San Diego Gas & Electric Company — Docket Nos. EL00-95-182

v.

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

Investigation of Practices of the California Independent System Operator Corporation and the California Power Exchange Corporation — EL00-98-168

ORDER ON REHEARING AND REQUEST FOR CLARIFICATION

(Issued June 18, 2009)

1. In this order, we deny rehearing of a Commission order that established the appropriate methodology for allocating approved cost offset amounts for sellers into the California Independent System Operator (CAISO) and the California Power Exchange (PX) markets during the period of October 2, 2000 through June 20, 2001 (Refund Period).[1] We also address the APX, Inc. (APX) motion for clarification.

[1] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 115 FERC ¶ 61,171 (2006) (May 12, 2006 Cost Allocation Order).

I. **Background**

2. On July 25, 2001, the Commission issued an order that established the scope and methodology for calculating refunds related to transactions in the markets operated by the CAISO and the California Power Exchange (PX) during the Refund Period.[2] The July 25, 2001 Order also initiated formal evidentiary proceedings to further develop the record with regard to implementation of the mitigated market clearing price (MMCP) refund methodology and a determination of what refunds are owed to whom.[3] The Commission directed the CAISO and PX to rerun their settlement billing processes (preparatory reruns) and determined that the preparatory rerun data should form the basis of any refund requested by the parties.[4]

3. Since the issuance of the July 25, 2001 Order, the Commission has continued to develop and refine the refund calculation process. Ultimately, the CAISO will make a compliance filing that includes the preparatory rerun adjustments; the refund rerun (which applies the MMCPs to the preparatory rerun baseline); and the financial settlement phase, including adjustments made for emissions costs, fuel cost allowances, cost offsets, interest, and the refund shortfall.[5]

4. On December 19, 2001, the Commission declared that it would provide an opportunity after the refund hearing for marketers and resellers of purchased power to submit cost evidence concerning whether the refund methodology results in an overall revenue shortfall for their transactions into the CAISO and PX markets during the Refund Period.[6] In the order issued May 15, 2002, this opportunity was extended to all sellers in California markets during the relevant time frame.[7] On August 8, 2005, the Commission

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[2] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 96 FERC ¶ 61,120, at 61,516-519 (2001) (July 25, 2001 Order), *order on clarification and reh'g*, 97 FERC ¶ 61,275 (2001).

[3] *Id.* at 61,519-520.

[4] *Id.*

[5] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 109 FERC ¶ 61,218, at P 80 (2004).

[6] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 97 FERC ¶ 61,275 (2001) (December 19, 2001 Order).

[7] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 99 FERC ¶ 61,160 (2002) (May 15, 2002 Order).

established the framework and procedure for sellers to follow in preparing cost filings to demonstrate revenue shortfalls during the Refund Period.[8]

5. On September 28, 2005, the Commission granted requests to establish a schedule for filing comments on the methodology for allocating any approved cost offsets.[9] On January 26, 2006, the Commission determined which sellers had demonstrated overall revenue shortfalls for their transactions in California markets during the Refund Period, and also required several sellers to submit additional compliance filings to enable the Commission to assess further their eligibility for a cost offset.[10] After evaluating the filings submitted in compliance with the January 26, 2006 Order, on November 2, 2006, the Commission completed its evaluation of which sellers are entitled to cost offsets from refunds.[11]

6. The cost offsets are one of three categories of adjustments or offsets from refunds permitted by the Commission in connection with the California refund proceeding. The other two categories of offsets are for emissions and the fuel cost allowance, or FCA. The Commission established the allocation methodologies for emissions and the fuel cost allowance in other orders.[12]

7. Briefly stated, in the May 12, 2006 Cost Allocation Order, the Commission required the allocation of cost offset amounts to buyers in proportion to the net refunds they are owed. The Commission determined that this allocation methodology "is the most efficient and equitable" and will "avoid a confiscatory result for sellers with

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[8] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 112 FERC ¶ 61,176 (2005) (August 8, 2005 Order).

[9] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 112 FERC ¶ 61,344 (2005) (September 28, 2005 Order).

[10] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 114 FERC ¶ 61,070, at P 1 (2006) (January 26, 2006 Order). The Commission noted that the amount of offsets approved may change as the CAISO and PX data was not final. *Id.* at n.1.

[11] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 117 FERC ¶ 61,151 (2006) (November 2, 2006 Order).

[12] *See San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs*., 95 FERC ¶ 61,418 (2001) (Emissions Costs Order) and *San Diego Gas and Elec. Co. v. Sellers of Energy and Ancillary Servs.,* 109 FERC ¶ 61,297, at P 30-32 (2004) (Fuel Cost Allocation Order).

approved cost offsets."[13] The Commission also ordered the allocation of cost offset amounts across all separate markets, scheduling intervals and time periods.[14]

8. On June 12, 2006, the California Parties,[15] the Salt River Project Agricultural Improvement and Power District (Salt River) and Powerex Corporation (Powerex) filed requests for rehearing of the May 12, 2006 Cost Allocation Order. On that same date, APX filed a motion for clarification. On June 27, 2006, Salt River and the California Parties filed oppositions to Powerex's request for rehearing. The California Parties' filing also included an answer to the APX motion. The Indicated Sellers[16] filed a reply to the California Parties' request for rehearing on June 27, 2006. On July 12, 2006, APX filed an answer to the California Parties' answer.

II. Discussion

A. Procedural Matters

9. Rule 713(d)(1) of the Commission's Rules of Practice and Procedure prohibits answers to requests for rehearing.[17] Accordingly, we reject the Indicated Sellers' answer to the California Parties' rehearing request, as well as Salt River's and the California Parties' answers to Powerex's rehearing request. Similarly, Rule 213(a) (2) does not

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[13] May 12, 2006 Cost Allocation Order, 115 FERC ¶ 61,171 at P 25.

[14] *Id.* P 45. The Commission rejected the contention that the allocation should be divided into pre-CERS and CERS periods. *Id.* P 46. CERS is the California Energy Resources Scheduling Division of the California Department of Water Resources, which began purchasing energy in January 2001. The "pre-CERS" period denotes the portion of the Refund Period that extends from October 2, 2000 until January 17, 2001, when CERS began purchasing energy. The CERS period, therefore, refers to the period running from January 18, 2001 to June 20, 2001.

[15] The California Parties are the People of the State of California *ex rel.* Bill Lockyer, Attorney General, the California Public Utilities Commission, Southern California Edison Company, and Pacific Gas and Electric Company.

[16] The Indicated Sellers are Coral Power, L.L.C., Portland General Electric Company, Avista Energy, Inc., Public Service Company of New Mexico, Powerex, and Puget Sound Energy, Inc.

[17] 18 C.F.R. § 385.713(d)(1) (2008).

permit answers to answers unless otherwise ordered by the decisional authority.[18] We are not persuaded to accept the answer of APX and, therefore, reject it.

B. Allocation Methodologies

10. Allocations of costs or refunds to market participants are generally based upon various widely-accepted principles, such as cost causation, equity, or recognition of benefits received.[19] The Commission has addressed the issue of cost allocation in the California refund proceeding several times in prior orders, each time concerning a different aspect of the refund process.[20] The choice of how to allocate each of these distinct cost or refund components has varied, based upon the nature of the cost or refund element and the relevant objective of the phase of the refund process involving that particular element. In some instances, the objective has been to assess customers or sellers a share of costs, based upon their role in the incurrence of the costs, while the objective in other instances has been the equitable sharing of a shortfall. In each case, for each particular cost or refund element, the Commission explained why the allocation methodology it established would best achieve its particular stated objective.

