ORAL ARGUMENT SCHEDULED FOR APRIL 12, 2004

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 03-1025, *et al.*

PACIFIC GAS & ELECTRIC COMPANY,
PETITIONER,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.

ON PETITIONS FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION

BRIEF FOR RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

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FEBRUARY 12, 2004

CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties and Amici

The parties before this Court are identified in Petitioner's brief.

B. Rulings Under Review

1. *California Power Exchange Corporation*, "Order Accepting for Filing Special Purpose Rate Schedule," 100 FERC ¶ 61,178 (August 8, 2002);

2. *California Power Exchange Corporation*, "Order Rejecting Requests for Rehearing Granting Clarification and Rejecting Compliance Filing," 101 FERC ¶ 61,330 (December 20, 2002);

3. *California Power Exchange Corporation*, "Letter Order," 101 FERC ¶ 61,403 (December 31, 2002);

4. *California Power Exchange Corporation*, "Order Accepting Compliance Filings, Subject to Modification and Denying Requests for Rehearing," 102 FERC ¶ 61,208 (February 25, 2003);

5. *California Power Exchange Corporation*, "Order on Compliance and Accepting Special Purpose Rate Schedule Subject to Condition," 104 FERC ¶ 61,005 (July 1, 2003); and

6. *California Power Exchange Corporation*, "Notice of Denial of Rehearing," 104 FERC ¶ 61,230 (August 29, 2003).

C. Related Cases

This case has not previously been before this Court or any other court. Counsel is not aware of any other related cases involving substantially the same parties and the same or similar issues pending before this or any other court.

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Attorney

February 12, 2004

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BRIEF OF RESPONDENT
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STATEMENT OF THE ISSUE

Whether the Commission appropriately ruled that the California Power Exchange's ("CalPX" or "PX") rate schedule designed to recover the costs incurred by the CalPX for its ongoing wind-up operations was just and reasonable under the Federal Power Act ("FPA").

STATUTES AND REGULATIONS

Pertinent sections of the Federal Power Act and the Commission's regulations are set out in the Addendum to this brief.

STATEMENT OF THE CASE

I. NATURE OF THE CASE, COURSE OF PROCEEDINGS, AND DISPOSITION BELOW

In 1996, California comprehensively restructured its electric power industry from a cost-based rate system to a market-based rate system. *In re California Power Exchange Corporation*, 245 F.3d 1110, 1114-1115 (9th Cir. 2001). As part of that restructuring, CalPX, a non-profit entity, was created to provide various auction markets for the trading of electricity under a FERC-approved tariff and rate schedules. *Id.* CalPX not only ran the auction markets, but also determined the amounts to be paid by buyers purchasing power, and how those funds were to be allocated among sellers. In this role, CalPX was allowed to recover its administrative costs through a charge to those using its markets.

After the summer of 2000 witnessed significant increases in the wholesale price of electricity in the California market, the Commission adopted a number of remedies to address flaws it found in that market and its governing rules. *California Power Exchange*, 245 F.3d at 1115-17; *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator and the California Power Exchange*, 93 FERC ¶ 61,294 at 61,999-62,001 (2000). These actions led, among other things, to the termination of CalPX's rate schedules and the suspension of operations in its markets. *California Power Exchange*, 245 F.3d at 1119.

CalPX could not simply wind down its operations because it is still required to perform certain FERC-jurisdictional functions, including participation in ongoing FERC proceedings regarding whether prices charged in 2000-01 were just and reasonable.

Those proceedings will ultimately bear on the disposition of customers' outstanding account balances still being maintained by CalPX for transactions during that period. The termination of its auction markets meant, however, that CalPX no longer had a means for recovering the new costs incurred for providing these services. Accordingly, CalPX filed a new rate schedule intended to recover the costs for these ongoing activities by apportioning them among the participants that benefit from these continuing activities, namely customers who still maintained account balances with the PX.

The Commission found that CalPX's proposed rate schedule, as modified, was an appropriate mechanism to allow the CalPX to fund its continuing operations. *California Power Exchange Corp.*, 101 FERC ¶ 61,178 (2002). A series of later orders approved, with modifications, CalPX's rate filings for recovery of these costs related to subsequent six-month periods over PG&E's objections. *California Power Exchange, Inc.*, 101 FERC ¶ 61,330 (2002) and 101 FERC ¶ 61,403 (2002), *reh'g denied*, 102 FERC ¶ 61,208 (2003); *California Power Exchange, Inc.*, 104 FERC ¶ 61,005, *reh'g denied*, 104 FERC ¶ 61,230 (2003).

These appeals followed.

II. STATEMENT OF FACTS

A. Statutory And Regulatory Framework

Section 201(b) of the FPA, 16 U.S.C. § 824(b), confers jurisdiction on the Commission over all rates, terms and conditions of transmission service provided by public utilities in interstate commerce, as well as over those for the sale by public utilities of electric energy at wholesale in interstate commerce. A "public utility" is defined under the FPA as "any person who owns or operates facilities subject to the jurisdiction of the Commission under this part." 16 U.S.C. § 824(e).

