PROJECT NO. 41905

RULEMAKING PROCEEDING TO AMEND PUC SUBST. R. 25.236 RELATING TO RECOVERY OF FUEL COSTS	**§ § § §**	**PUBLIC UTILITY COMMISSION OF TEXAS**

ORDER ADOPTING AMENDMENTS TO §25.236
AS APPROVED AT THE MAY 16, 2014 OPEN MEETING

The Public Utility Commission of Texas (commission) adopts amendments to §25.236, relating to Recovery of Fuel Costs, without changes to the proposed text as published in the January 3, 2014 issue of the *Texas Register* (39 TexReg 23). The amendment adds environmental consumables required to reduce emissions of pollutants and whose use is directly proportional to the fuel consumed to generate electricity, and that are properly recorded in the Federal Energy Regulatory Commission (FERC) Uniform System of Accounts, Account 502, Steam Expenses, as eligible fuel expenses. The amendment also adds costs properly recorded in FERC Account 509, Allowances, as eligible fuel expenses, and further requires that these costs be offset by any gains properly recorded in FERC Account 411.8, Gains from Disposition of Allowances. The amendment also deletes the provision that requires that a fuel reconciliation be requested in a general rate proceeding. In addition, the amendment deletes obsolete language from the section. This amendment is adopted under Project Number 41905.

The commission received comments on the proposed amendments from El Paso Electric Company (EPE), Entergy Texas, Inc. (ETI), Office of Public Utility Counsel (OPUC), Southwestern Public Service Company (SPS), Southwestern Electric Power Company (SWEPCO), and Texas Industrial Electric Consumers (TIEC).

Section 25.236, Recovery of Fuel Costs

Subsection (a), Eligible Fuel Expenses

Subsection (a)(3) and (4)

OPUC requested that the commission not amend §25.236 (fuel rule) to include environmental consumables and allowances. OPUC stated that they agreed with comments filed by the Cities Advocating Reasonable Deregulation (CARD) in response to commission staff's strawman rule in this rulemaking project. OPUC argued that environmental consumables and allowances are largely within the control of the utility; the "special circumstances" provision in the rule already balances the interests of utilities and ratepayers; there is no sound policy reason to treat environmental costs differently from other base rate costs, such as labor and operations and maintenance (O&M) that also vary with fuel usage; and the level of environmental costs at issue are not likely to be significant until April 2015, when the new Mercury and Air Toxics Standards (MATS) rule takes effect.

OPUC stated that the volatility of fuel costs, which are particularly subject to dramatic and unforeseeable changes, is the key justification for allowing periodic adjustment of fuel costs under the fuel rule. OPUC opined that while environmental consumables and allowance costs may vary, they are not inherently volatile. OPUC stated that the costs are more comparable to a variety of other variable costs such as certain labor and O&M costs that are recovered through base rates. OPUC argued that potential variability in environmental consumables and allowances does not warrant automatic treatment as eligible fuel costs.

OPUC concluded that the special circumstances provision in the fuel rule authorizes the commission to determine on a case-by-case basis whether special circumstances warrant treating a given cost as an eligible fuel cost and that this provision could be used if there are special circumstances for treating a particular environmental consumable or allowance as an eligible fuel cost.

Consistent with the proposed amendments to the fuel rule, EPE, ETI, SPS and SWEPCO supported the proposal to add environmental consumables that are required to reduce emissions of pollutants as eligible fuel expenses. The utilities also agreed with the proposed amendments that allowances received concurrent with the monthly emission of sulfur dioxide and nitrogen oxides, offset by any gains, should be included as eligible fuel expenses.

SPS and ETI disagreed with OPUC and argued that the use of environmental consumables, as defined in subsection (a)(3) of the proposed rule, is not within the total control of the utility. SPS explained that it is not always possible or practical to switch to generation sources that do not require the use of environmental consumables and that such switching, if not done in a systematic and thoughtful manner, is likely to increase costs. SPS stated that in 2013, coal comprised 34 percent of the statewide generation mix in Texas and 48 percent of SPS's total generation mix. SPS opined that replacing such a significant amount of generation with other fuel sources would take significant capital investments and a number of years. Therefore, incurring environmental consumable costs is likely to be a more cost-effective option for customers than reducing coal-fired generation and incurring costs related to alternate and higher-cost generation sources. ETI likewise acknowledged that a utility must prudently choose how to comply with emissions standards in the same manner that it determines its generation mix. ETI commented that the commission recognized through the fuel rule that a utility's prudent decisions on generation mix necessarily expose the utility to fuel costs that are not within the control of the utility. Similarly, ETI claimed that the proposed rule recognizes that a utility's prudent decisions on environmental consumables and emission allowances are no more within the utility's control than are fuel costs. ETI asserted that OPUC's argument that environmental consumables and allowances are largely within the control of the utility wrongly assumes that the only prudent choice is to avoid such variable costs.

SPS commented that it is appropriate for the commission to modify the fuel rule rather than relying on the special circumstances provision of the rule as suggested by OPUC. SPS noted that the EPA has already established requirements that necessitate the use of environmental consumables and it is likely that further requirements will be established. SPS asserted that requiring the use of the special circumstances provision would unnecessarily increase administrative inefficiencies on the part of all parties for matters that are ongoing and material. SPS opined that regulatory lag would also likely result, unfairly penalizing utilities that have little ability to avoid the costs.

SWEPCO stated that because environmental consumables and emissions allowances expenses are likely to be highly variable and are correlated with the burning of fuel, these costs are more appropriately recovered through eligible fuel than through base rates. SWEPCO added that these costs represent an incremental cost of generating electricity and that by including these costs in eligible fuel, their varying costs can be signaled to customers through periodic adjustment to the utility's fuel factor. SWEPCO and SPS commented that as an element of fuel cost, these costs can be tracked and reconciled, ensuring more timely and accurate recovery than would be the case in base rates.