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[18] 18 C.F.R. § 385.213 (a)(2) (2008).

[19] *See generally Public Service Commission of Wisconsin v. FERC,* 545 F.2d 1058, 1067 (D.C. Cir. 2008) (cost causation principles require that all approved rates reflect "to some degree" the costs actually caused by the customer who must pay them); *KN Energy, Inc. v. FERC,* 968 F.2d 1295, 1300-1302 (D.C. Cir. 1992) (upholding Commission's conclusion that in unusual circumstances it may abandon cost causation principles and base rates upon cost-spreading and value of service); *Wisconsin Public Power v. FERC,* 493 F.3d 239, 277 (D.C. Cir. 2007) (shifting costs to other market participants was justified where those participants benefit from early commencement of market operations); *Elizabethtown Gas Co. v. FERC,* 10 F.3d 866, 872 (D.C. Cir. 1993) (noting with approval the Commission's policy of making pragmatic adjustments in the event a particular method is theoretically consistent with the Commission's objectives but leads to undesirable or inequitable results).

[20] *See, e.g.,* Emissions Costs Order , 95 FERC ¶ 61,418; *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.,* 102 FERC ¶ 61,317 (2003)(March 26, 2003 Order) (fuel cost allowance); Fuel Cost Allocation Order, 109 FERC ¶ 61,297, at P 30-32; *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.* 110 FERC ¶ 61,333, at P 41, 56 (2005) (interest shortfall); *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.,* 121 FERC ¶ 61,067, at P 38 (2007) (*Bonneville Remand Order*), *order on rehearing,* 125 FERC ¶ 61,214 (2008) (refund shortfall).

11. Parties' rehearing requests challenge the justness and reasonableness of the Commission's determinations in this cost offset phase of the refund process. In this phase, the Commission's objective is to ensure that the substitution of the MMCP for the market clearing price is not confiscatory to any individual seller.[21] If sellers were able to establish that the application of the MMCP resulted in a confiscatory loss, that demonstrated loss must then be allocated among buyers in an equitable manner. In the May 12, 2006 Cost Allocation Order, the Commission determined that allocating sellers' net losses to buyers' net income (refunds) is both equitable and efficient.[22] Among other things, parties challenge the consistency of this allocation decision with other allocation decisions the Commission has made in the past involving other aspects of the refund methodology. In order to place the Commission's cost offset allocation decision in context, and better understand the Commission's rationale for allocating cost offset amounts *pro rata* to net refund recipients, we discuss below the allocation methods for each of the various relevant cost or refund components and the Commission's reasoning behind such allocation method.

1. MMCP

12. The MMCP itself was initially established by the Commission, refined by an Administrative Law Judge in the evidentiary phase of the refund proceeding, and subsequently modified and implemented by a series of Commission orders.[23] The Commission established the MMCP to serve as a just and reasonable proxy for the rates that a competitive energy market would have produced in the CAISO and PX markets during the Refund Period.[24] The refund methodology substitutes the MMCP for the market clearing price in the CAISO and PX markets during the Refund Period, for intervals when the market clearing price was higher than the MMCP. The MMCP formula endeavors to approximate the marginal cost of the last unit dispatched to meet load in the CAISO and PX real-time markets, as adjusted to reflect various inputs (natural gas prices, adders for non-fuel costs such as operations and maintenance and a 10 percent risk premium/creditworthiness adder). The MMCP formula's factor for the cost of the fuel used to generate the electricity sold in those markets is based upon the heat rate of

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[21] *See, e.g.*, January 26, 2006 Order, 114 FERC ¶ 61,070, at P 2 (2006).

[22] May 12, 2006 Cost Allocation Order, 115 FERC ¶ 61,171 at P 25.

[23] *See, e.g.*, March 26, 2003 Order, 102 FERC ¶ 61,317, *order on reh'g,* 105 FERC ¶ 61,066 (2003).

[24] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 108 FERC ¶ 61,219, at P 2 (2004) (citing July 25, 2001 Order, 96 FERC ¶ 61,120).

the marginal unit, as well as miscellaneous costs, e.g., transportation.[25] Thus, in order to determine each seller's refund liability, the MMCP was developed and applied to gross sales on a 10-minute interval basis, consistent with the CAISO's market pricing rules at the time.[26] The reasonableness of this approach lies in the fact that for each interval the marginal unit and related heat rate would vary, as would the marginal costs.

13. After the Commission established the MMCP to serve as the proxy rate, several parties raised concerns regarding the effect of applying that rate. For example, some generators raised concerns that the factor for the cost of fuel was lower than what they had actually paid for fuel during the Refund Period. Similarly, some sellers claimed that applying the MMCP to their specific sales would not enable them to recover their costs. In response, the Commission conducted a variety of "mini-proceedings" designed to address their specific concerns, with the goal being to ensure that the MMCP did not result in confiscatory rates for individual sellers. These proceedings are discussed below.

2. Emissions Costs

14. As described above, sellers whose costs were not sufficiently covered under the MMCP refund methodology were allowed to show that they incurred costs in excess of the MMCP through the fuel cost allowance and cost offset process. Significantly, however, emissions costs[27] differ from the fuel cost allowance and cost offsets in that they are not related to the MMCP calculation at all. Rather, emissions costs were incurred in connection with the CAISO's reliability directives. The recovery of the emissions costs, therefore, is not tied to whether the MMCP is confiscatory with respect to any individual seller. Emissions costs were not included in the MMCP calculation and, as such, the Commission made the determination of the manner in which sellers could recover the emissions costs that were incurred during the Refund Period. The

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[25] It originally was also based on gas price indices, July 25, 2001 Order, 96 FERC ¶ 61,120, but the Commission subsequently changed the methodology for calculating the fuel cost component of the MMCP because it found that the gas indices published at the time of the Refund Period were flawed, and, therefore, unreliable. March 26, 2003 Order, 102 FERC ¶ 61,317 at P 56-63.

[26] August 8, 2005 Order, 112 FERC ¶ 61,176 (2005).

[27] Emissions costs were costs incurred by some sellers in order to comply with certain emissions restrictions and environmental compliance fees. March 26, 2003 Order, 102 FERC ¶ 61,317 at P 98. These costs were not factored into the MMCP and were incurred when generators were required to run in accordance with CAISO dispatch instructions and the must offer requirement. *Id.* P 14; Emissions Costs Order, 95 FERC ¶ 61,418 at 62,562.

December 19, 2001 Order found that total gross load was the most appropriate method to use to assess emissions costs because they were incurred in connection with clean air requirements, and the reliability function served by the CAISO's markets benefited all customers.[28] While the link between reliability and clean air may not be intuitively obvious, during the Refund Period, the CAISO directed certain resources to run for reliability purposes, even though this resulted in those resources incurring emissions costs imposed by clean air regulations. In the absence of this directive, these resources could have avoided the emissions costs by electing not to run. Since these resources did run for reliability purposes, however, the Commission found it appropriate to assess emissions costs against all buyers or load served on the CAISO's transmission system, on the basis of control-area gross load. The Commission also reasoned that "total gross load" was the most appropriate method to use to allocate emissions costs.[29] The rationale for this allocation methodology was that these costs should be socialized to all CAISO/PX customers because they all benefitted from greater reliability and from cleaner air.[30]

3. Fuel Cost Allowance

15. On March 26, 2003, the Commission revised the methodology for calculating the fuel component of the MMCP.[31] Recognizing that the revised methodology could reduce the MMCP, potentially even below sellers' actual fuel costs, the Commission provided generating resources with the opportunity to submit claims for a fuel cost allowance to recover the difference between their actual fuel costs for mitigated sales and the proxy for gas prices used in developing the MMCP.[32] Each generator seeking a fuel cost allowance was required to submit a filing demonstrating its actual fuel cost and requesting a fuel cost allowance, which the Commission would use to offset the seller's refund obligation. Those generating resources claiming entitlement to a fuel cost allowance were to base their claims on the actual daily cost of fuel incurred to make sales into the CAISO and PX markets during the Refund Period.[33] Then, in order to properly

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[28] December 19, 2001 Order, 97 FERC ¶ 61,275.

