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OFFICE OF PUBLIC UTILITY COUNSEL’S
RESPONSE TO EL PASO ELECTRIC COMPANY’S
MOTION FOR SUMMARY DECISION

TO THE HONORABLE ADMINISTRATIVE LAW JUDGE:

Pursuant to Order No. 9 issued by the Administrative Law Judge (“ALJ”) on April 25, 2003, the Office of Public Utility Counsel (“OPC”) hereby submits its response to the Motion for Summary Decision filed by El Paso Electric Company (“EPE”) on April 22, 2003. OPC urges the ALJ to deny EPE’s motion in all respects.


EPE contends that, as a matter of law, it is entitled to a summary decision that rejects Intervenors’ recommended disallowances for imputed capacity costs. It also contends that there are no material facts in dispute.1 EPE argues that the Agreed Order in Docket 12700, which intended to preserve the status quo, prohibits the Intervenors from determining the existence of capacity costs through imputation. It argues that this is so because the Agreed Order prohibits cost shifting and requires that costs eligible for recovery through fuel are those defined by the fuel rule in effect on July 1, 1995.2

OPC rejects EPE’s reasoning and contends that the very opposite of its contentions is true. EPE is not entitled as a matter of law to a summary decision, and there are significant

1 EPE’s Motion at 1.
2 Id. at 2.
material facts in dispute, the major disputed fact being whether ineligible capacity costs are hidden within costs designated as energy costs. OPC agrees that the Agreed Order prohibits cost shifting, but disagrees that ignoring hidden capacity costs avoids cost shifting. Ignoring such costs would have the very opposite effect.

Contrary to EPE’s assertions, Intervenors are completely complying with the 1995 Fuel Rule. There is no change in the language regarding the recovery of purchased power costs between the 1995 version of the Commission’s fuel rule and the current fuel rule. That provision reads:

“For Account 555, the utility may not recover demand or capacity costs.”

In determining the level of hidden [imputed] capacity costs contained within EPE’s purchased power expense, Intervenors are doing no more than following the requirement of the 1995 Commission fuel rule. This is exactly what is required by the Agreed Order in Docket 12700. What has changed since 1995 is the industry’s practice toward identifying capacity costs. Whereas in 1995, the industry practice was to clearly designate and segregate costs associated with capacity from those associated with energy costs, the current practice is to subsume much of the capacity cost into the energy cost without identifying it as capacity or demand cost. This change in practice requires a concomitant change in analysis, resulting in a different method and approach to determining the level of capacity or demand cost. Since demand and capacity costs are already included in EPE’s base rates, failing to impute these subsumed costs would do what EPE claims should not be done, i.e., it would shift base rate cost into fuel recovery. This not only is cost-shifting, but it is also double recovery.

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4 See OPC witness Johnson’s direct testimony, page 6, line 12 through page 10, line 13.
5 Id. at page 10, lines 5-13.
II. Docket No. 23550

EPE attempts to portray the Commission's capacity imputation decision in Docket No. 23550 as somehow unique to the special circumstances of Entergy Gulf States, Inc. ("EGSI") in that case. Yet EPE's amicus brief filed in Docket No. 23550 stands in contradiction to that portrayal. After noting that the issue in Docket No. 23550 addresses "industry-wide shifts in the nature of wholesale contracts" EPE concluded that the capacity imputation issue was not unique to that case:

"From the information available to EPE, it appears that the contracts at issue in this case are common take-or-pay energy products for on-peak blocks of power. These are not issues unique to EGSI, but will instead affect all sellers and purchasers of power in Texas as well as the nature of power products sold in Texas markets." [emphasis added]

In Docket 23550, the Commission imputed capacity costs to single price purchase power transactions based upon the same fuel rule language applicable to this docket.

III. A Label Designating a Cost as a Capacity Cost is not Required for Disallowance

As pointed out in the City of El Paso's Opposition to EPE's Motion, the authorities EPE cites in its Motion on page 3, footnote 7, do not stand for the proposition that a capacity cost must be identified as such by the utility in order to be disallowed. While the cases cited involved capacity costs that were identified as such, there is no ruling that requires that such be the case before capacity or demand costs can be disallowed. On the contrary, there is language in the Gulf States case that supports OPC's position:

The price of any purchase of electric power is made up of an energy component, the variable costs associated with the production of electric energy (primarily the cost of fuel and some operating and maintenance expenses), and a capacity component, costs associated with providing the capability to deliver energy (primarily the capital costs of facilities).