SPS stated that the cost of environmental consumables is directly related to the amount of fuel used in generating electricity and their use is to comply with applicable state and/or federal emissions reduction statutes, orders, and regulations. SPS also asserted that the cost and quantity of chemicals used for environmental compliance is variable. SPS further stated that including such expenses in base rates, as opposed to fuel expense, exposes both the customer and the company to risk of over- or under-collecting such expenses.

SPS disagreed with OPUC's statement that there is no sound public policy reason to treat environmental consumable costs differently from other base rate costs, such as labor and O&M that also vary with fuel usage. Instead, SPS asserted that environmental consumables have a direct and clear relationship with fuel usage, while other variable expenses such as labor and certain O&M expenses vary with production but not necessarily with specific fuel type use. SPS stated that if it decreased coal production and replaced that production with natural gas, the variable O&M would remain fairly constant. However, a decrease in coal production results directly in a reduction to environmental consumable costs. Therefore, SPS argued that it is reasonable and appropriate to differentiate environmental consumables from other types of variable O&M.

In response to OPUC's comments regarding the cost of environmental consumables, SPS agreed that the current cost is relatively minor but pointed out that implementation of the EPA's MATS rule and other regulations will materially impact SPS. SPS stressed that adoption of modifications to the fuel rule is timely because the MATS rule is expected to go into effect in early 2015, not long after a final commission rule would be effective. SPS opined that delaying implementation of the rule serves no useful public policy objective.

Regarding emission allowances, SPS stated that including the allowance costs and revenues in the proposed rule ensures no over-recovery of allowance revenue or under-recovery of allowance expense, consistent with the sound regulatory practice of matching expense and revenue. SPS commented that allowing these costs, which vary based on the amount of fuel consumed and the allowance values, in fuel expenses ensures that customers do not over-pay for variable costs directly tied to fuel usage and provides for stability of utility earnings when costs are increasing. SPS added that crediting revenues from the sale of emission allowances through fuel provides the same benefits.

Commission response

The commission agrees with ETI, SWEPCO, EPE, and SPS that a utility's fuel factor is the most suitable cost recovery mechanism for environmental consumables required to reduce emissions and sulfur dioxide and nitrogen oxide allowances. There is a direct relationship between the type and amount of fuel burned and the number of emission allowances required and environmental consumable expenses incurred. These costs, which directly vary with the type and amount of fuel burned, are unlike base rate costs such as certain

types of labor and other O&M expenses that vary with power produced and vary little because of specific fuel type use. Due to this direct relationship, the commission agrees with SPS and SWEPCO that environmental consumable and allowance costs are more appropriately recovered through the fuel factor as eligible fuel expenses than through base rates.

Regarding OPUC's proposal to use the special circumstances provision in the fuel rule to determine on a case-by-case basis whether special circumstances warrant treating a particular environmental consumable or allowance cost as an eligible fuel expense, the commission agrees with SPS that it is more appropriate to amend the fuel rule to include these costs as an eligible fuel expense than to rely on the special circumstances provision. The commission notes that established emission reduction requirements, which require the use of environmental consumables and allowances, already exist. In addition, compliance with the EPA's MATS rule is likely to increase the need for environmental consumables. The commission believes that relying on the special circumstances provision for recovery of these costs would result in administrative inefficiencies for costs that are ongoing and material.

In response to OPUC's comment that the cost of environmental consumables are not likely to be significant until the MATS rule takes effect in the spring of 2015, the commission agrees with SPS's observation that amendment to the fuel rule is, therefore, timely and delaying implementation of the rule serves no useful public policy objective.

TIEC requested that reference to nitrogen oxides emission allowances be removed from proposed subsection (a)(4) because there is no mention of allowances expensed concurrently with nitrogen oxides in the description of FERC Account 509, Allowances.

EPE, ETI, SPS, and SWEPCO supported the proposed addition of subsection (a)(4), which provides that both sulfur dioxide and nitrogen oxides emissions properly recorded in FERC Account 509, Allowances, are eligible fuel expenses and recommended that the commission reject TIEC's proposal to exclude nitrogen oxides emission allowances as eligible fuel expenses. In addition, the utilities stated that the description of FERC Account 509 in its entirety includes the reference to General Instruction No. 21, which is not limited solely to sulfur dioxide emission allowances. As further evidence that nitrogen oxides allowances are properly charged to FERC Account 509, ETI attached excerpts in its reply comments from the Form 1 template provided on the FERC's website, which provides for separate reporting of sulfur dioxide and nitrogen oxides emission allowances recorded in FERC Account 158, Allowance Inventory. Identical instructions for both reports require accounting for emission allowances according to General Instruction 21, which requires that allowances be charged to FERC Account 509 when expensed. SWEPCO contended that it is not uncommon for FERC not to specify every possible example of an item that might be properly recorded in any given account or to use a term like "allowances" for general inclusion. ETI added that while FERC has not yet taken the administrative step to conform descriptions of FERC Accounts 158 and 509 to its accounting requirements, FERC clearly intends that costs associated with nitrogen oxide allowances be recorded in FERC Account 509 the same way sulfur dioxide emission allowances are. In addition, ETI stated that subsection (a) defines eligible fuel expense by reference to FERC accounts "as modified by this subsection." ETI concluded that this gives the commission discretion to include as eligible fuel expenses costs that may not explicitly fall within the description of a particular FERC account.

EPE opined that the allowance costs associated with limiting nitrogen oxides should be accounted for in the same manner as sulfur dioxide. ETI, SPS, and SWEPCO agreed and stated that from a policy perspective, there is no basis to draw a cost recovery distinction between sulfur dioxide and nitrogen oxides allowances.