[29] *Id*. at 62,370.

[30] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 114 FERC ¶ 61,313, at P 20 (2006).

[31] March 26, 2003 Order, 102 FERC ¶ 61,317, *order on reh'g,* 105 FERC ¶ 61,066 (2003).

[32] Fuel Cost Allocation Order, 109 FERC ¶ 61,297 at P 1.

[33] March 26, 2003 Order, 102 FERC ¶ 61,317 at P 61.

assess the actual cost of fuel, the Commission directed comparison between claimed actual fuel costs and the MMCP for each 10-minute interval of the Refund Period in CAISO and PX markets. This comparative assessment was made on a gross interval basis.[34] The fuel cost allowance amounts were developed on the basis of gross sales per interval in order to match the interval methodology used to develop the MMCP.

16. Having determined eligibility for the fuel cost allowance based on a gross interval analysis, therefore, the Commission then logically determined that the fuel cost allowance should be allocated on the basis of gross purchases.[35] Because the Commission determined that there was no social benefit associated with individual customers' purchase patterns, in contrast to the social benefit related to emissions costs, it reasoned that the sellers' fuel cost allowance should be allocated on a cost-causation basis to buyers. Since fuel cost allowance amounts were developed on the basis of gross sales by interval, the Commission concluded that the most logical method to use to match buyer contribution to cost was to allocate the fuel cost allowance on a gross purchase basis, using the same interval as the MMCP.[36] The Commission reasoned that the gross purchase allocation method reflects the degree to which a buyer relied on the CAISO/PX markets to obtain energy.[37]

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[34] In this order, the term "gross interval" refers to looking at the relevant cost or refund item as computed for the relevant time interval under the tariff without netting such cost or refund item across all time intervals for the Refund Period. Net interval basis means the costs or refunds are netted across all time intervals during the calculation process.

[35] Fuel Cost Allocation Order, 109 FERC ¶ 61,297 at P 30-32.

[36] *Id.* P 20-21.

[37] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 110 FERC ¶ 61,293, at P 39 (2005) (March 18, 2005 Order). The Commission also found that it was not possible to match a megawatt hour sold into the mitigated CAISO and PX markets with another megawatt hour purchased from the mitigated CAISO/PX markets. Thus, the calculation and allocation of the fuel cost allowance could not be done on an absolute net basis. The Commission did, however, make an exception to the fuel cost allowance "gross" methodology for uninstructed energy transactions, finding that these should be allocated to sellers on a net basis. *Id.* P 37.

4. **<u>Cost Offsets</u>**

17. The final category of costs for which a seller could demonstrate that its actual costs exceeded the MMCP was cost offsets. On September 28, 2005, the Commission granted requests to establish a schedule for filing comments on the methodology for allocating any approved cost offsets from refunds.[38] In the orders issued January 26, 2006 and November 2, 2006, the Commission determined which sellers had demonstrated overall revenue shortfalls for their transactions in California markets during the Refund Period.[39] The relevant objective of the cost offset process was to measure the net revenue for each individual seller with a cost offset claim by comparing its cost to the MMCP in order to determine if application of the MMCP produced a confiscatory rate for any particular seller.

18. In order to be eligible to offset costs from refund liability, a seller had to demonstrate that, as a direct consequence of the application of the MMCP, it sustained losses on its entire portfolio of transactions, both purchases and sales, in CAISO and PX markets during the Refund Period.[40] Thus, it was necessary to <u>net</u> all costs for making energy sales in the CAISO and PX markets against all revenues from those markets during the Refund Period, so that sellers "will not have unfettered discretion to 'pick and chose' for which transactions they will present evidence."[41] As a result, unlike fuel cost allowance claims, the claim of a seller submitting a cost filing is based on a <u>netting</u> of all expenses and revenues related to transactions in California markets during the Refund Period. Demonstrable losses sustained from application of the MMCP refund methodology are then subtracted from the individual seller's refund liability. Accordingly, consistent with the net interval approach used to calculate the cost offset, the Commission allocated cost offset amounts to buyers in proportion to the net refunds they are owed because this allocation methodology "is the most efficient and equitable" and will "avoid a confiscatory result for sellers with approved cost offsets."[42]

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[38] September 28, 2005 Order, 112 FERC ¶ 61,344 (2005).

[39] January 26, 2006 Order, 114 FERC ¶ 61,070 at P 1. The Commission noted that the amount of offsets approved may change as the CAISO and PX data was not final. *Id.* at P 1 and n.1.

[40] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 99 FERC ¶ 61,160 at 61,652.

[41] *Id.*

[42] May 12, 2006 Cost Allocation Order, 115 FERC ¶ 61,171 at P 25.

5. **Interest Shortfalls**

19. In the March 26, 2003 Order,[43] the Commission adopted the presiding Administrative Law Judge's proposed finding that the interest on refunds as well as unpaid balances would be calculated in the manner set out in section 35.19a of the Commission's regulations.[44]

20. After this determination, the CAISO raised an issue involving mismatches between interest receivable and payable. The Commission found that these mismatches occurred for structural reasons that were not primarily attributable to either debtors or creditors.[45] The Commission refused to adopt the CAISO's proposal in which all positive mismatches (more interest due from debtors than owed to creditors) would be allocated to debtors, while all negative mismatches (less interest due from debtors than to creditors) would be allocated to creditors. Since no evidence was provided to support the conclusion that creditors were more responsible than debtors, or vice versa, for the structural defects that led to these mismatches, the Commission found that all mismatches should be allocated *pro rata* (i.e. shared equally) among all debtors and creditors.[46]

21. Also, subsequent to the March 26, 2003 Order, the Commission was informed that the PX was not earning the rate of interest set forth in section 35.19a of the Commission's regulations on the PX Settlement Trust Account. Rather, the actual rate of interest on this account was lower. On November 23, 2004, the Commission determined that this interest shortfall was attributable to the PX's actions, and not primarily attributable to buyers or sellers. Therefore, the Commission determined that both buyers and sellers should share the burden of the shortfall equally. The Commission directed allocation of the shortfall *pro rata* among buyers and sellers. This treatment was similar to the method used to resolve the CAISO market interest shortfall.[47]

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[43] March 26, 2003 Order, 102 FERC ¶ 61,317 (2003).

[44] *Id.* at P 140 (citing 18 C.F.R. § 35.19a).

[45] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 105 FERC ¶ 61,066 at P 105.

[46] *Id.*

[47] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 109 FERC ¶ 61,218 at P 34.