FPA §§ 205(a) and (b), 16 U.S.C. §§ 824d(a) and (b), provide that all rates and charges made, demanded, or received by a public utility in connection with interstate transmission or the wholesale sale of electric energy in interstate commerce must be just and reasonable, and that no public utility may unduly discriminate against (or unduly prefer) any customer. FPA § 205(c), 16 U.S.C. § 824d(c), requires public utilities to file "schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission. . . ." FERC may suspend a proposed rate for a period of up to five months, at which point the proposed rate becomes effective, subject to refund. FPA § 205(e), 16 U.S.C. § 824d(e). If the Commission ultimately finds that the initially-suspended rate is not just and reasonable, it may order refunds of amounts collected in excess of the just and reasonable rate. *Id.*

FPA § 206, 16 U.S.C. § 824e, authorizes the Commission, on its own motion or on complaint, to investigate whether existing rates are lawful. If the Commission finds that an existing rate or charge is "unjust, unreasonable, unduly discriminatory, or preferential," it must determine or fix by order the just and reasonable rate or charge "to be thereafter observed and in force." FPA § 206(a), 16 U.S.C. § 824e(a). FERC may order "refunds of any amounts paid, for the period subsequent to the refund effective date through a date fifteen months after such refund effective date, in excess of those which would have been paid under the just and reasonable rate . . . ." FPA § 206(b), 16 U.S.C. § 824e(b). The refund effective date "shall not be earlier than the date 60 days after the filing of such complaint nor later than 5 months after the expiration of such 60-day period." *Id.*

B. Events Leading To The Challenged Orders

1. Restructuring of the California Electric Energy Market

In January 1995, retail electricity rates in California were nearly double the national average and rising. *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator and the California Power Exchange*, 93 FERC ¶ 61,120 at 61,351 n.6 (2000). In response, the California legislature restructured the state's electric energy industry with the passage of Assembly Bill 1890 ("AB 1890"). *California Power Exchange*, 245 F.3d at 1114-1115; *San Diego Gas & Electric*, 93 FERC at 61,351. "AB 1890 was intended as a step towards a 'market-based' regulatory regime, in which neither wholesale nor retail rates would be, after the transition period, ordained by regulators, but determined by market forces. This new regime, it was thought, would bring California's electricity rates more in line with average rates." *Pacific Gas & Electric Co. v. Lynch*, 216 F.Supp.2d 1016, 1035 (N.D. Cal. 2002).

AB 1890 called for the creation of the CalPX, a nonprofit entity that served primarily as a mandatory auction market for the trading of electricity in California. *California Power Exchange*, 245 F.3d at 1114. As a public utility under the FPA, the CalPX commenced operations in 1998 pursuant to a FERC-approved tariff and FERC wholesale rates schedules. *Id.* CalPX recovered its start-up, development, operating and financing costs through an Administrative Charge assessed against its market participants according to a tariff formula. Record Document 1 at p. 2 (Joint Appendix "JA" 19).

AB 1890 also created the California Independent System Operator ("Cal-ISO"), a non-profit entity charged with managing the state's electricity transmission grid. *California Power Exchange*, 245 F.3d at 1115. As grid manager, the Cal-ISO operated a real-time imbalance energy market to ensure that electricity supply met demand at the time of delivery. *Id.*

In addition, AB 1890 required California's three main investor-owned utilities ("IOUs") – Pacific Gas & Electric Company ("PG&E"), Southern California Edison Company ("SCE"), and San Diego Gas & Electric Company – to divest a substantial portion of their generation assets and to purchase all their required electricity supply from the CalPX spot markets during a transition period. *Id.* at 1114-15. The California Public Utilities Commission later permitted the IOUs to purchase a limited amount of their combined load in a forward contract market operated by the CalPX, but the bulk of their load still had to be purchased in the CalPX spot market. *Id.* at 1115.

2. Events of Summer 2000

In the summer of 2000, California wholesale electricity prices increased dramatically, affecting all markets run by the CalPX. *California Power Exchange*, 245 F.3d at 1115; *San Diego Gas & Electric*, 93 FERC at 61,353. In response, FERC instituted hearing procedures under FPA § 206 to investigate, *inter alia*, the justness and reasonableness of the rates of the FERC-jurisdictional sellers into the CalPX and Cal-ISO markets. *San Diego Gas & Electric*, 93 FERC at 61,370. On November 1, 2000, the Commission determined that, "while this record does not support findings of specific instances of market power, and while we are not able to reach definite conclusions about the actions of individual sellers, there is clear evidence that the California market structure and rules provide the opportunity for sellers to exercise market power when supply is tight and can result in unjust and unreasonable rates [for short-term or spot market energy] under the FPA." *Id.* at 61,350.[1]

To remedy the situation, FERC ordered a number of structural and rule changes for the California electricity markets. *San Diego Gas & Electric Co.*, 93 FERC ¶ 61,294 (2000). Among other things, the Commission eliminated the requirement to sell into and