Commission response

The commission declines to remove nitrogen oxides emission allowances from proposed subsection (a)(4). As noted by EPE, ETI, SPS, and SWEPCO, the description of FERC Account 509 includes a reference to General Instruction 21, which refers broadly to allowances and is not limited to sulfur dioxide emission allowances. In addition, as pointed out by the utilities, the template for reporting allowances on the FERC website provides for separate reporting of sulfur dioxide and nitrogen oxides emission allowances recorded in FERC Account 158, Allowance Inventory. Identical instructions for both pages require accounting for emission allowances according to General Instruction 21, which requires that allowances be charged to FERC Account 509 when expensed. The commission agrees with ETI's assessment that FERC clearly intends that costs associated with nitrogen oxide allowances be recorded in FERC Account 509 the same way sulfur dioxide emission allowances are. The commission concurs with ETI, SPS, and SWEPCO that, from a policy perspective, there is no basis to draw a cost recovery distinction between sulfur dioxide and nitrogen oxides allowances.

Subsection (a)(6) and (8)

ETI opined that compliance with government-mandated environmental standards should not create cost recovery risk for utilities. ETI commented that renewable energy credit (REC) costs are of the same nature as the emission reduction costs addressed by proposed subsection (a) and recommended that they be treated in the same manner. To accomplish this, ETI furnished suggested changes to subsection (a)(6) and (a)(8) of the proposed rule. ETI commented that customers' interests would not be adversely affected by a shift in cost recovery for RECs because the fuel rule requires that only reasonable and necessary costs be recovered as fuel expense. ETI contended that RECs are intended to reduce emissions; exhibit a direct relationship to fuel and purchased energy; and present variable cost exposure for the utility.

ETI stated that the commission's adoption of §25.173 instituted a REC trading program. ETI explained that the order adopting the REC trading program in Project Number 20944, *Rulemaking Relating to Renewable Energy Mandate under Section 39.904 of Utilities Code*, recognizes that a policy objective of the REC trading program is to reduce emissions. ETI stated that the order states in part: "New renewable resources, although potentially more expensive than other electric resources, are an effective means for cleaning the air. Through [Public Utility Regulatory Act (PURA)] §39.904, the legislature clearly sought to support the development of renewable resources in Texas to efficiently and economically reduce emissions from electricity generation. The demand for electricity in Texas has been and is projected to continue to increase, and the legislature mandated the use of energy derived from renewable resources in Texas so that a portion of the additional future energy generated and consumed by Texans would result in cleaner air for all Texans."

ETI argued that similar to environmental consumables and allowances that are intended to reduce emissions, REC costs are an appropriate fuel expense because they also bear a direct relationship to fuel. ETI stated that the number of RECs a utility is obligated to acquire each year is determined based on the consumption of energy by the utility's retail customers in proportion to total statewide consumption. ETI commented that a utility incurs REC costs to provide energy to serve customers just as they incur environmental consumable and allowance costs to provide energy to serve customers. ETI opined that the fact that REC costs are more a function of energy consumed by customers versus the fuel consumed by the utility is not a basis for distinction in cost recovery.

ETI contended that the utility has no control over REC costs. ETI reiterated that a utility's REC responsibility will change each compliance period because a utility's retail sales, total statewide sales and their proportional relationship changes over time. Additionally, ETI commented that the mandate in PURA §39.904(a) that gave rise to the REC trading program places an escalating obligation on utilities through 2025. ETI also stated that the cost of the REC is market-driven and subject to the forces of supply and demand that can cause price volatility.

TIEC recommended that ETI's proposal to shift REC cost recovery to the fuel factor from base rates be rejected. TIEC compared ETI's proposal to its request for a REC rider in Docket Number 39896, *Application of Entergy Texas, Inc. for Authority to Change Rates, Reconcile*

Fuel Costs, and Obtain Deferred Accounting Treatment, that was denied by the commission. TIEC stated that the proposal for decision (PFD) rejected ETI's argument that REC costs are volatile and should be recovered similarly to fuel because the contention was not supported by substantial evidence. TIEC stated that the commission adopted the PFD and also denied ETI's REC rider on the basis that it constituted piecemeal ratemaking with no express statutory authorization. TIEC recommended that the commission reject ETI's request to include REC costs as an eligible fuel expense for the same policy and statutory grounds that it denied ETI's proposed REC rider in Docket Number 39896.

TIEC opined that ETI's proposal would result in improper piecemeal ratemaking and claimed that REC costs belong in base rates. TIEC stated that to determine whether changes in a utility's REC costs justify an overall rate increase, the commission must examine the utility's overall costs and revenues at once, as required by PURA §36.051.

In addition, TIEC contended that because RECs are substantively dissimilar to fuel costs or emissions costs, it would be inappropriate to include REC costs as eligible fuel expense. TIEC explained that REC costs are essentially the renewable capacity component of renewable generating plant or purchased power agreements. TIEC stated that PURA §39.904 makes it clear that REC purchases are to satisfy renewable capacity requirements and are therefore not analogous to fuel purchases. TIEC continued that while renewable energy that generates RECs may displace emissions from fossil-fuel resources, a REC is a capacity purchase just like a generating plant or purchased power agreement. TIEC stated that acquiring a REC is fundamentally the same as purchasing renewable resources. Because of this, TIEC claimed that

RECs should be treated in the same manner as other resource costs, which are collected in base rates and not as an eligible fuel expense.

Commission response

The commission declines to change the proposed rule to include REC costs as an eligible fuel expense. Under §25.173(h)(2), the number of RECs that an entity is required to purchase is a function of the total RECs required to be purchased by all entities subject to the Renewable Portfolio Standard (RPS) (statewide RPS requirement). The statewide RPS requirement is a function of the renewable energy capacity goal in PURA §39.904(a) for the year at issue. The statewide RPS requirement does not vary by the total amount of energy generated, purchased, or sold by the entities subject to the RPS requirement. An entity's allocation of the statewide RPS requirement is that entity's percentage of the total Texas retail energy sales of all entities subject to the RPS requirement, subject to certain adjustments. A utility's fuel factor is designed to recover the utility's Texas retail customer costs resulting from its fuel usage and energy purchases. In contrast, a utility's RPS requirement is not a direct function of its fuel usage or energy purchases. The number of RECs that a utility is obligated to purchase may decrease even as that utility's fuel usage and energy purchases grow, or increase even as that utility's fuel usage and energy purchases decrease. The commission therefore will not include REC costs as eligible fuel expenses, because these costs are not directly tied to a utility's fuel use and energy purchases.