6. <u>Refund Shortfalls</u>

22. In the order on remand from *Bonneville Power Administration v. FERC*,[48] the Commission recognized the Ninth Circuit's finding that the Commission, in the context of this proceeding, has no authority to order governmental entities and other non-public utilities to pay refunds under section 206 of the Federal Power Act (FPA).[49] Nevertheless, the Commission concluded that it was in the public interest for the CAISO and PX to complete their refund calculations, including all entities that participated in the CAISO and/or PX markets, i.e., public and non-public utilities as well as governmental entities.[50]

23. As a result of the *Bonneville* opinion, however, the Commission found that the total amount of refunds that otherwise would have been paid by governmental entities and other non-public utilities for their sales into the CAISO and PX markets during the Refund Period must be reflected in reduced refund amounts that buyers will receive.[51] The Commission determined that this shortfall in refunds must be allocated somehow among buyers.[52] The Commission agreed with the CAISO that a reasonable approach to allocating this shortfall would be to implement a simplified financial clearing in which refund recipients receive a *pro rata* reduction in their refunds.[53]

24. The Commission found that *pro rata* reduction to refund recipients based on their final net refund position in relation to total net refunds is a closer approximation to their exposure in the CAISO and PX markets than *pro rata* reduction based on refund recipients' overall share of CAISO load during the Refund Period would be.[54] Under this approach, all net refund recipients – public utilities and non-public utilities/governmental entities – would receive an allocation of the shortfall in proportion to their refunds.[55] The Commission found that its approach was consistent with how the Commission decided to

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[48] 422 F.3d 908 (9th Cir. 2007).

[49] *Bonneville Remand Order*, 121 FERC ¶ 61,067 at P 38.

[50] *Id.*

[51] *Id*. P 39.

[52] *Id*.

[53] *Id*.

[54] *Id*.

[55] *Id.*

allocate the interest shortfall, stating that, in both situations, the shortfall was allocated in a fair and proportional manner.[56]

C. The California Parties' and Salt River's Requests for Rehearing

25. The California Parties raise several allegations of error. They contend that the Commission erred by directing the CAISO to allocate cost offsets only to net refund recipients and by reversing our earlier determination that fuel cost allowances would be allocated on a gross basis. The California Parties also claim that the Commission erred by failing to distinguish between the pre-CERS and CERS Periods. Finally, the California Parties also claim that the Commission failed to justify its conclusion that confiscation would result if sellers with approved cost offsets were required to bear an allocated share of the fuel cost allowances.

26. Salt River also raises several allegations of error, many of which echo the concerns raised by the California Parties. Salt River objects to the Commission's cost allocation methodology, its change in the fuel cost allocation methodology, and the Commission's reliance on sellers' claims that a gross allocation methodology would result in iterative cost offset filings. In addition, Salt River also contends that the Commission erred in two additional ways: (1) by not allocating cost offsets to separate markets; and (2) in failing to address Salt River's proposal that to the extent any cost offsets are based on losses that sellers would have experienced even in the absence of application of the MMCP, those losses should not be included in the cost offset calculations. Finally, Salt River contends that refund "shortfalls" caused by the cost offsets should be allocated through revenue neutrality and cash shortfall mechanisms contained in the CAISO and PX tariffs.

1. Allocation of cost offsets to net refund recipients

27. Both the California Parties and Salt River object to the allocation of cost offsets to "net" buyers.[57] Both parties claim that the May 12, 2006 Cost Allocation Order is inconsistent with the August 8, 2005 Order establishing the framework for the cost offset filing process,[58] as well as with the Commission's prior rulings related to emissions

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[56] *Id*.

[57] Salt River's June 12, 2006 Rehearing Request, Docket Nos. ER00-95-182 and EL00-98-168, at 5 (Salt River's Rehearing Request); California Parties' June 12, 2006 Rehearing Request, Docket Nos. ER00-95-182 and EL00-98-168, at 7 (California Parties' Rehearing Request).

[58] August 8, 2005 Order, 112 FERC ¶ 61,176 (2005).

costs[59] and fuel cost allowances.[60] These parties contend that because the Commission's methodology for calculating cost offsets is based on gross sales, the methodology for allocating these costs should be based on each buyer's proportionate share of total refunds based on gross purchases, on a dollar basis.[61] According to both parties, the methodology adopted by the Commission will result in cross subsidization, which is contrary to the principles of cost causation.[62]

Commission Determination

28. We deny the California Parties' and Salt River's rehearing requests. The California Parties and Salt River simply advocate an alternative method of allocation, namely allocation to gross purchasers. The fact that other allocation methods exist, however, does not render the Commission's chosen methodology erroneous.[63] As we explained in the May 12, 2006 Cost Allocation Order and again below, the methodology we selected in this instance, *pro rata* allocation to net refund recipients, is just and reasonable because it is not prohibitively complicated and yields a fair result.[64]

29. Challengers assert that the Commission's cost offset allocation methodology is inconsistent with the allocation methods selected for other offsets and refund elements such as interest and the refund shortfall. We disagree. While the allocation methods may differ, these differences are justifiable and fair given the differences in computing the cost offsets, as opposed to how the other elements/offsets were determined. Thus, there is no inconsistency. The California Parties and Salt River cite no authority for their contention that allocation methodologies must match within and among the refund components. To the contrary, the Supreme Court has held that "an otherwise reasonable rate is not subject to constitutional attack by questioning the theoretical consistency of the method that produced it."[65] As the discussion in Section B above illustrates, the

[59] Emissions Costs Order, 95 FERC ¶ 61,418.

[60] March 26, 2003 Order, 102 FERC ¶ 61,317.

[61] California Parties' Rehearing Request at 7-8.

[62] Salt River's Rehearing Request at 6; California Parties' Rehearing Request at 8.

[63] *See, e.g., State Corp. Commission v. FPC,* 206 F.2d. 690, 709 (8th Cir. 1953) (another method might possibly be more reasonable or more accurate, but such a possibility does not justify reversal).

[64] May 12, 2006 Cost Allocation Order, 115 FERC ¶ 61,171 at P 25-28.

[65] *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 314 (1980) (*Duquesne*).

Commission thoroughly considered allocation issues raised in the California refund proceedings several times in prior orders.[66] In fact, the Commission held "mini-proceedings," giving parties and the Commission the opportunity to focus on the particular facts and purpose associated with each allocable cost or refund element. Through this process, the Commission carefully selected the allocation method appropriate for that particular refund element, based on widely-accepted allocation principles, such as cost causation, equity and/or recognition of benefits received. While there may be similarities among the categories of cost or refund offsets, there are critical distinctions as well, which make the Commission's decision to tailor each allocation based on these distinctions reasonable and not inconsistent within the whole refund process. Contrary to parties' assertions, therefore, the Commission's selection of different allocation methods for different cost or refund components is not a mark of inconsistency, but rather demonstrates that the Commission acted reasonably, adding sufficient process to enable it to make a "rational connection between the facts found and the choices made."[67]

30. Salt River aims to blur the distinction between the fuel cost allowance and the cost offset by arguing that the underlying rationale for the two offsets is the same: making generators (fuel cost allowance) and sellers (cost offset) whole for their costs of serving CAISO and PX markets. Salt River ignores, however, the salient difference between the cost offset and the fuel cost allowance. Unlike cost offsets, the fuel cost allowance involves only one variable in the MMCP calculation, the fuel cost portion of the MMCP formula, which is relatively easy to isolate. Thus, the Commission was able to determine the amount that the MMCP precludes a generator from recovering of its actual fuel cost for serving CAISO/PX markets during each 10-minute interval of the Refund Period. Because fuel cost is generally specific to a time interval, it is appropriate to consider the relationship between the fuel cost and the MMCP over the same time interval as the MMCP is calculated. From a cost causation perspective, therefore, it is possible, and indeed desirable, to allocate this fuel cost amount to purchasers of electricity in CAISO/PX markets during that same 10-minute interval as the mitigated sale was made that gave rise to the associated fuel cost. If the Commission did not allocate the fuel cost allowance in this manner, then other purchasers, who did not necessarily purchase

[66] Emissions Costs Order, 95 FERC ¶ 61,418; March 26, 2003 Order, 102 FERC ¶ 61,317 (2003); *Bonneville Remand Order*, 121 FERC ¶ 61,067 at P 38; and *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 109 FERC ¶ 61,218.