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6 See Attachment 1.
7 Id. At 2-3.
8 City's Opposition at 4, 5 [Item 5].
In this docket, EPE has requested recovery of energy charges dramatically in excess of the contemporaneous cost of fuel, thereby raising the issue as to whether the excess costs are purely fuel-related in nature.

IV. Conclusion

OPC urges the ALJ to deny EPE's Motion for Summary Decision in all respects. To begin with, significant issues of fact exist. EPE does not deny that the applicable 1995 Fuel Rule prohibits the recovery of demand or capacity costs. The Intervenors claim that capacity costs exist that EPE has not identified. This is a fact issue and is sufficient in itself to defeat EPE's Motion. In addition, EPE has not met its burden of proof that it is entitled to summary decision as a matter of law. Intervenors have not breached the requirements of the Agreed Order in Docket 12700.

Dated: May 14, 2003

Respectfully submitted,

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[Signature]

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ATTORNEYS FOR THE
OFFICE OF PUBLIC UTILITY COUNSEL
CERTIFICATE OF SERVICE
Docket No. 26194

I hereby certify that today, May 14, 2003, I served a true copy of the foregoing document on all parties of record via United States First-Class Mail, hand-delivery or facsimile.

Eva King Andries
ATTACHMENT 1
Now comes El Paso Electric Company (EPE) and files this amicus brief in support of EGSI’s motion for rehearing concerning the Commission’s decision on imputed capacity costs in energy-only power contracts in this case.

I.

INTRODUCTION

In its order in this proceeding, the Commission has determined to impute (i.e., disallow) a capacity charge of 24% of the cost of purchased power contracts that appear on their face to be purchases of energy only. EPE files this amicus brief to urge that any decision whether to impute capacity costs to energy-only power contracts raises industry-wide issues that should not be addressed in a litigated case involving only a handful of parties.

II.

AD HOC RULEMAKING

A. Nature of the Commission’s Decision

EPE is concerned that the Commission’s decision to impute capacity costs in EGSI’s purchased power contracts may constitute an ad hoc rule that will be applied to the entire electric industry in Texas, even though neither EPE nor most other industry participants have had an opportunity to participate in the resolution of that issue. The Commission should not adopt a general rule concerning imputed capacity costs in a litigated case.
Portions of the Commission's order in this proceeding suggest that it may be adopting an imputed capacity rule of general applicability, rather than making a decision based on facts and circumstances unique to this case. In particular, the Commission's order recognizes that the contracts at issue were priced as energy-only\(^1\) and finds that EGSI's energy payments were market-based and did not increase when capacity charges were eliminated from the contracts. The Commission relies on the testimony of OPC's Mr. Falkenberg, which clearly recognizes that this issue has arisen because of the recent shift in the wholesale energy market from cost-based to market-based pricing. As Mr. Falkenberg explained it:

\[
\ldots \text{In general, under cost-based pricing, a firm purchase contract would have separate demand and energy charges.}
\]

Over recent years, this cost-based pricing has given way to market-based pricing. This has resulted in development of new products, such as "5 by 16" power blocks, (footnote omitted) where the price is on a pure per kWh basis.\(^2\)

Mr. Falkenberg went on to testify:

\[
\ldots \text{Given the historical fact that most firm power contracts had both a demand and an energy component, this was not a terribly complex issue for regulators to deal with.}
\]

Q. Has that situation changed?

A. Yes. In the case at hand, the changes in the market played a role. Many of the power contracts (even firm contracts) available now do not have a separately stated demand charge. \(^3\)

As evidenced by Mr. Falkenberg's testimony, the issue addressed by the Commission in this proceeding appears to concern industry-wide shifts in the nature of wholesale power contracts based on the development of competitive markets and standardized power products.

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\(^1\) With the exception of one contract for which the Commission imputed a larger capacity charge than shown in the contract.

\(^2\) Direct Testimony of Randall J. Falkenberg at 14.

\(^3\) Id. at 16.
From the information available to EPE, it appears that the contracts at issue in this case are common take-or-pay energy products for on-peak blocks of power. These are not issues unique to EGSI, but will instead affect all sellers and purchasers of power in Texas as well as the nature of power products sold in Texas markets.