Subsection (a)(7)

TIEC suggested that the commission eliminate subsection (a)(7) of the proposed rule as part of this rulemaking proceeding. TIEC stated that the provision in proposed subsection (a)(7) allows an electric utility to recover as eligible fuel expenses fuel or fuel-related expenses otherwise excluded in the rule if the utility can demonstrate that special circumstances exist.

TIEC contended that the provision in the rule is broad and ambiguous, invites litigation regarding fuel or fuel-related expenses that are not otherwise eligible under the rule, and provides no guidance as to what constitutes special circumstances. TIEC opined that any fuel-related expenditure can be argued to provide increased reliability of supply. In addition, TIEC argued that the cost-effectiveness test provided in the provision is ill-defined and open-ended and that the meaning of "benefits received or expected to be received by ratepayers" is unclear. TIEC stated that the ability to prove that an expenditure is cost-effective depends in large part on the avoided costs that are assumed which, TIEC contended, are highly subjective and subject to litigation.

TIEC pointed to the commission's efforts to address litigation issues and rate case expenses and concluded that it would be appropriate to eliminate the provision. TIEC opined that while there may have been a reason in the past to include the special circumstances provision in the rule, under current commission ratemaking, there exists a host of cost-recovery mechanisms that significantly reduce the potential for regulatory lag. As an example, TIEC stated that the item most litigated over the past ten years, purchased power capacity costs, is now recoverable via the recently adopted purchased power capacity cost recovery factor (PCRF) rule. TIEC concluded that there is no longer any reason to rely on the special circumstances provision for purchased power capacity costs, and that the possibility of their inclusion under §25.236 would undermine the commission's decision on how these costs may be recovered under §25.238.

EPE, ETI, SPS, and SWEPCO disagreed with TIEC's comments and contended that the special circumstances provision should remain in the proposed rule. SPS stated that the provision does not provide for an automatic exception, but rather the utility must first request and meet the requirements in the rule to ensure customer protection before the commission grants an exception. ETI added that the cost-benefit test must first be satisfied to support a special circumstances finding in order to ensure that customers will receive benefits that exceed the costs afforded special circumstances treatment. SPS commented that the provision allows for exceptions to be granted in the event unforeseen costs would otherwise result in regulatory lag.

EPE stated that the fuel rule has contained a special circumstances provision in some form since 1986 and for the most part in its current form since 1993. EPE remarked that throughout this time period the provision has provided the commission the flexibility to respond appropriately when special circumstances have been presented.

EPE and ETI disagreed with TIEC's contention that the test to determine special circumstances is broad, ambiguous, and invites litigation. EPE stated that despite decades of experience under the rule, TIEC did not provide a single example of how the so-called broad and ambiguous language in the rule led to unnecessary litigation. ETI opined that TIEC's suggestion that the special circumstances provision be eliminated is misguided and contended that TIEC's comments propose that the best way to reduce litigation expenses is to prohibit a utility from bringing up a request for relief simply because it may be contested by another party. ETI stated that the desire to reduce the burden and cost of regulatory litigation should focus on making processes more efficient and streamlined rather than restricting the ability to seek relief or challenge relief that is sought.

EPE, ETI, and SWEPCO stated that TIEC made similar comments concerning the special circumstances provision in the 1993 amendment to the fuel rule, Project Number 11509, *Fuel Rule Amendment*, and stated that the commission rejected TIEC's comments in its response (18 TexReg 836, 839 (February 9, 1993)). In addition, ETI and SWEPCO stated that in the order in Project Number 19865, *Review of SUBST. R. 23.23 as it Relates to Electric Service Providers and Movement to SUBST. R. Chapter 25*, the commission reinforced its earlier decision and stated: "The commission rejects TIEC's argument that the "special circumstances" provision of §25.236(a)(6) should be deleted. The commission believes that there are circumstances that warrant deviation from the rules and that the public interest is served when electric utilities know that such relief is available."

In response to TIEC's argument that the special circumstances provision is no longer needed because the commission has implemented various cost recovery mechanisms, in particular the PCRF, ETI disagreed and stated that although purchased power capacity costs have been the subject of special circumstances requests, it is not the sole purpose of the provision. ETI's comments referenced numerous other instances in which the special circumstances provision was granted. In addition, ETI opined that the commission should not foreclose the potential that special circumstances may exist to allow recovery of purchased capacity through fuel for a limited timeframe when a purchased power capacity recovery rider may not be justified nor should they forgo the ability to exercise discretion to apply the special circumstances provision on a case-by-case basis going forward.

ETI concluded that TIEC's arguments do not support a departure from current policy. ETI stated that the commission has a well-established history of applying the standards set out in the rule in a practical and conservative manner in order to identify special circumstances that justify a departure from the otherwise applicable fuel cost recovery rules. SWEPCO added that the provision complements sound long-term decision making by the utility and constitutes good public policy.

Commission response

The commission concurs with EPE, ETI, SPS, and SWEPCO's contention that the special circumstances provision should remain in the rule. In response to similar arguments by TIEC in Project Number 11509, *Fuel Rule Amendment*, the commission stated*:* "The commission is persuaded that the published language should be adopted. It presents an appropriate balance between the need for flexibility to meet the unexpected circumstances with the need for certainty in order to reduce disputes and litigation. TIEC's proposed additions largely remove the availability of the clause, which the commission believes should remain."

The commission acknowledges that the provision may increase the complexity of a fuel reconciliation proceeding. However, special circumstances are granted only in situations where the commission determines that the fuel expense or transaction giving rise to the ineligible fuel expense resulted in, or is reasonably expected to result in, increased reliability of supply or lower fuel expenses than would otherwise be the case, and that such benefits received or expected to be received by ratepayers exceed the costs that ratepayers otherwise would have paid or otherwise would reasonably expect to pay. The commission, therefore, believes that the benefit to customers in retaining the special circumstances provision outweighs the increased complexity the provision may add to a fuel reconciliation proceeding.