[67] *Edison Mission Energy, Inc. v. FERC*, 394 F.3d 964, 968 (D.C. Cir. 2005) (stating that the Commission must "articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made'") (quoting *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)).

electricity during that time interval, may be unfairly required to subsidize the cost of fuel purchased during that interval. Thus, the fuel cost allowances were developed based on a seller's actual gross interval costs and, correspondingly, allocated to buyers based on their gross interval purchases.[68]

31. In contrast, the cost offset addresses a wide range of costs that cannot be assigned to a specific 10-minute interval, such as return, fixed costs, or transmission costs. The cost offset, therefore, cannot be calculated on a gross interval basis. Furthermore, the overarching purpose of the cost offset is much broader than the fuel cost allowance, in that it was designed to protect sellers from overall confiscatory losses due to application of the MMCP. As explained in the May 12, 2006 Cost Allocation Order, the MMCP refund methodology was developed to determine the amount sellers should refund buyers for their purchase of energy at unjust and unreasonable prices during the Refund Period. The cost offset process was established to provide sellers the opportunity to demonstrate that the MMCP does not allow them to recover their costs of selling power into ISO/PX markets. Sellers with approved cost offsets, therefore, were under-compensated by the MMCP.

32. The amount of a seller's cost offset indicates the amount by which the MMCP is confiscatory vis-à-vis an individual seller. Consequently, it is reasonable to allocate this cost offset amount to net refund recipients because this method equitably reduces the amount of refunds they are entitled to receive by the amount that the MMCP is confiscatory towards sellers. Net refund recipients, therefore, ultimately receive the just and reasonable refund amount they are due.[69]

33. Both the California Parties and Salt River also contend that the cost offset allocation methodology is unjust and unreasonable because if the allocation and calculation methods are not "matched," both become unjust and unreasonable.[70] We disagree. The Federal Power Act (FPA) and Commission policy require that rate methodologies and outcomes must be just and reasonable.[71] Courts have found that different methodologies can be acceptable so long as the end result produces just and

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[68] Fuel Cost Allocation Order, 109 FERC ¶ 61,297 at P 30, 36, 42.

[69] *See* May 12, 2006 Cost Allocation Order, 115 FERC ¶ 61,171 at P 25-29.

[70] California Parties' Rehearing Request at 9.

[71] 16 U.S.C § 824(d)(a) (2008). *See, e.g., Enbridge Energy Co.*, 123 FERC ¶ 61,130, at P 50 (2008) ("Commission has ample authority to fashion rates and unique rate structures in appropriate cases; however the Commission still must determine if those rates and rate structures are just and reasonable.").

reasonable rates,[72] and the Commission is not required to utilize one "magic" formula. The refund proceeding is long and complex, with many sub-parts and differing fact patterns, circumstances and objectives. The California Parties and Salt River misconstrue the Commission's application of the net or gross allocation formula in different, non-analogous situations (i.e., emissions costs, fuel cost allowance, cost offsets) to argue inconsistency. On the contrary, the Commission appropriately and reasonably applied different allocation methodologies to different facets of the refund process where different facts and objectives were involved, such as hourly fuel costs, overall revenue shortfalls, or the accumulated interest shortfall, so as to obtain a just and reasonable result.

34. Moreover, the California Parties and Salt River misinterpret the August 8, 2005 Order. In the August 8, 2005 Order, we directed sellers to calculate their cost offsets by netting over the Refund Period all revenues with all associated costs. Thus, gross revenues from both mitigated and non-mitigated transactions were netted against the costs incurred to make those sales during the Refund Period.[73] Thus, contrary to the parties' argument, our August 8, 2005 Order actually supports the interval netting methodology. As we explained in the May 12, 2006 Cost Allocation Order, since cost offsets are calculated on a net dollar basis, cost offset amounts should be allocated on a net dollar basis as well.[74] The California Parties' and Salt River's contention that the cost offsets are calculated on a gross basis is simply incorrect.

35. Because the allocation and calculation of the cost offsets do match, in that both are netted over the Refund Period, then even under the standard espoused by the California Parties (i.e., that the cost calculation and allocation methods must be "matched") our methodology is just and reasonable. Since the California Parties rely on the same flawed assumption, namely that we ordered a gross rather than net calculation methodology, to argue that the cost allocation methodology is discriminatory, violates cost causation principles and is not within the "zone of reasonableness," we find that these contentions lack merit as well.

36. The California Parties and Salt River also assert that we justified our adoption of a netting methodology based on a concern that a gross interval allocation methodology could result in iterative calculations if some of the cost offset amounts were allocated

[72] *See Duquesne*, 488 U.S. at 314 (the economic judgments required in rate proceedings are often hopelessly complex and do not admit of a single correct result).

[73] This calculation was specifically designed to avoid "cherry-picking" among transactions. *See* August 8, 2005 Order, 112 FERC ¶ 61,176 at P 37.

[74] *Id.*

back to those sellers who initially received a cost offset.[75] While this was a valid concern of the Commission, our primary justification for allocating cost offsets to net refund recipients or load was based on cost causation principles. We determined that cost offsets should be allocated to net refund recipients or load because load ultimately benefited from the use of the power bought/sold in the CAISO and PX markets, and, therefore, net refund recipients and their load should incur the cost of serving those markets.[76] Our discussion of the iterative process further illustrated the inherent difficulties of charging a portion of cost offsets to a seller with an already approved cost offset because such seller has already demonstrated that the MMCP refund methodology produces a confiscatory rate in the amount of its cost offset.[77] Were the Commission to allocate a portion of cost offsets to a seller that already has a cost offset, the individual seller's rate would remain confiscatory, albeit to a lesser degree than it was after the original application of the MMCP refund methodology.[78]

37. Furthermore, we clearly explained why we would not require the CAISO to conduct an iterative process. In paragraph 30 of the May 12, 2006 Fuel Cost Allocation Order, we explained:

> If offsets are allocated on a gross refund basis, as California Parties and Southern Cities' advocate, since all buyers and sellers have gross refunds, including those sellers with cost offsets, this would result in allocation of a portion of cost offset dollars back to sellers with cost offsets. This would trigger an iterative process whereby, to avoid confiscation, sellers with approved cost offsets that are allocated costs from other sellers' as well as their own cost offsets would reapply to the Commission to recover compensation for these additional costs. This second cost offset, if again allocated back to such sellers, would prompt return to the Commission to demonstrate need for yet another cost offset.[79]

[75] California Parties' Rehearing Request at 11-12; Salt River's Rehearing Request at 8.

[76] May 12, 2006 Cost Allocation Order, 115 FERC ¶ 61,171 at P 29.

[77] *Id.* P 30.

[78] To illustrate, if a seller has a $100 cost offset, and that cost offset is allocated equally among 10 market participants, including the seller, then the seller would have to cover a $10 shortfall. This means that, whereas the MMCP methodology was originally $100 confiscatory vis-à-vis the seller pre-allocation, it is still $10 confiscatory to that original seller, post allocation.