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[1] A separate evidentiary hearing was called to develop a factual record related to appropriate refunds for Cal-ISO and CalPX spot market transactions during the refund effective period. *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator and the California Power Exchange*, 96 FERC ¶ 61,120 at 61,499 (2001) ("Refund Proceeding"). The Refund Proceeding ultimately found that suppliers owe the Cal-ISO and CalPX a refund of $1.8 billion dollars, but since the suppliers, in turn, were owed $3.0 billion, the net result is that suppliers are due $1.2 billion after refunds. *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange*, 102 FERC ¶ 61,317, *order on reh'g*, 105 FERC ¶ 61,066 (2003). Dozens of appeals of these and other Commission orders in the Refund Proceeding are currently pending before the United States Court of Appeals for the Ninth Circuit. *See Public Utilities Commission of the State of California, et al. v. FERC*, 9th Cir. Nos. 01-71051, *et al.*

In addition, the Commission staff investigated whether any entity manipulated prices in electricity or natural gas markets or otherwise exercised undue influence over wholesale electricity prices in the West since January 1, 2000. *Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, 98 FERC ¶ 61,165 (2002). Based on the staff's investigative report, other evidence and comments, the Commission determined that certain entities appeared to have participated in activities that constitute gaming and/or anomalous market behavior in violation of the Cal-ISO and CalPX tariffs between January 1, 2000 and June 20, 2001 that could warrant monetary or non-monetary remedies. Those entities must show cause in trial-type evidentiary proceedings why they should not be found to have violated the tariffs' gaming practice provisions. *See, e.g., American Electric Power Corp., et al.*, 103 FERC ¶ 61,345 (2003).

buy from the CalPX by taking the "unusual step of terminating the PX's wholesale tariffs which would enable it to continue to operate as a mandatory exchange." *Id.* at 61,999. It also precluded the IOUs from selling all but their surplus generation into the CalPX markets. *Id.* at 62,001.

In the meantime, PG&E and SCE were unable to pass their increased wholesale power costs on to their customers because they were still subject to a retail rate freeze imposed by AB 1890. *Duke Energy Trading and Marketing v. Davis*, 267 F.3d 1042, 1045 (9th Cir. 2001); *California Power Exchange Corp.*, 98 FERC ¶ 61,097 at 61,302 (2002). As a result, in January 2001, PG&E and SCE defaulted on hundreds of millions of dollars of obligations to CalPX for December and January purchases in the CalPX markets. *Duke Energy*, 267 F.3d at 1045. On January 18, 2001, after PG&E and SCE's debt ratings were downgraded to "junk" status, the CalPX suspended their trading privileges. *Id.* As PG&E and SCE were two of the largest CalPX participants, their default had a severe impact on CalPX. *Id.* at 1045-46. By the end of January 2001, the CalPX had suspended trading in its markets and commenced wrapping up its operations. *Id.* at 1046. On March 9, 2001, CalPX filed for bankruptcy. *Id.* The CalPX's rate schedules were terminated effective at the close of business on April 30, 2001. 93 FERC at 62,020; Record Document No. 1 at 4 (JA 21).

3. CalPX Wind-Up Cost Tariff Filing

Even after CalPX had closed its markets and was "winding down" its operations, it continued to incur expenses for the performance of certain FERC-jurisdictional responsibilities, including: (1) acting as custodian of certain financial rights owed by and to participants in its defunct markets; (2) acting as records custodian for California markets transactions; and (3) participating in ongoing Commission and judicial proceedings. Record Document 1 at 2-4 (JA 19-21); *California Power Exchange*, 98 FERC at 61,305. CalPX's ability to continue funding its operations through its original Administrative Charge ended when its tariff was terminated and it ceased operating its markets. CalPX estimated that it would exhaust its reserve of operating funds by the end of August 2002. Record Document 1 at 2-4 (JA 19-21). Absent an alternative cost recovery mechanism, CalPX would have to end its operations, dispose of its assets, and dismiss its remaining staff. *Id.* at 4 (JA 21).

To avoid those results, on July 3, 2002, CalPX filed a new rate schedule under FPA § 205 intended to recover the costs of its ongoing operations. Record Document No. 1 (JA 18-74). The proposed "Wind-Up Charge" was designed "to apportion the costs of CalPX's wind-up and ongoing operations equitably among the participants for whose benefit CalPX is continuing those operations." *Id.* at p.4 (JA 21). CalPX proposed to allocate its net cost for a semi-annual period among its customers based on the ratio of each customer's cash balance (either for what it owes or is due from the CalPX) to the total cash balances. *Id.* at p.5 (JA 22) and Attachment 1 (JA 25-28). The allocation would be based on the latest available data, which were the March 13, 2002 balances in each customer's individual account summary. *Id.* at Attachment 1 (JA 25-28) and Attachment 3 p.16 (Miller Testimony) (JA 57).

PG&E protested CalPX's rate filing. Document 21 (JA 115-23). While PG&E "fully support[ed] the PX's need for funding while it winds up its regulatory obligations" and agreed that "[t]he PX is a necessary party to litigation pending before the FERC and must be provided adequate funds to ensure its meaningful participation in that litigation," *id.* at 3, it objected to the proposed allocation methodology.

C. The Challenged Orders

On August 8, 2002, the Commission accepted, as modified, the CalPX's rate schedule filing. *California Power Exchange Corp.*, 100 FERC ¶ 61,178 (2002) ("August 8 Order") (JA 146-53). The Commission agreed that because CalPX was still performing functions that were imperative to protect the public interest, it was appropriate to fund its ongoing operations. 100 FERC at 61,636 (JA 148-49). "CalPX is custodian of various monetary obligations that must be returned to market participants once an appropriate distribution is determined in the ongoing proceedings. Similarly, determining an appropriate distribution will require access to the data which CalPX maintains and the expertise which CalPX's employees and contractors possess." *Id.* at ¶ 21 (JA 149).