TIEC stated that over the past ten years special circumstance requests have dealt primarily with issues related to purchased power costs, which are now covered by §25.238, the PCRF rule. However, the long list of filings detailed in ETI's comments confirm that the special circumstances provision has been used for numerous other issues, including the recovery of natural gas call options, recovery of consulting fees incurred to obtain a refund of natural gas taxes paid, and recovery of legal and consulting costs incurred for negotiation and litigation related to fuel and transportation costs. The special circumstances provision provides a utility a stronger incentive to take actions for the benefit of its customers. The commission, therefore, rejects TIEC's request to remove the special circumstances provision.

Subsection (a)(9)

EPE requested that the commission consider revising the percentage of margins retained by the utility as a result of off-system sales. EPE stated that while off-system sales can potentially offer substantial benefits to customers and the utility, the current rule provision allows the utility to retain only 10% of the margins. EPE contended that this percentage is a minimal amount and provides little cushion for the risks and costs associated with off-system sales. EPE urged the commission to explore the possibility of increasing the percentage of margins retained by the utility and to consider whether this would also benefit customers by providing the utility a greater incentive to engage in off-system sales transactions. EPE suggested that the commission also consider whether off-system sales margins should be limited to sales from rate-based generation or whether a different sharing percentage should apply to non-rate-based generation or to margins earned on arbitrage transactions where a purchase of energy is made in order to make an off-system sale. In addition, EPE requested that the commission consider the proper treatment of purchases or sales of spinning reserves.

TIEC recommended that the commission reject EPE’s proposal. TIEC stated that the margin sharing already in place is generous and does not need to be revisited. TIEC explained that it does not support rewarding a utility for fulfilling its statutory obligation to serve customers at just and reasonable rates. TIEC stated that this obligation includes providing sufficient service at the lowest reasonable cost and selling energy off-system when it is economical to do so. TIEC stated that allowing utilities to charge ratepayers 100% of their fuel costs while retaining 10% of the profits from re-selling power creates an arbitrage opportunity. TIEC contended that any further increase in the sharing of margins would exacerbate the problem and result in a windfall opportunity for utilities.

TIEC opposed EPE's suggestion to consider whether off-system sales margins should be limited to sales from rate-based generation or whether a different sharing percentage should apply to non-rate-based generation. TIEC opined that this distinction is not meaningful for traditional off-system sales of utility-owned generation. TIEC commented that if a utility's rates are set at a level that allows it to continue to earn a reasonable rate of return, the utility may not need to include a new generation plant or purchased power contracts in its rate base. TIEC concluded that the idea that margin sharing should differ based on whether or not the generation is in the rate base is flawed and should be rejected.

In regard to other activities that generate margins, TIEC remarked that the current rule does not prevent a utility from proposing a different sharing mechanism. As an example, they referred to Docket Number 40824, *Application of Southwestern Public Service Co. for Authority to Change Rates and to Reconcile Fuel and Purchased Power Costs for the Period January 1, 2010 through June 30, 2012*, where SPS proposed different sharing mechanisms for wholesale commodity trading.

Commission response

The commission concurs with EPE's position that off-system sales can potentially offer substantial benefits to customers and the utility. However, in regard to EPE's request that the commission consider increasing the percentage of margins retained by the utility in

order to provide the utility with a greater incentive to engage in off-system sales, the commission believes that the percentage currently allowed under the rule is adequate and declines to make a change. As noted by TIEC, utilities have a statutory obligation to serve customers at just and reasonable rates. This includes providing service to their customers at the lowest reasonable cost. Achieving the lowest reasonable cost requires utilizing generating plants in an economical manner, which includes making off-system sales when it is beneficial to do so. The commission believes, therefore, that profits from off-system sales, less the percentage of margins the rule currently allows the utilities to retain, should be credited to customers.

Regarding EPE's request to consider whether off-system sales margins should be limited to sales of rate-based generation or whether a different sharing percentage should apply to non-rate-based generation or to margins earned on arbitrage transactions, the commission agrees with TIEC's argument that this distinction is not meaningful for traditional off-system sales of utility-owned generation. The commission concurs with TIEC that if a utility's rates are set at a level that allows it to continue to earn a reasonable rate of return, the utility may not need to include a new generation plant or purchased power contracts in its rate base. The commission, therefore, declines to address this issue any further.

EPE identified the proper treatment of purchases or sales of spinning reserves as an issue that could be addressed in this project. However, EPE did not provide an explanation or detailed support for such a change and, further, EPE did not propose any specific rule language. Because EPE merely identified this as an issue that could be addressed, without

sufficient explanation or support, the commission declines to examine the issue in this rulemaking.

Subsection (b), Reconciliation of Fuel Expenses

ETI and SPS stated that the fuel rule should not be amended to require separate fuel reconciliation proceedings. Both utilities stated that while there may be instances where a separate fuel reconciliation is beneficial to customers and/or the utility, there are also instances where it may make sense to couple the two cases to more effectively address issues concerning whether costs should be treated as fuel expenses or base-rate costs. SPS opined that without an opportunity for a combined filing, customers and utilities may be unfairly at risk. Both ETI and SPS suggested rule language that would allow the utility the option to file a fuel reconciliation with a general rate proceeding. TIEC agreed with the comments of the utilities and is not opposed to the SPS's suggested rule language.

Commission response

The current fuel rule generally requires that a utility petition to reconcile eligible fuel expense every one to three years, which usually results in a stand-alone fuel reconciliation. However, under the current rule, a utility must include a fuel reconciliation in a base-rate proceeding, even if the time period covered is less than a year. The current fuel rule allows a fuel reconciliation to be severed from a base-rate proceeding upon a showing of good cause, but in that case a utility will have already incurred the expense of including the fuel reconciliation as part of the base-rate proceeding. Requiring a short time period for a reconciliation in a base-rate proceeding is inefficient, which results in additional rate-case

expenses. The proposed rule deletes the provisions that couple a fuel reconciliation with other rate proceedings.