[79] May 12, 2006 Cost Allocation Order, 115 FERC ¶ 61,171 at P 30.

38. An iterative process would require repeated rounds of cost allocation until eventually the process converged on a final number, but unless that number is zero allocation to sellers with cost offsets, the result would be confiscatory. We emphasize here that the point is not whether an iterative process could be conducted or not, but rather whether there is any benefit to be gained by such process.[80] The Commission originally determined that there would be no benefit to such a process, and we continue to find no benefit, and that such an iterative process would not only run afoul of cost causation principles, but would also unnecessarily complicate this proceeding further.[81]

39. As stated in the January 26, 2006 Order,[82] the Commission's primary concern in this refund proceeding is to remedy rates that buyers may have paid above the zone of reasonableness, which led the Commission to establish the MMCP.[83] However, as we noted, this key objective must be balanced with the statutory obligation to ensure that the MMCP does not result in a confiscatory rate for any individual seller.[84] The netting methodology we adopted for allocating net revenue shortfalls (or cost offsets) permits us to achieve both objectives.

40. Salt River argues that allocating cost offsets to net purchasers rather than gross purchasers is unreasonable. Specifically, Salt River argues that the Commission's use of the term "sellers" is a misnomer because most, if not all, sellers also bought energy in he ISO and PX markets. Accordingly, they paid mitigated prices for energy and, if the prices they paid in their role as buyers were too low, Salt River insists that they must also contribute to the costs of the energy used to serve them. Salt River argues that it does not follow that a seller who sold more than it bought should escape responsibility for bearing the costs incurred to serve it. Salt River contends that the Commission's methodology is unreasonable because it fails to recognize that net sellers also benefited from the mitigation of prices during hours in which they purchased energy from California markets during the Refund Period.

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[80] The courts have acknowledged that "feasibility concerns play a role in approving rates." *Sithe/Independence Power Partners, L.P. v. FERC*, 285 F.3d 1, 5 (D.C. Cir. 2002).

[81] This rationale also applies to the California Parties contention that we failed to explain why an iterative process could not be conducted for the fuel cost allowance. *See* California Parties' Rehearing Request at 19.

[82] January 26, 2006 Order, 114 FERC ¶ 61,070 at P 33.

[83] *Id.* P 4.

[84] *Id.*

41. Salt River's argument overlooks the fact that only sellers with net refund liability can offset costs from their refund obligation.[85] While net sellers may have benefited from the refund methodology in their role as purchasers, the benefit they received is outweighed by their position as net sellers. The benefit net sellers received from the MMCP methodology is taken into account when their refund entitlement (as purchasers) is subtracted from their refund liability, and they obtain no net refunds. The fact that net sellers have cost offsets indicates the amount by which the MMCP methodology is confiscatory, and allocating a portion of this loss back to the net seller would still constitute a loss to the seller, in violation of the FPA and Constitution.

42. Parties also argue that allocation to net buyers is not in accordance with cost causation principles. The Commission does not agree with this argument because: (1) the Commission is not required to allocate based on cost causation alone; and (2) even if it were, allocating cost offsets to net buyers as required by the May 12, 2006 Cost Allocation Order is consistent with cost causation principles.

43. First, cost causation principles require that "all approved rates reflect *to some degree* the costs actually caused by the customer who must pay them."[86] Compliance with this principle is evaluated "by comparing that costs assessed against a party to the burden imposed or the benefits drawn by that party."[87] Costs need not be allocated with "exact precision,"[88] and we are not required to reject a rate mechanism simply because that mechanism may possibly track cost causation principles less than perfectly.[89] As the Supreme Court found, "allocation of costs is not a matter for the slide-rule. It involves judgment on a myriad of facts. It has no claim to an exact science."[90] "Cost itself is an inexact standard and may, in a particular set of circumstances, serve as a basis for several

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[85] *Id.* P 129.

[86] *Midwest ISO v. FERC*, 373 F.3d 1361, at 1368 (D.C. Cir. 2004) (citations omitted) (emphasis added).

[87] *Id.* (citations omitted).

[88] *Id.* at 1369.

[89] *Sithe/Independence Power Partners, L.P. v. FERC*, 285 F.3d 1, 5 (D.C. Cir. 2002) ("FERC is not bound to reject any rate mechanism that tracks the cost-causation principle less than perfectly.").

[90] *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 589, *reh'g denied*, 325 U.S. 891 (1945).

different rates."[91] Neither statutes nor court decisions "require the Commission to utilize a particular formula or a combination of formulae to determine whether rates are just and reasonable."[92]

44. The methodology proposed by the California Parties and Salt River is itself imperfect and simply their preferred methodology.[93] The fact that we decline to adopt this methodology does not result in the conclusion that the adopted methodology fails to meet cost causation principles. Regardless, allocating cost offsets to net buyers *is* consistent with cost causation. As we stated in the May 12, 2006 Cost Allocation Order:

> Consistent with cost causation principles, the resultant cost offsets should be allocated to net refund recipients, or load. Load ultimately should incur the cost of serving the market because load ultimately benefited from the use of the power. We find that allocating more costs to sellers is inconsistent with cost causation. Accordingly, we find it just and reasonable, as well as equitable, to allocate cost offsets to net refund recipients in proportion to their net refund dollars.[94]

45. Salt River also contends that the cost offsets should not be allocated on a combined basis across both the CAISO and PX markets. According to Salt River, this combined basis methodology will result in even further cross subsidization for net buyers who purchased substantially less energy in the CAISO market than in the PX market. Salt River claims that the Commission offered no explanation regarding why the offsets cannot be allocated separately by market.[95]

46. We deny Salt River's request for rehearing on this issue. We continue to find that the allocation methodology should be consistent with the manner in which the cost offsets are calculated. In the August 8, 2005 Order, we directed sellers to calculate their cost offsets by netting all revenues with all associated costs, including netting across the

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[91] *Alabama Electric Coop. v. FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982).

[92] *Id.*

[93] *United Distribution Cos. v. FERC,* 88 F.3d 1105, 1171 (D.C. Cir. 1996) ("There is no 'neutral' or inherently 'fair' allocation of fixed costs, as the history of rate design amply demonstrates.").

[94] May 12, 2006 Cost Allocation Order, 115 FERC ¶ 61,171 at P 29. *See also id.* at P 26-28 for further explanation of how the allocation methodology is consistent with cost causation principles.

[95] Salt River's Rehearing Request at 11.

CAISO and PX markets. Furthermore, the CAISO has argued that matching specific transactions to the individual markets would be labor intensive and time-consuming.[96] Finally, we note that since the preponderance of sellers could not match specific transactions in specific markets and therefore utilized the average portfolio methodology for valuing transactions, Salt River's proposal raises the thorny question of how to match the transactions in a seller's average portfolio to the appropriate market. Salt River's concerns do not justify these efforts.