The Commission rejected Petitioner's contention that CalPX's filing sought to impose new charges for past services in violation of the filed rate doctrine. *Id.* at ¶ 22 (JA 149).

> Rather, by (1) maintaining data that will enable the Commission to determine appropriate rate levels and associated refunds for the past period; (2) maintaining the financial rights and accounts that will help ensure that any refunds and additional charges can be appropriately disbursed; and (3) otherwise remaining prepared to aid the Commission in the needed calculations, CalPX is requesting funding for prospective activities that were not recovered through the CalPX's prior administrative charge. The proposal, therefore, does not violate the filed rate doctrine and it is completely appropriate for CalPX to be reimbursed for these activities under a modified version of the proposed rate schedule. The modified rate schedule removes any uncertainty as to the responsibility of participants for

CalPX's expenses associated with these new activities.

Id.

FERC also found CalPX's proposed allocation methodology reasonable, subject to certain modifications. 100 FERC at 61,637 (JA 149-50). FERC agreed that CalPX's costs should be allocated among its participants in proportion to their relative exposure as measured by the absolute value of their current payables and receivables with the CalPX. *Id.* at ¶ 24 (JA 150). "This is consistent with the fact that CalPX's ongoing activities are essentially centered around the appropriate and orderly disposition of these payables and receivables." *Id.* Moreover, the Commission found that use of the most current account information, which was reflected in the March 13, 2002 Account Summaries, reasonably identified the customer base for allocating these costs. *Id.* at ¶ 25 (JA 150). Recognizing that the account balances change over time for various reasons, FERC did not allow the allocation to "stand indefinitely based on this snapshot." *Id.* Instead, FERC required the CalPX to modify the allocation, in subsequent six-month rate filings to track any changes in the Account Summaries balances. *Id.* [2]

PG&E and others sought rehearing of the August 8 Order. On September 9, 2002, the CalPX filed a revised rate schedule, later amended, to comply with the August 8 Order. On November 1, 2002, the CalPX filed a proposed rate schedule to recover expenses projected for the next six-month period, January 1 to June 30, 2003. Record

[2] FERC accepted the CalPX's initial six-month budget projections, and required the CalPX to submit new Section 205 filings every six months along with supporting cost information. 100 FERC at 61,367 ¶26 (JA 150).

Document 82 (JA 233-77).

On December 20, 2002, the Commission denied rehearing and rejected the CalPX's compliance filing. *California Power Exchange Corp.*, 101 FERC ¶ 61,330 (2002) (JA 190-95). As pertinent here, the Commission rejected PG&E's renewed filed rate doctrine objections as confusing "two distinct issues: rates previously charged for transactions in the PX market (which is not being decided here) and responsibility for the PX's newly incurred wind-up costs." *Id.* at 62,370 ¶ 16 (JA 192). As the Commission explained:

> The Commission has directed CalPX to engage in certain administrative activities necessary to wind up its operations. While these administrative wind-up activities include compiling information necessary to resolve PX market pricing issues related to prior transactions, the costs related to these activities are newly incurred by the PX and are thus properly reflected in prospective rates at issue here. All customers are responsible for these new administrative wind-up costs, as the costs are being incurred to resolve matters related to the market as it operated during their participation. In short, the rates for these new services are based on newly incurred costs and, therefore, are not an additional charge associated with past services as PG&E contends. Moreover, contrary to PG&E's claims, the parties were on notice that CalPX would have to perform these wind-up activities, as the Commission instituted the requirements in publicly issued orders.

Id.

FERC also rejected PG&E's objections to the use of CalPX's March 13 Account Summaries balances as a basis for allocating costs among participants. As the Commission explained:

> We believe that the primary focus of CalPX's on-going activities is to support this Commission's efforts to calculate just and reasonable rates and associated refunds, if any, for participants in CalPX's markets. At the time of CalPX's filing, each participant's Account Balance was the best approximation of what the participant would ultimately owe to, or be owed

> by, the CalPX. The August 8 Order essentially found that the magnitude of each Account Balance correlates with the importance to each participant of the Commission's effort to calculate just and reasonable rates and associated refunds, if any, because the larger the Account Balance, the greater the impact of the refund proceeding on the participant.

Id. As the March 13, 2002 Account Balances constituted "the most recent Account Balances available at the time of filing," they were used for allocation purposes, but the Commission reiterated that CalPX should use the most up-to-date Account Balance information in any subsequent filings. *Id.* at 62,370 ¶ 17 & n.13 (JA 192, 195). For these same reasons, the Commission rejected PG&E's contention that the CalPX charges should be subject to refund. *Id.* at 62,370-71 ¶ 18 (JA 192-93). [3]

On December 31, 2002 and January 8, 2003, the CalPX submitted compliance filings in response to the Commission's December 20 and 31, 2002 Orders. PG&E protested both compliance filings. It argued that all CalPX's expenses should be allocated to net sellers instead of to all CalPX market participants. It also contended that the CalPX should have included the Cal-ISO's account balance in its cost allocation.