Excluding fuel reconciliations from base-rate proceedings improves the commission's workload management. Even without a fuel reconciliation, a base-rate proceeding initiated by a utility is a very time-intensive proceeding that has a timeline that is grounded in the 185-day benchmark arising from PURA §36.102 and §36.108. In contrast, the fuel rule generally requires a one-year deadline for a separate fuel reconciliation, thereby avoiding the time crunch of including the reconciliation in a base-rate proceeding. This deadline is generally appropriate because completion of a fuel reconciliation is less urgent, as the utility has already recovered through its fuel factor the costs being reconciled. In addition, a reconciliation can be time consuming because it can involve, among other things, hundreds of millions of dollars and large numbers of fuel and purchased power transactions. Recognizing that multiple fuel reconciliations can be initiated close in time to each other, subsection (f) of the fuel rule has an additional provision to address workload management for separate fuel reconciliations: "However, if the deadlines result in a number of electric utilities filing cases within 45 days of each other, the presiding officers shall schedule the cases in a manner to allow the commission to accommodate the workload of the cases irrespective of whether such procedural schedule enables the commission to issue a final order in each of the cases within one year after a materially complete petition is filed."

ETI and SPS stated that there may be instances where it may make sense to couple a fuel reconciliation with a base-rate proceeding to more effectively address issues concerning whether costs should be treated as fuel expenses or base-rate costs. ETI cited *Application of Entergy Gulf States, Inc. for Authority to Change Rates and Reconcile Fuel Costs*, Docket Number 34800, Order at finding of fact 43 (addressing fuel cost recovery for emission allowance costs and revenues). That finding stated in relevant part: "The signatories agree to adopt Commission Staff's position on the following resolution of fuel-related matters set out in Commission Staff's pre-filed direct testimony: (a) recovery of sulfur dioxide (SO2) and nitrous oxide (NOX) emissions revenues recorded in Account 411.8 and expenses recorded in Account 509 will be allowed as eligible fuel expense going forward until further order of the Commission realigning such costs …." However, this finding addresses prospective recovery of the expenses as eligible fuel expense, whereas a fuel reconciliation covers costs that have already been incurred.

The commission declines to adopt ETI's and SPS's proposal to give a utility the discretion to include a fuel reconciliation in a base-rate proceeding. Inclusion of a fuel reconciliation in a base-rate proceeding could be unnecessarily burdensome on the commission, commission staff, and intervenors. Under ETI's and SPS's proposal, commission staff and intervenors would have the burden of filing and prevailing on a motion to sever the fuel reconciliation from the base-rate proceeding, which could be disruptive to the base-rate proceeding and put substantial time pressures on commission staff and intervenors. The commission can foresee few, if any, situations where it is desirable to include a fuel reconciliation in a base-rate proceeding. Under the proposed amendment, a utility

nevertheless can obtain consolidation of a fuel reconciliation with a base-rate proceeding if it can meet the standards of §22.34(a) (procedural rule addressing consolidation of proceedings). Therefore, the commission adopts the amendments to subsection of the fuel rule as proposed.

Subsection (d), Fuel Reconciliation Proceedings

ETI proposed that the commission amend subsection (d)(2) to specify that line loss factors that are used to reconcile fuel expense should be the same commission-approved loss factors that were used in the utility's applicable fixed or interim fuel factor as required for inter-class allocations of refunds and surcharges in subsection (e)(3). ETI stated that in the Order on Rehearing in Docket Number 39896, *Application of Entergy Texas, Inc. for Authority to Change Rates, Reconcile Fuel Costs and Obtain Deferred Accounting Treatment*, the commission ruled that the most recent available line loss factors should have been used to reconcile ETI's fuel costs as opposed to the line loss factors used to determine the fuel factor rate charged to customers to collect fuel expense. ETI recognized that Docket Number 39896 presented a set of circumstances wherein the fuel factor formula used to set the company's fuel factor rate specified use of line loss factors from the late 1990s. ETI stated that the commission, obviously concerned with the age of the loss factors used to collect fuel expense during the reconciliation period, addressed the situation in Docket Number 40654, *Application of Entergy Texas, Inc. to Revise Fixed Fuel Factor (Schedule FF) in Compliance with Order in Docket Number 32915*, by approving new loss factors for use in ETI's fuel factor formula going forward. ETI opined that the commission's ruling in Docket Number 39896 has had the unintended consequence of setting the foundation in future fuel reconciliations for impermissible windfalls by the utility or its customers as well as winners and losers among customer classes due to the effect of loss factors on the allocation of fuel costs.

ETI contended that the retroactive use of new loss factors to calculate the company's fuel over/under-recovery balance after the fact in a fuel reconciliation will result in a mismatch between revenues recovered under the fuel factor and the costs billed and allocated to the various customer classes. ETI stated that costs would be billed to customers based on one set of line loss factors but reconciled based on a different set of line loss factors. ETI claimed that the result of retroactive application of line loss factors is that the utility will recover either too little fuel expense or will overcharge fuel expense creating windfalls for utilities or customers.

ETI expressed concern that it would also create winners and losers in the interclass allocation of refunds and surcharges. ETI stated that if the total fuel balance is determined based on the retroactive application of new line loss factors and the utility has either an over- or under-recovery, application of subsection (e)(3) requires that: "Interclass allocations of refunds and surcharges, including associated interest, shall be developed on a month-by-month basis and shall be based on the historical kilowatt-hour usage of each rate class for each month during the period in which the cumulative under- or over-recovery occurred, adjusted for line losses using the same commission-approved loss factors that were used in the electric utility's applicable fixed or interim fuel factor." ETI concluded that the effect is that each class would receive a portion of the refund allocated to it on a basis other than what was used to determine its responsibility for total fuel costs.