B. Applicable Law

Decisions that establish general rules are not usually appropriate for litigated proceedings, but should instead be made in a rulemaking where all industry participants have an opportunity to participate. In a recent case involving the Workers' Compensation Commission, the Texas Supreme Court condemned the practice of *ad hoc* rulemaking in broad language:

> A presumption favors adopting rules of general applicability through the formal rulemaking procedures as opposed to administrative adjudication. Allowing an agency to create broad amendments to its rules through administrative adjudication rather than through its rulemaking authority undercuts the Administrative Procedure Act (APA). The APA details the procedure that a state agency must follow when adopting rules. ... Under those procedures, the agency must provide notice, publication, and invite public comment, among other things. In this way, the APA assures that the public and affected persons are heard on matters that affect them and receive notice of new rules. Indeed, the Legislature delegates formal rulemaking power to an agency in the expectation that an agency will ordinarily adopt rules of general application through that power.

In exceptional cases, an agency may choose to formulate and enforce a general requirement through a decision in a particular case. An agency may do this when using the rulemaking procedure would frustrate the effective accomplishment of the agency's functions. Adjudicative rulemaking may be appropriate, for example, when the agency is construing a new rule or when a dispute deals with a problem that requires *ad hoc* resolution because the issue cannot be captured within the bounds of a general rule. The agency's discretionary choice to rely on adjudication is subject to judicial review and revision.

* * *

The Legislature enacted the APA to avoid the very problems these broad *ad hoc* exceptions [to the Workers' Compensation Commission's formal rule] create. We are unable to ascertain whether all Commission appeals panels or contested case hearings officers recognize these exceptions or are obligated to apply them consistently in all cases. And reading the Commission's rules would not give an employee or insurance carrier notice of these exceptions ... because
the exceptions are not found in the printed rules. Indeed, informally amending this rule through a contested case hearing or an appeals panel decision results in the "issuance of a private opinion that will never be known by anyone except those few persons who take the time to research the files of an agency."^4

As this passage makes clear, the Supreme Court generally disapproves of *ad hoc* rulemaking except in "exceptional cases." The Court recognizes several problems with such rulemaking, including departure from statutory procedures, lack of notice to affected parties, and uncertainty about the scope and applicability of the resulting rule. In addition, *ad hoc* rulemaking does not allow the Commission to obtain the broad range of industry comment that usually leads to a better-formulated and more thorough rule. For these and other reasons, the Commission should refrain from adopting a general principle governing imputation of capacity costs in market-based power contracts in this proceeding.

This case does not contain any of the exceptional circumstances identified by the Supreme Court that might justify *ad hoc* rulemaking. Using rulemaking procedures would not frustrate accomplishment of the Commission's functions, nor is the issue of capacity imputation the type that cannot be captured within the bounds of a general rule. As the Court noted, departure from the presumption in favor of formal rulemaking procedures requires exceptional reasons, and is subject to judicial review and revision.

C. Practical Considerations

Practical considerations also mitigate against addressing the issue of capacity imputation in this contested proceeding. A formal rulemaking would allow broader participation by affected parties, and would allow the Commission to undertake a better-informed examination of a variety of issues, such as:

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• Whether the contracts at issue are typical of market-based contracts traded in other parts of Texas, such as the Western Interconnection in which EPE operates, the SPP, and ERCOT.

• Whether a decision to impute capacity costs could impact the development of wholesale markets or the nature of products traded in those markets.

• Whether the pricing of such contracts is impacted by the removal of capacity costs.

• Whether market-based energy-only contracts truly contain capacity characteristics and, if so, what level of capacity should be imputed to such contracts.
  o Whether the level of capacity imputed to contracts, if any, should vary based on the characteristics of those contracts or should be constant.

• Whether there is a risk of double recovery of capacity costs in base rates and the fuel factor, as OPC and Cities contend.

In EPE’s view, these and a host of other issues have not been adequately explored in this proceeding for the Commission to make a potentially broad decision concerning recovery and disallowance of costs of new market-based energy-only contracts. Decisions made in such a fashion frequently have unintended consequences and create considerable uncertainty about their scope and applicability in the industry. For the benefit of the industry and all its participants, the Commission should avoid making a decision about capacity imputation in market-based contracts in this proceeding.

Wherefore, El Paso Electric Company urges the Commission not to address the issue of imputed capacity costs in this case. Alternatively, the Commission should clarify that its decision is not applicable outside the circumstances of this case.
Respectfully submitted,

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[Signature]
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ATTORNEYS FOR EL PASO ELECTRIC COMPANY

Certificate of Service

I certify that a true and correct copy of the foregoing document was served on all parties of record this 3rd day of September, 2002.

[Signature]
Kerry McGrath