On February 25, 2003, the Commission accepted the CalPX's compliance filings, subject to modification. *California Power Exchange Corp.*, 102 FERC ¶ 61,208 (2003) (JA 228-32). FERC rejected PG&E's claim that the CalPX's ongoing expenses should be paid only by net sellers, as follows:

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[3] On December 31, 2002, the Commission accepted the CalPX's November 1 tariff filing, subject to the condition that the CalPX revise it consistent with the December 20 Order. *California Power Exchange Corp.*, 101 FERC ¶ 61,403 (2002). PG&E sought rehearing of the December 31 Order.

> As we have explained in prior orders, CalPX is now operating primarily to support the effort to properly resolve outstanding claims in the Refund Proceeding. Essentially, its ongoing operations revolve around the proper settlement of the account balances. Thus it is appropriate that its expenses should be allocated to those who have account balances in proportion to the size of their balances. As we have stated all along, each subsequent six-month rate filing should be based on the latest account balance information available and the initial six-month rate filing was appropriately based on the original March 13 account balance, the most recent balance available at the time of that filing.

Id. at 61,606 ¶ 20 (JA 230).

The Commission found no merit to PG&E's contention that the account balance for Cal-ISO should be considered in the allocation methodology. *Id.* at ¶ 21 (JA 230-31). FERC explained:

> CalPX was not a traditional market participant. Its only purpose was to operate its energy markets and serve as Scheduling Coordinator for its energy market customers. It had no load of its own. Accordingly, any real-time energy charges assessed to CalPX by the ISO would have been assessed to it as a Scheduling Coordinator for its customers; *i.e.*, entities like PG&E. Since those amounts, in turn, clearly would be recoverable from CalPX's customers, it follows that those amounts are already reflected in the account balances that have been used to determine the initial allocation. Thus, PG&E's proposal would result in the same costs being counted twice for purposes of cost allocation. Even ignoring for the moment the propriety of double-counting in this manner, the resulting shift of cost responsibility for CalPX's ongoing operations to the ISO would be extremely difficult to support since the ISO, like CalPX itself, is a non-profit entity with no real stake in the outcome of the Refund Proceeding. Any money that may flow to the ISO under the Refund Proceeding would be destined for other parties. As noted above, CalPX's customers for its on-going operations are essentially those entities with a stake in the Refund Proceeding; *i.e.*, entities like PG&E.

Id.

On April 30, 2003, the CalPX sought to recover projected expenses from July 1 to December 31, 2003. PG&E protested the April 30 filing. The Commission found that

PG&E's objections had been raised and addressed in prior CalPX orders. *California Power Exchange Corp.*, 104 FERC ¶ 61,005 (2003) (JA 429-30). PG&E filed a request for rehearing, which was denied by operation of law. 104 FERC ¶ 61,230 (2003) (JA 464).[4]

[4] On October 31, 2003, CalPX filed a proposed rate schedule to recover its projected expenses from January 1 to June 30, 2004, which the Commission approved over PG&E's objections. *California Power Exchange Corporation*, 105 FERC ¶ 61,329 (2003).

SUMMARY OF ARGUMENT

The challenged orders approving CalPX's wind-up cost recovery methodology are reasonable and comport with ratemaking precedent. Since CalPX's ongoing wind-up activities are centered on the settlement of its customers' account balances, those customers who benefit from CalPX's activities should bear the cost of them. Moreover, allocating costs to each customer based on the size of its most up-to-date account balance is also reasonable, as it approximates the customer's stake in the outcome of CalPX's ongoing activities.

Contrary to PG&E's claim, allocating wind-up costs for the initial six-month period based on customers' March 13, 2002 Account Balances was neither arbitrary nor capricious, as those account balances represented the most current data available for that allocation. Moreover, because FERC recognized that customers' account balances could change after March 13, 2002, it required CalPX to use customers' most recent account balances in any subsequent six-month filings to renew recovery of its wind-up costs.

The allocation methodology is not unduly discriminatory simply because PG&E has the highest account balance and pays the highest share of CalPX's ongoing wind-up costs. Rather, it reflects the rational determination that customers with larger account balances are deemed to have a greater stake in the outcome of CalPX's ongoing activities, and as a consequence, are allocated a greater share of the costs for those activities.

The allocation methodology does not conflict with the filed rate doctrine or the rule against retroactive ratemaking. The wind-up charges pay for new costs CalPX incurs for new, ongoing services provided in connection with the disposition of its customers' account balances. It is not an attempt to collect for an under-recovery of costs for CalPX's past services performed for PG&E's and others' transactions in 2000 and 2001.

The Commission also reasonably rejected PG&E's request to include Cal-ISO's account balance in the wind-up cost allocation on the ground that Cal-ISO's balance is distinguishable from all other participants' account balances. The Cal-ISO's balance reflects CalPX's role as Scheduling Coordinator for its energy market customers. Because of this, including the Cal-ISO balance in the allocation would amount to double-billing as that balance is already reflected in other customers' account balances. Moreover, there is no basis for allocating costs to Cal-ISO as it has no stake in CalPX's ongoing activities, and does not stand to benefit from the final disposition of CalPX's account balances.