Commission response

The commission declines to change subsection (d)(2) as proposed by ETI. In a fuel reconciliation proceeding, the values of the line loss factors used in the reconciliation is an issue that may affect the determination of the appropriate amount of fuel expenses allocable to Texas retail ratepayers. This is separate from the inter-class allocation of any refund or surcharge balance among the Texas retail rate classes addressed in subsection (e)(3). ETI's proposed change would inappropriately limit the scope of a fuel reconciliation proceeding, which involves a final determination of the appropriate amount of fuel expenses recoverable from Texas retail ratepayers during the reconciliation period.

All comments, including any not specifically referenced herein, were fully considered by the commission.

The amendment is adopted under the Public Utility Regulatory Act, Texas Utilities Code Annotated §14.002 (West 2007 and Supp. 2013) (PURA), which provides the Public Utility Commission with the authority to make and enforce rules reasonably required in the exercise of its powers and jurisdiction; PURA §14.052, which requires the commission to adopt and enforce rules governing practice and procedure before the commission and, as applicable, practice and procedure before the utility division of the State Office of Administrative Hearings; and PURA §36.203(e), which provides for the reconciliation of a utility's fuel costs on a timely basis.

Cross Reference to Statutes: Public Utility Regulatory Act §§14.002, 14.052, and 36.203(e).

§25.236. Recovery of Fuel Costs.

(a) **Eligible fuel expenses.** Eligible fuel expenses include expenses properly recorded in the Federal Energy Regulatory Commission Uniform System of Accounts, numbers 501, 502, 503, 509, 518, 536, 547, and 555, as modified in this subsection, as of April 1, 2013, and the items specified in paragraph (8) of this subsection. Any later amendments to the System of Accounts are not incorporated into this subsection. Subject to the commission finding special circumstances under paragraph (7) of this subsection, eligible fuel expenses are limited to:

(1) For any account, the electric utility may not recover, as part of eligible fuel expense, costs incurred after fuel is delivered to the generating plant site, for example, but not limited to, operation and maintenance expenses at generating plants, costs of maintaining and storing inventories of fuel at the generating plant site, unloading and fuel handling costs at the generating plant, and expenses associated with the disposal of fuel combustion residuals. Further, the electric utility may not recover maintenance expenses and taxes on rail cars owned or leased by the electric utility, regardless of whether the expenses and taxes are incurred or charged before or after the fuel is delivered to the generating plant site. The electric utility may not recover an equity return or profit for an affiliate of the electric utility, regardless of whether the affiliate incurs or charges the equity return or profit before or after the fuel is delivered to the generating plant site. In addition, all affiliate payments must satisfy the Public Utility Regulatory Act (PURA) §36.058.

(2) For Accounts 501 and 547, the only eligible fuel expenses are the delivered cost of fuel to the generating plant site excluding fuel brokerage fees. For Account 501, revenues associated with the disposal of fuel combustion residuals will also be excluded.

(3) For Account 502, the only eligible fuel expenses are environmental consumables that are: properly recorded in the Account as chemicals; required to comply with applicable state or federal emission reduction statutes, orders, and regulations; and whose use is directly proportional to the fuel consumed to generate electricity.

(4) For Account 509, the only eligible fuel expenses are allowances expensed concurrent with the monthly emissions of sulfur dioxide and nitrogen oxides.

(5) For Accounts 518 and 536, the only eligible fuel expenses are the expenses properly recorded in the Account excluding brokerage fees. For Account 503, the only eligible fuel expenses are the expenses properly recorded in the Account, excluding brokerage fees, return, non-fuel operation and maintenance expenses, depreciation costs and taxes.

(6) For Account 555, the electric utility may not recover demand or capacity costs.

(7) Upon demonstration that such treatment is justified by special circumstances, an electric utility may recover as eligible fuel expenses fuel or fuel related expenses otherwise excluded in paragraphs (1) - (6) of this subsection. In determining whether special circumstances exist, the commission shall consider, in addition to other factors developed in the record of the reconciliation proceeding, whether the fuel expense or transaction giving rise to the ineligible fuel expense resulted in, or is reasonably expected to result in, increased reliability of supply or lower fuel

expenses than would otherwise be the case, and that such benefits received or expected to be received by ratepayers exceed the costs that ratepayers otherwise would have paid or otherwise would reasonably expect to pay.

(8) Eligible fuel expenses shall not be offset by revenues by affiliated companies for the purpose of equalizing or balancing the financial responsibility of differing levels of investment and operation costs associated with transmission assets. In addition to the expenses designated in paragraphs (1) - (7) of this subsection, unless otherwise specified by the commission, eligible fuel expenses shall be offset by:

(A) revenues from steam sales included in Accounts 504 and 456 to the extent expenses incurred to produce that steam are included in Account 503;

(B) revenues from off-system sales in their entirety, except as permitted in paragraph (9) of this subsection; and

(C) revenues from disposition of allowances properly recorded in Account 411.8.

(9) **Shared margins from off-system sales.** An electric utility may retain 10% of the margins from an off-system energy sales transaction if the following criteria are met:

(A) the electric utility participates in a transmission region governed by an independent system operator or a functionally equivalent independent organization;

(B) a generally-applicable tariff for firm and non-firm transmission service is offered in the transmission region in which the electric utility operates; and

(C) the transaction is not found to be to the detriment of its retail customers.

(b) **Reconciliation of fuel expenses.** Electric utilities shall file petitions for reconciliation on a periodic basis so that any petition for reconciliation shall contain a maximum of three years and a minimum of one year of reconcilable data and will be filed no later than six months after the end of the period to be reconciled.