47. Salt River also claims that the Commission failed to address its proposal that to the extent that any of the cost offsets are based on losses that would have occurred even prior to mitigation, the Commission should allocate those offsets to the sellers who would have experienced such losses. According to Salt River, failure to remove these losses from the cost offsets will compound the cross subsidization problem.[97]

48. We will deny Salt River's request for rehearing on this issue because it is beyond the scope of the May 12, 2006 Cost Allocation Order. Salt River's claim is speculative, as well as a collateral attack on our prior orders establishing the cost offset methodology and determining the amount of cost offsets. As noted previously, in the December 19, 2001 Order, we allowed marketers and resellers to submit cost evidence concerning whether the refund methodology results in an overall revenue shortfall for their transactions into the CAISO and PX markets during the Refund Period.[98] We explained that the Commission would "consider the impact on a marketer's *entire portfolio* over the duration of the Refund Period."[99] The Commission required the netting of all losses against all gains so that sellers would not have unfettered discretion to "pick and choose" the transactions for which they would present evidence of an "overall revenue shortfall."[100]

49. Since Salt River's proposal would require singling out transactions – "cherry picking bad cherries" – to examine whether losses occurred, it is a collateral attack on our

[96] May 12, 2006 Cost Allocation Order, 115 FERC ¶ 61,171 at P 42.

[97] Salt River's Rehearing Request at 12.

[98] December 19, 2001 Order, 97 FERC ¶ 61,275 at 62,254. On May 15, 2002, we extended this opportunity to all sellers in the CAISO and PX markets during the relevant time frame. *See San Diego Gas & Elec. Co.*, 99 FERC ¶ 61,160 (2002).

[99] December 19, 2001 Order, 97 FERC ¶ 61,275, at 62,254 (emphasis added).

[100] *Id.*

decision to require use of a portfolio approach to determine eligibility for cost offsets.[101] Furthermore, Salt River simply speculates that losses occurred on transactions, and presents no method by which sellers could attribute costs to those sales that would be excluded. Finally, Salt River's proposal would introduce an unmanageable amount of complexity into an already complicated refund calculation.

50. Moreover, Salt River's attempt to characterize its proposal to disallow certain costs that reflect losses sellers would have experienced even in the absence of an MMCP as an "allocation" issue is a misuse if that term. Essentially, Salt River is proposing that the Commission deny various aspects of the sellers' cost offset claims. This is a collateral attack on the August 8, 2005 Order that established the framework for cost offsets, and the January 26, 2006 Order (and subsequent November 2, 2006 Order) establishing the cost offset amounts.[102]

51. Furthermore, according to Salt River, the "net" buyers will experience a refund shortfall because their refunds will be reduced based on the cost offsets, including offsets for costs incurred to serve other market participants. Salt River contends that any remaining refund shortfall should be allocated through the mechanisms contained in the CAISO and PX tariffs that were in effect when the transactions occurred.[103]

52. We deny Salt River's request for rehearing on this issue. Salt River's contention that allocation of the cost offsets will result in a refund "shortfall" is simply incorrect. Cost offset allocation is part of the formula for determining each buyer's refund amount. To the extent a seller has a cost offset, this demonstrates the degree to which the MMCP is confiscatory with respect to that individual seller, and did not produce a just and reasonable rate for the seller. In other words, the cost offset indicates the amount a net refund recipient is "over refunded." Thus, deducting the cost offset *pro rata* from net refunds does not result in a shortfall. Rather, it results in the appropriate determination of the amount of refund owed to each buyer. Nor has Salt River pointed to language in the May 12, 2006 Cost Allocation Order, which did not address refund shortfall or its allocation, that requires clarification or rehearing. Salt River's argument essentially is an impermissible collateral attack on our prior decision to permit cost offsets.

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[101] The Commission has discouraged cherry-picking in other contexts. *Questar Pipeline Co.*, 62 FERC ¶ 61,192 (1993); *French Broad Elec. Membership Corp. v. CP&L*, 92 FERC ¶ 61,283 (2000).

[102] August 8, 2005 Order, 112 FERC ¶ 61,176; January 26, 2006 Order, 114 FERC ¶ 61,070.

[103] Salt River's Rehearing Request at 13.

2. **Fuel Cost Allocation Methodology**

53. Both the California Parties and Salt River object to our decision directing the CAISO to do the following: (1) add the fuel cost allowance amounts that are allocated to sellers with approved cost offset filings to those sellers' cost offsets; and then (2) allocate the aggregate cost offset amounts to purchasers that are due net refunds. Both parties claim that this order is inconsistent with the previous Commission order in which the calculation of the fuel cost allowance based on gross interval sales was rationalized by allocating the fuel cost allowance based on gross purchases.[104] The California Parties also claim that the allocation of the fuel cost allowance as an addition to the cost offset violates the Commission's determinations in the August 8, 2005 Order and January 26, 2006 Order. According to the California Parties, these orders make clear that only a portion of the costs associated with CAISO and PX purchases, and in some instances none of those costs at all, are to be reflected in the cost offset.[105]

54. The California Parties also claim that they entered into a settlement with the Mirant Parties[106] in reliance on the Fuel Cost Allowance allocation methodology adopted in previous Commission orders.[107] The California Parties claim that the "new" methodology "shatters" their "reasonable expectations" in the Mirant settlement.[108] The California Parties further object to our failure to conduct a case-by-case evaluation to determine whether sellers would actually be harmed if a gross refund allocation methodology were adopted.[109]

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[104] California Parties' Rehearing Request at 16 (*citing* March 18, 2005 Order, 110 FERC ¶ 61,293 at P 37-40).

[105] *Id.* at 16-17 (citing January 26, 2006 Order, 114 FERC ¶ 61,070 at P 108; August 8, 2005 Order, 112 FERC ¶ 61,176 at P 68-71).

[106] The Mirant Parties comprise the following: Mirant Corporation, Mirant Americas, Inc., Mirant Americas Energy Marketing, LP, Mirant Americas Energy Marketing Investments, Inc., Mirant Americas Generation, LLC, Mirant California Investments, Inc., Mirant California, LLC, Mirant Delta, LLC, Mirant Potrero, LLC, Mirant Special Procurement, Inc., Mirant Services, LLC, and Mirant Americas Development, Inc.

[107] *Id.* at 18 (citing Fuel Cost Allocation Order, 109 FERC ¶ 61,297 at P 36 and 42, and March 18, 2005 Order, 110 FERC ¶ 61,293 at P 39-40).

[108] California Parties' Rehearing Request at 18.

[109] *Id.* at 19.

Commission Determination

55. We deny the California Parties' and Salt River's requests for rehearing on this issue. Both parties misread our May 12, 2006 Cost Allocation Order. We did not change the fuel cost allowance allocation methodology. Rather, we simply took into account the special circumstances affecting sellers with approved cost offsets. As the MMCP refund methodology is confiscatory towards such sellers in the amount of their approved cost offset, allocating fuel cost allowance offsets to such sellers would not fully ameliorate the confiscatory revenue shortfall.[110] Calculating refunds is a process with a number of different steps. Once the fuel cost allowance is calculated and allocated, the resulting figure is then combined with any other offsets to derive the final refund amount for each party. It is this next step, the combining of the different offsets into one refund amount after the fuel cost allowance calculation is complete, which the May 12, 2006 Cost Allocation Order directed the CAISO to conduct. These next steps were clearly contemplated in our previous orders.[111]

56. Thus, since we have not altered the fuel cost allowance methodology, the California Parties' and Salt River's allegations of error are incorrect. Furthermore, our decision cannot be viewed as impacting the California Parties' settlement with the Mirant Parties since the methodology the California Parties relied upon in reaching their settlement is still applicable. In addition, we disagree with the California Parties' objection that the Commission should have conducted a case-by-case evaluation to determine if sellers with cost offsets would be harmed by receiving allocation of the fuel cost allowance. The Commission reasonably concluded that allocating additional costs, i.e., the fuel cost allowance, to a seller that already had a confiscatory loss, would compound that loss. Since this is a reasoned decision, case-by-case fact-finding investigations could not disprove the rational principle underpinning this conclusion, but would unnecessarily complicate and delay the proceeding.