ARGUMENT

I. STANDARD OF REVIEW

A court determines whether the Commission's action was "arbitrary and capricious." *See* 5 U.S.C. § 706(2)(A); *Sithe/Independence Power Partners v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999). A court must satisfy itself that the agency "examine[d] the relevant data and articulate[d] a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made." *Motor Vehicle Mfrs. Ass'n of United States, Inc. v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 43 (1983)(quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)). A court need only find that the agency "has met the minimum standards set forth in the statute;" it cannot "substitute its own judgment for that of the [agency]." *United States Postal Service v. Gregory*, 534 U.S. 1, 11 (2001). Deference to FERC's decisions regarding rate issues is broad, because of "the breadth and complexity of the Commission's responsibilities" under the FPA. *Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968).

As demonstrated below, the Commission's approval of CalPX's rate schedule providing it with a means to pay for its ongoing activities relating to the disposition of its customers' account balances was reasonable, supported by substantial evidence and consistent with ratemaking precedent; accordingly, it must be sustained.

II. THE ALLOCATION OF CALPX'S WIND-UP COSTS TO CUSTOMERS BASED ON THEIR MOST RECENT ACCOUNT BALANCES WAS REASONABLE AND CONSISTENT WITH RATEMAKING PRECEDENT.

The challenged orders applied the well-established ratemaking principle that "costs should be allocated, where possible, to customers based on customer benefits and cost incurrence." 101 FERC at 62,370 ¶ 15 (JA 192); 104 FERC at 61,009 ¶ 12 (JA 429A). Although CalPX is no longer operating its markets, it must continue to engage in certain administrative activities. 101 FERC at 62,370 ¶ 16 (JA 192).[5] These ongoing activities "are essentially centered around the appropriate and orderly disposition of [the] payables and receivables" in CalPX's customers' account balances. 100 FERC at 61,637 ¶ 24 (JA 150). *See also* 101 FERC at 62,370 ¶ 17 ("the primary focus of CalPX's ongoing activities is to support this Commission's efforts to calculate just and reasonable rates and associated refunds, if any, for participants in CalPX's markets") (JA 192); 102 FERC at 61,606 ¶ 20 (CalPX's "ongoing operations revolve around the proper settlement of the account balances") (JA 230). Accordingly, the Commission determined that "[a]ll customers are responsible for these new administrative wind-up costs, as the costs are being incurred to resolve matters related to the market as it operated during their participation." 101 FERC at 62,370 ¶16 (JA 192).

Allocation of new costs associated with CalPX's ongoing activities among all customers who benefit from their incurrence is consistent with ratemaking precedent.

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[5] PG&E agrees that "[t]he PX is a necessary party to litigation pending before the FERC and must be provided adequate funds to ensure its meaningful participation in that litigation." Record Document 21 at p.3 (JA 117).

See, e.g., *Entergy Services, Inc. v. FERC*, 319 F.3d 536, 542-45 (D.C. Cir. 2003)(affirming roll-in to all transmission customers of system upgrade costs based on agency's judgment that all users of the grid benefit from the upgrades); *Western Massachusetts Electric Co. v. FERC*, 165 F.3d 922, 927-28 (D.C. Cir. 1999)(affirming roll-in of costs to all transmission customers, based on presumption that "[w]hen a system is integrated, any system enhancements . . . benefit the entire system").

CalPX's ongoing administrative costs relate largely to FERC determinations as to what each customer owes or is owed. Use of customers' most current March 13, 2002 Account Balances constituted "the best approximation of what the participant would ultimately owe to, or be owed by, the CalPX." 101 FERC at 62,370 ¶ 17 (JA 192). Accordingly, those balances were used in the allocation methodology. PG&E argues that this allocation methodology contravenes cost causation principles because customers' March 13, 2002 Account Balances have no relation to the PX's wind-up charges. Br. at 27-28.

FERC found otherwise: "the magnitude of each Account Balance correlates with the importance to each participant of the Commission's efforts to calculate just and reasonable rates and associated refunds, if any, because the larger the Account Balance, the greater the impact of the refund proceeding on the participant." 101 FERC at 62,370 ¶ 17 (JA 192). Thus FERC found that the size of customers' account balances reasonably approximates their "stakes" in the end result of CalPX's ongoing activities, and could appropriately be used to allocate costs incurred as a result of those activities.

PG&E's claim that FERC arbitrarily and unreasonably selected the March 13, 2002 Account Balances for allocating CalPX's wind-up costs, Br. at 28-30, is unavailing. Contrary to PG&E's implicit suggestion, FERC did not pluck the March 13, 2002 date out of thin air, but chose it for the ***initial*** allocation because that was the ***most recent balance information available*** at the time. Record Document No. 1 at Attachment 3 p. 16 ("amounts from the Account Summaries as of March 13, 2002 . . . represent the latest data available.") (JA 57); 101 FERC at 62,370-71 (JA 192-93); 102 FERC at 61,606 ¶ 20 (JA 230). Thus, using March 13, 2002 Account Balances satisfied FERC's concern that allocation of these ongoing costs should reflect the most current data as to how much each customer has at stake. As PG&E does not dispute that the March 13, 2002 Account Balances constituted the most recent account information available, that determination must be sustained. *See* FPA § 313(b) (FERC finding of fact, if supported by substantial evidence, is conclusive); 16 U.S.C. § 825*l*(b).