(c) **Petitions to reconcile fuel expenses.** In addition to the commission prescribed reconciliation application, a fuel reconciliation petition filed by an electric utility must be accompanied by a summary and supporting testimony that includes the following information:

(1) a summary of significant, atypical events that occurred during the reconciliation period that affected the economic dispatch of the electric utility's generating units, including but not limited to transmission line constraints, fuel use or deliverability constraints, unit operational constraints, and system reliability constraints;

(2) a general description of typical constraints that limit the economic dispatch of the electric utility's generating units, including but not limited to transmission line constraints, fuel use or deliverability constraints, unit operational constraints, and system reliability constraints;

(3) the reasonableness and necessity of the electric utility's eligible fuel expenses and its mix of fuel used during the reconciliation period;

(4) a summary table that lists all the fuel cost elements which are covered in the electric utility's fuel cost recovery request, the dollars associated with each item, and where to find the item in the prefiled testimony;

(5) tables and graphs which show generation (MWh), capacity factor, fuel cost (cents per kWh and cents per MMBtu), variable cost and heat rate by plant and fuel type, on a monthly basis; and

(6) a summary and narrative of the next-day and intra-day surveys of the electricity markets and a comparison of those surveys to the electric utility's marginal generating costs.

(d) **Fuel reconciliation proceedings.** Burden of proof and scope of proceeding are as follows:

(1) In a proceeding to reconcile fuel factor revenues and expenses, an electric utility has the burden of showing that:

(A) its eligible fuel expenses during the reconciliation period were reasonable and necessary expenses incurred to provide reliable electric service to retail customers;

(B) if its eligible fuel expenses for the reconciliation period included an item or class of items supplied by an affiliate of the electric utility, the prices charged by the supplying affiliate to the electric utility were reasonable and necessary and no higher than the prices charged by the supplying affiliate to its other affiliates or divisions or to unaffiliated persons or corporations for the same item or class of items; and

(C) it has properly accounted for the amount of fuel-related revenues collected pursuant to the fuel factor during the reconciliation period.

(2) The scope of a fuel reconciliation proceeding includes any issue related to determining the reasonableness of the electric utility's fuel expenses during the reconciliation period and whether the electric utility has over- or under-recovered its reasonable fuel expenses.

(e) **Refunds.** All fuel refunds and surcharges shall be made using the following methods.

(1) Interest shall be calculated on the cumulative monthly ending under- or over-recovery balance at the rate established annually by the commission for overbilling and underbilling in §25.28 (c) and (d) of this title (relating to Bill Payment and Adjustments). Interest shall be calculated based on principles set out in subparagraphs (A) - (E) of this paragraph.

(A) Interest shall be compounded annually by using an effective monthly interest factor.

(B) The effective monthly interest factor shall be determined by using the algebraic calculation x = (1 + i) (1/12) - 1; where i = commission-approved annual interest rate, and x = effective monthly interest factor.

(C) Interest shall accrue monthly. The monthly interest amount shall be calculated by applying the effective monthly interest factor to the previous month's ending cumulative under/over recovery fuel and interest balance.

(D) The monthly interest amount shall be added to the cumulative principal and interest under/over recovery balance.

(E) Interest shall be calculated through the end of the month of the refund or surcharge.

(2) Rate class as used in this subparagraph shall mean all customers taking service under the same tariffed rate schedule, or a group of seasonal agricultural customers as identified by the electric utility.

(3) Interclass allocations of refunds and surcharges, including associated interest, shall be developed on a month-by-month basis and shall be based on the historical kilowatt-hour usage of each rate class for each month during the period in which the cumulative under- or over-recovery occurred, adjusted for line losses using the same commission-approved loss factors that were used in the electric utility's applicable fixed or interim fuel factor.

(4) Intraclass allocations of refunds and surcharges shall depend on the voltage level at which the customer receives service from the electric utility. Retail customers who receive service at transmission voltage levels, all wholesale customers, and any groups of seasonal agricultural customers as identified by the electric utility shall be given refunds or assessed surcharges based on their individual actual historical usage recorded during each month of the period in which the cumulative under- or over-recovery occurred, adjusted for line losses if necessary. All other customers shall be given refunds or assessed surcharges based on the historical kilowatt-hour usage of their rate class.

(5) Unless otherwise ordered by the commission, all refunds shall be made through a one-time bill credit and all surcharges shall be made on a monthly basis over a period not to exceed 12 months through a bill charge. However, refunds may be

made by check to municipally-owned electric utility systems if so requested. Retail customers who receive service at transmission voltage levels, all wholesale customers, and any groups of seasonal agricultural customers as identified by the electric utility shall be given a one-time credit or assessed a surcharge made on a monthly basis over a period not to exceed 12 months through a bill charge. All other customers shall be given a credit or assessed a surcharge based on a factor which will be applied to their kilowatt-hour usage over the refund or surcharge period. This factor will be determined by dividing the amount of refund or surcharge allocated to each rate class by forecasted kilowatt-hour usage for the class during the period in which the refund or surcharge will be made.

(6) A petition to surcharge or refund a fuel under- or over-recovery balance not associated with a proceeding under subsection (d) of this section shall be processed in accordance with the filing schedules in §25.237(d) of this title (relating to Fuel factors) and the deadlines in §25.237(e) of this title.

(f) **Procedural schedule.** Upon the filing of a petition to reconcile fuel expenses in a separate proceeding, the presiding officer shall set a procedural schedule that will enable the commission to issue a final order in the proceeding within one year after a materially complete petition was filed. However, if the deadlines result in a number of electric utilities filing cases within 45 days of each other, the presiding officers shall schedule the cases in a manner to allow the commission to accommodate the workload of the cases irrespective of whether such procedural schedule enables the commission to issue a final order in each of the cases within one year after a materially complete petition is filed.

This agency hereby certifies that the adoption has been reviewed by legal counsel and found to be a valid exercise of the agency's legal authority. It is therefore ordered by the Public Utility Commission of Texas that §25.236 relating to Recovery of Fuel Costs is hereby adopted with no changes to the text as proposed.

SIGNED AT AUSTIN, TEXAS the _21st__ day of MAY 2014.

PUBLIC UTILITY COMMISSION OF TEXAS

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DONNA L. NELSON, CHAIRMAN

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KENNETH W. ANDERSON, JR., COMMISSIONER

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