3. Pre-CERS and CERS Periods

57. The California Parties contend that the May 12, 2006 Cost Allocation Order fails to distinguish between the pre-CERS Period and the CERS Period. According to the California Parties, this failure represents an unexplained departure from previous decisions.[112] The California Parties further claim that the failure to distinguish between

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[110] May 12, 2006 Cost Allocation Order, 115 FERC ¶ 61,171 at P 36.

[111] *See, e.g.,* Fuel Cost Allocation Order, 109 FERC ¶ 61,297 at P 30.

[112] California Parties' Rehearing Request at 20-21.

the two periods results in one group of buyers and/or sellers subsidizing another group.[113] Finally, the California Parties contend that splitting the two periods would not be difficult or complicated.[114]

Commission Determination

58. The Commission denies rehearing on this issue and notes that the California Parties raise no new issues or arguments that have not been previously addressed in the May 12, 2006 Cost Allocation Order. The Commission fully addressed the California Parties' arguments in that order, denies rehearing on the basis set forth in that order and will not repeat those determinations here.[115]

D. Powerex's Request for Rehearing

59. Powerex asks the Commission to direct the CAISO to add emissions cost allocation amounts to the cost offsets of sellers with approved cost offsets. Powerex contends that this is similar to the addition of fuel cost allowance amounts allocated to such sellers.[116] Powerex further asserts that it may not have been apparent to the Commission when it issued the May 12, 2006 Cost Allocation Order that some sellers with approved cost offsets would be allocated emissions costs.[117] Powerex argues that because emissions costs are allocated to load, and because Powerex is a Scheduling Coordinator with load, Powerex will be allocated emissions costs which should, according to Powerex, then be flowed through its cost offset.[118]

Commission Determination

60. We deny Powerex's request for rehearing. As we noted in Section B above, emissions costs differ from the fuel cost allowance and cost offsets in that they are not related to the MMCP calculation at all. Rather, emissions costs were incurred in connection with the CAISO's reliability directives. Since the focus of this cost offset phase of the refund proceeding is ensuring that the MMCP methodology is not

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[113] *Id.* at 22.

[114] *Id.* at 22-23.

[115] *See* May 12, 2006 Cost Allocation Order, 115 FERC ¶ 61,171 at P 46.

[116] Powerex's Rehearing Request at 2.

[117] *Id.*

[118] *Id.* at 5.

confiscatory, and emissions costs are not part of the MMCP calculation or application, emissions costs are irrelevant to assessing whether the MMCP refund calculation is confiscatory with respect to any seller. Consequently, it would be unreasonable to allocate the emissions cost obligation Powerex incurred in its role as Scheduling Coordinator for load on the basis that these costs create a confiscatory loss to Powerex related to the MMCP because these costs are not part of the assessment of whether the MMCP refund calculation is confiscatory.

61. Moreover, if Powerex is ultimately allocated emissions allowance costs, it will be because it was serving load, or itself was load, not because of its sales. The fact that Powerex finds itself in the position of being allocated emissions costs does not disprove our general conclusion that marketers who claim cost offsets are unlikely to have emission costs. As Powerex concedes "most wholesale power sellers that submitted [cost offset filings] would not expect to have any load that would be allocated emissions costs."[119] Thus, as Powerex acknowledges, the Commission's statement in the May 12, 2006 Cost Allocation Order "that emissions amounts will be allocated to gross load, which will not affect approved cost filers' was generally appropriate."[120] Our conclusion that emissions allowance costs should be allocated to gross load was not premised on the fact that companies that are sellers with cost offsets could not be allocated these costs in their capacity as load/load serving entities. We were merely pointing out that generally sellers with approved cost offsets would not be affected by this allocation methodology. Powerex's unique circumstances do not justify a change in the allocation methodology.

62. Specifically, Powerex, as a Scheduling Coordinator[121] with load, should not be permitted to shift its costs to others. We note that Powerex may have entered into arrangements wherein Powerex acted as a load serving entity on behalf of other entities having load. We do not opine as to any ability Powerex may have under such arrangements to shift its emissions or other costs to such entities. The emissions costs are costs to sellers that we determined should be borne by those who benefitted from the

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[119] *Id.*

[120] *Id.* at 5 (citing May 12, 2006 Cost Allocation Order, 115 FERC ¶ 61,171at P 36 n.31).

[121] The Commission has held that refund liability attaches to the Scheduling Coordinator of the transaction. *See* March 26, 2003 Order, 102 FERC ¶ 61,317; *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 107 FERC ¶ 61,166, at P 18, *clarified*, 108 FERC ¶ 61,219, *reh'g denied and partial clarification granted*, 108 FERC ¶ 61,311 (2004); *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 116 FERC ¶ 61,167, at P 45 (2006), *reh'g denied and clarification granted*, 122 FERC ¶ 61,274 (2008).

reliability and environmental benefits that accrued in connection with incurrence of these costs, i.e., load. Powerex's obligation to pay these costs was not incurred in its role as seller. Powerex's situation, as both a seller and the effective buyer for load served by others does not justify undermining our conclusion that emissions costs should be allocated to in-state load because all customers in California benefited from cleaner air.[122]

E. APX Motion for Clarification

63. On June 12, 2006, APX filed a request for clarification, asking the Commission to provide guidance with respect to the implementation issues raised by the PX, which the Commission found beyond the scope of the May 12, 2006 Cost Allocation Order.[123] APX asks whether a motion for clarification is the appropriate vehicle by which to bring these issues to the Commission's attention. In addition, APX asks for clarification concerning the Commission's expectations for coordination among the CAISO, PX and APX in allocating cost offsets. APX states that it anticipates passing-through CAISO and PX cost offset allocations when calculating the refunds owed to buyers that participated in CAISO and PX markets through APX. APX asks the Commission to confirm that it does not contemplate more extensive coordination.

Commission Determination

64. We confirm that APX's suggested approach is appropriate, i.e., that APX should pass-through CAISO and PX cost offset allocations when calculating the refunds owed to buyers that participated in the CAISO and PX markets through the APX. Regarding

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[122] As we have noted throughout this order, the nature of emissions costs and the objectives to be achieved in imposing those costs differ from the nature and objectives of the fuel cost allowance and cost offsets. It is these differences that justify the differing treatment of the costs. *See* Section B, subsections 2-4 of this order.

[123] APX's June 12, 2006 Clarification Request at 3 (citing May 12 Cost Allocation Order, 115 FERC ¶ 61,171 at P 7). The Commission described these implementation issues as follows:

> (1) whether the total amount of offsets per hour is limited by the amount of refunds in this hour; (2) whether, if in any hour, the total offsets exceed the refund amount for a zone, the PX should apply any offsets for that hour to the same hour in other ones that have available refund amounts; and (3) in what order should the PX apply fuel cost allowance, emissions and cost offsets?

May 12, 2006 Cost Allocation Order, 115 FERC ¶ 61,171 at P 7.

more extensive coordination, we direct APX, CAISO and the PX to provide each other with whatever guidance is necessary to complete the refund process. It is difficult to give further detailed instruction in the abstract, beyond asking parties to act reasonably towards one another. If issues or conflict arise, parties are directed to bring these issues to the Commission's attention promptly for resolution.

<u>The Commission orders</u>:

(A) Rehearing is denied as discussed in the body of this order.

(B) The APX's request for clarification is granted in part and denied in part as discussed in the body of this order.

By the Commission. Commissioner Spitzer is not participating.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.