PG&E creates the impression that the March 13, 2002 Account Balances must be used not only for the initial six-month recovery, but also for all subsequent six-month rate filings. Br. at 16. That impression is false. FERC required CalPX to use the most up-to-date Account Balance information available at the time of any subsequent six-month rate filings. 101 FERC at 62,370 n.13 (JA 195); 102 FERC at 61,606 ¶ 20 (JA 230).[6]

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[6] CalPX's subsequent filings have continued to use the March 13, 2002 Account Balances for allocation purposes, because those balances are the most recent ones for use in those filings, a fact that PG&E does not dispute.

Next, PG&E contends that use of the March 13, 2002 Account Balances results in its having the highest allocated share of these costs, which it claims, unfairly benefits certain participants and discriminates against others. Br. at 28-31. PG&E's allocated share merely reflects that it has "the highest 'unpaid' balances in the PX Settlement and Clearing Account," Br. at 29, not that the methodology was designed in an unduly discriminatory manner. Allocating costs on the basis of customers' account balances has a rational basis in that the higher cash-value customers "have the greatest stake in the CalPX's ongoing activities which will eventually lead to the determination of appropriate rate levels and associated refunds that customers will be permitted to receive." 100 FERC at 61,634¶ 8 (JA 147). Thus, the Commission reasonably found it "appropriate that [CalPX's] expenses should be allocated to those who have account balances in proportion to the size of their balances." 102 FERC at 61,606 ¶ 20 (JA 230).[7]

PG&E asserts that even if it paid off its account balance, it would not impact the PX's continuing obligations. Br. at 31. While true, it is also beside the point, because it would affect PG&E's allocated share of the costs. If a participant pays down its account balance prior to completion of the ongoing proceedings (as SCE did), that change in the customer's balance would be reflected in updated account summaries used to allocate

[7] While PG&E blames its high account balance on the fact that it is in bankruptcy, Br. at 28-29, the wind-up cost allocation methodology does not look to why PG&E, or any other participant, maintains a balance. Any participant who maintains an account balance, for whatever reason, benefits from the CalPX's ongoing activities, and CalPX is entitled to recover its costs from them.

cost recovery in future six-month rate filings. 100 FERC at 61,637 ¶ 25 & n.13 (JA 150, 153).

PG&E also attacks use of the March 13, 2002 Account Balances on the ground that those balances are not billed and settled, and are subject to change. Br. at 32-35. The Commission fully recognized that the March 13 Account Balances are subject to change based on the outcome of ongoing disputes or because participants might pay down their balances. 100 FERC at 61,637 ¶ 25 (JA 150). Accordingly, the March 13, 2002 Account Balances were not allowed to stand indefinitely. *Id.* (refusing to set future allocations based on March 13 "snapshot"). Instead, CalPX must use the most up-to-date account balance information available at the time of its subsequent six-month rate renewal filings.[8] 102 FERC at 61,606 ¶20 ("As we have stated all along, each subsequent six-month rate filing should be based on the latest account balance information available") (JA 230); 101 FERC at 62,370 n.13 ("the most up-to-date Account Balance information available at the time shall be used in any subsequent filings by CalPX to renew its rate request for additional six-month periods") (JA 195); 100 FERC at 61,637 ¶25 (CalPX must "prospectively modify its allocation, as needed, in any subsequent six-

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[8] PG&E's complaint that CalPX should have used interim figures from the Refund Proceeding which would have dropped PG&E's cost allocation from 76 percent to 57 percent, Br. at 34, contradicts its position below. There, PG&E objected to CalPX's use of interim Refund Proceeding figures. Record Document 78 at 5 (JA 221); 102 FERC at 61,605 ¶ 14 (JA 229) ("PG&E supports the December 20 Order's rejection of CalPX's updated account balances even though they would have resulted in a reduced allocation to PG&E (58 percent instead of the current 76 percent)."). PG&E cannot have it both ways.

month filing to renew its rate authority, to track any changes in the balances contained in its Account Summaries") (JA 150).

III. FERC'S RULING DOES NOT VIOLATE THE FILED RATE DOCTRINE OR CONSTITUTE RETROACTIVE RATEMAKING.

PG&E argues that allocating costs based on CalPX's outstanding account balances violates the filed rate doctrine and the rule against retroactive ratemaking. Br. at 20-27. The argument is meritless, as neither the filed rate doctrine nor the rule against retroactive ratemaking applies in these circumstances.

The filed rate doctrine "forbids a regulated entity [from] charg[ing] rates for its services other than those properly filed with the appropriate regulatory authority." *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 (1981). A corollary to the filed rate doctrine is the rule against retroactive ratemaking, which "prohibits the Commission from adjusting current rates to make up for a utility's over- or under-collection in prior periods." *Towns of Concord, Norwood, & Wellesley, Mass. v. FERC*, 955 F.2d 67, 71 n.2 (D.C. Cir. 1992). Thus, the doctrine and its corollary properly focus on the costs being charged, not on the methodology to allocate those costs among customers.

PG&E concedes that CalPX's wind-up charges are "new charges for the costs of the PX to wind-up its operations." Br. at 24. It nonetheless contends that the imposition of the new charge for CalPX's ongoing administrative expenses in connection with its wind-up based on balances PG&E continues to maintain for service it took from the PX in 2000-01 imposes an additional charge for services already rendered. Br. at 21-24.

To the contrary, "PG&E's contentions confuse two distinct issues: rates previously charged for transactions in the PX market (which is not being decided here) and responsibility for the PX's newly incurred wind-up administrative costs." 101 FERC at 62,370 ¶ 16 (JA 192). PG&E claims that CalPX's wind-up cost charge attempts to recover administrative costs for services CalPX provided in connection with customers' purchases made in 2000-01. Br. at 22. Not true. In fact, the wind-up charges pay for newly incurred costs for new services CalPX is now providing that are "essentially centered around the appropriate and orderly disposition of [the] payables and receivables" reflected in the account balances. 100 FERC at 61,637 ¶24 (JA 150). Thus, "[w]hile these administrative wind-up activities include compiling information necessary to resolve PX market issues related to prior transactions, the costs related to these activities are newly incurred by the PX and thus are properly reflected in prospective rates at issue here." 101 FERC at 62,370 ¶16 (JA 192).

Notwithstanding PG&E's spin, Br. at 21, CalPX is not attempting to charge for an under-recovery of past administrative costs, but is seeking to recover costs for ongoing services arising from the resolution and disposition of its customers' outstanding account balances.[9] To be sure, the allocation factors based on account balances relate to services provided in the past. Neither the filed rate doctrine nor the rule against retroactive ratemaking, however, preclude allocating the costs of CalPX's ongoing activities to its

[9] Because CalPX's wind-up charges relate to newly incurred costs for newly provided services, none of the filed rate doctrine cases cited by PG&E, Br. at 25-26, are applicable.

customers proportionate to their account balances simply because those balances are related to prior transactions. *See Town of Norwood, Mass. v. FERC*, 962 F.2d 20, 24-25 (D.C. Cir. 1992)(using past consumption pattern to determine future price not retroactive ratemaking).

Nor can PG&E seriously claim that it had no reason to think that it would have to pay its share of the costs for these ongoing services. Br. at 26-27. As the Commission explained, "contrary to PG&E's claims, the parties were on notice that CalPX would have to perform these wind-up activities, as the Commission instituted the requirements in publicly issued orders." 101 FERC at 62,370 ¶ 16 (JA 192). As CalPX is performing these activities to resolve matters relating to all customers' outstanding account balances, allocating their costs among those same customers is reasonable.

IV. CAL-ISO'S ACCOUNT BALANCE WAS PROPERLY EXCLUDED FROM THE WIND-UP COST ALLOCATION.

PG&E contends that the exclusion of the CalPX's debt balance to the Cal-ISO for real-time purchases from the allocation methodology fails to account for all balances on both the buy and sell sides of CalPX transactions and shifts a disproportionate share of the cost burden on to PG&E. Br. at 36-38. The contention is meritless.

As the Commission explained, CalPX was distinguishable from other market participants. 102 FERC at 61,606 ¶ 21 (JA 230-31). Unlike load serving entities such as PG&E, CalPX had no load of its own. *Id.* It operated energy markets and served as

Scheduling Coordinator[10] for its energy market customers. *Id.* CalPX's real-time energy charges[11] assessed by Cal-ISO would have been assessed to CalPX in its role as Scheduling Coordinator on behalf of CalPX's load serving entities, like PG&E. *Id.* Since CalPX would recover those amounts from its customers, they are already reflected in the customer account balances that have been used in the allocation methodology. *Id.*

Thus, contrary to PG&E's claim, Br. at 37, the allocation methodology applies equally to all buyers and sellers who maintain account balances with the CalPX. It does not, however, count balances twice: once on behalf of the market participant and then again as reflected in the CalPX's debt to Cal-ISO. 102 FERC at 61,606 (JA 230-31).

In addition, unlike PG&E and the other market participants, Cal-ISO is a non-profit entity with no stake in the outcome of the Refund Proceedings. *Id.* Any refunds forthcoming from those proceedings will be flowed through the ISO to other parties. *Id.* Since the CalPX's current customers for its ongoing operations are those other parties, like PG&E, with a stake in the Refund Proceeding, excluding the Cal-ISO account balance from the CalPX's cost allocation methodology was entirely reasonable. *K N Energy, Inc. v. FERC*, 968 F.2d 1295, 1301-02 (D.C. Cir. 1992)(costs of resolving problems should be apportioned to those who stand to benefit from them).

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[10] As a scheduling coordinator, CalPX was required to comply with Cal-ISO instructions to revise generation and load schedules to maintain grid reliability. *Pacific Gas & Electric Co.*, 77 FERC ¶ 61,204 at 61,798 (1996).

[11] When Cal-ISO had not received bids from generators that must operate to resolve a real-time system problem, the ISO had the authority to issue dispatch orders to those generators and pay them for the energy they produce at the real-time market price. *California Independent System Operator, Inc.*, 91 FERC ¶ 61,026 at 61,085 (2000).

CONCLUSION

For the reasons stated, the petitions for review should be denied, and the Commission's orders should be affirmed in all respects.

Respectfully submitted,

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