

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO

DOCKET NO. 04A-050E

IN THE MATTER OF THE APPLICATION OF PUBLIC SERVICE COMPANY OF
COLORADO FOR A REVIEW OF ITS ELECTRIC COMMODITY TRADING OPERATIONS.

**ORDER APPROVING SETTLEMENT
WITH MODIFICATIONS
AND APPROVING UNOPPOSED MOTION**

Mailed Date: October 15, 2004

Adopted Date: October 5, 2004

I. BY THE COMMISSION

A. Statement

1. This matter concerns the application of Public Service Company of Colorado (Public Service or Company) for review of its electric trading operations. The application was filed in accordance with the terms and conditions of a settlement reached in the Company's most recent general rate case, Docket No. 02S-315EG. Under the rate case settlement, the Company was allowed to continue electric trading operations for both its Generation Book (GenBook) and Proprietary Book (PropBook) with certain conditions.

2. The first condition addressed the ratemaking treatment of the costs for conducting electric trading operations. The settlement stated that A&G/non-production O&M expenses associated with the Company's trading business would be reduced by \$1.74 million for GenBook operations and by \$1 million for PropBook operations.

3. The second condition was to extend all of the terms and conditions of the 2000 Trading Stipulation through December 31, 2004, except that the 2000 Trading Stipulation

was modified.¹ The modifications also provided that for the calendar years 2003 and 2004 the definition of short-term electric energy transaction would be up to two years in term length; the Value at Risk limits for GenBook and PropBook would not be increased, in whole or in part, to specifically accommodate longer term trading; there would be no PropBook trades made on behalf of Public Service with delivery dates after December 31, 2004, absent Commission approval; the Company would not request to share all or a portion of any net aggregated losses from either GenBook or PropBook operations; and certain changes would be made to the margin calculation, margin sharing thresholds, and percentages.

4. The rate case settlement also provided that margin sharing would be calculated separately for each of the GenBook and PropBook operations. PropBook margins would be calculated from Public Service's share of margins under the Joint Operating Agreement. Within each of these books, the gross margins would be aggregated annually. If the aggregated gross margin from either book was negative, the negative margin would not be passed on to retail customers. If the annual aggregated gross margin in either book was positive, then such positive annual gross margin would be shared annually with retail customers through the Electric Commodity Adjustment (ECA) as follows:

- Positive Annual GenBook Gross Margin: Retail customers will receive the first \$1.74 million; the Company will retain the next \$1.74 million; and the remaining Gross Margin will be shared 60 percent retail customers/ 40 percent Company.
- Positive Annual PropBook Gross Margin: The Company shall retain the first \$1 million; the remaining Gross Margin will be shared 40 percent retail customers/ 60 percent Company.

5. The third condition was that, by July 1, 2003, the Company would establish and use separate general ledger accounts to track the GenBook and PropBook costs and revenues that are used to calculate the gross margins in each of the books.

¹ See Decision No. R00-0830 for the 2000 Trading Stipulation.

6. The fourth condition was to reduce to writing the trading Business Rules that the Company would follow from the effective date of the rate case settlement through December 31, 2004.

7. The fifth condition was that the Company would arrange for an agreed-upon procedures audit of its GenBook and PropBook electric trading operations. The intention of the procedures audit was to demonstrate that the Company had established a clear and verifiable process from transaction initiation to final accounting with respect to its energy trading activities. The audit would cover the period of January 1, 2003 through June 30, 2003, and would be conducted and completed by October 1, 2003. The cost of the audit would be treated as an allowable expense in the 2004 Earnings Test.

8. The sixth condition was that in January 2004 the Company would file an application for Commission review of its electric trading operation, including the Company's proposal as to the Colorado regulatory treatment to be afforded the Company's trading operations, the Company's trading Business Rules, and the Company's cost assignment and cost allocation procedures related to short-term wholesale transactions. Under the rate case settlement, the parties expected that the Commission order resulting from the Company's application would govern the Colorado regulatory treatment of the Company's trading operation after December 2004. Any change in cost assignment, cost allocation, or in the trading Business Rules ordered by the Commission would apply prospectively only, beginning January 1, 2005. Finally, the Company reserved the right to terminate the ECA and implement instead an adjustment mechanism for 100 percent pass-through of Energy Costs, should the Company believe that the Commission Order does not afford the Company with sufficient opportunity to cover the risks inherent in an incentive adjustment mechanism.

9. The seventh condition was that the Company would provide funds to hire a consultant selected by the Trial Staff and the Office of Consumer Counsel (OCC) in order to provide them with technical advice and consulting services regarding prospective changes that should be made, if any, to the Colorado regulatory treatment of Public Service's trading activities. The Company's expenditures for this consultant would be fully recoverable, dollar for dollar, as a separate expense through the Interim Adjustment Clause and/or ECA, depending upon the year in which all or part of these expenditures are made.

B. Procedural History

10. On January 30, 2004, Public Service filed the application. At the March 17, 2004 Commissioners' Weekly Meeting, the Commission allowed the application to be automatically deemed complete on March 19, 2004. An intervention was filed by Holy Cross Energy (Holy Cross). A stipulation was reached between Holy Cross and the Company regarding Holy Cross' limited participation in the docket. Both the OCC and Staff of the Colorado Public Utilities Commission (Staff) intervened by filing their entry of appearance.

11. By Decision No. C04-0283, the Commission set a prehearing conference for March 31, 2004, and informed the parties that it intended to hear the case *en banc*.

12. A prehearing conference was held on March 31, 2004. In Decision No. C04-0447, the Commission granted the stipulation between Holy Cross and Public Service, set forth the filing dates for testimony, and established hearing dates of September 7 through 10, 13 and 14, 2004.

13. By Decision No. C04-0868, the Commission vacated the hearing dates of September 13 and 14, 2004 and established September 15, 2004 as an additional hearing date.

14. On September 2, 2004, Staff filed an Unopposed Motion to Vacate Hearing Dates, Reschedule Hearing Date, and Waive Response Time (the Motion). The Motion stated that the parties had engaged in extensive settlement negotiations and believed they had reached an agreement in principle. The Motion indicated that the parties intended to file the settlement no later than September 9, 2004, and requested that the current hearing dates be vacated. Staff suggested that the hearing on the proposed settlement be held on September 16, 2004. By Decision No. C04-1063, the Commission granted the Motion.

15. On September 9, 2004, Staff filed an Unopposed Motion for an Additional Day to File Proposed Settlement and Waive Response Time. By Decision No. C04-1106, the Commission granted the one-day extension.

16. On September 10, 2004, the parties filed the Stipulation and Settlement Agreement (Settlement Agreement) in this case.

17. On September 14, 2004, Public Service filed an Unopposed Motion to Remove Restriction on Proprietary Book Trading upon Commission Approval of Stipulation and Settlement Agreement. This motion asks the Commission to remove the current restriction which prevents the Company from entering into PropBook trades made on behalf of Public Service with delivery dates after December 31, 2004, absent Commission approval. This condition was imposed under the rate case settlement discussed above.

18. On September 16, 2004, the Commission held a hearing on the proposed Settlement Agreement. Oral testimony was provided by Company witnesses Stoffel and Imber, and by Staff witness Santos-Rach.

C. Findings

19. Through the application, the Company seeks the following changes to the trading Business Rules: (1) change the allocation of fixed costs of transmission between Gen and Prop Book based on proportionate usage by each book of the transmission path; (2) change the evaluation of hourly purchases to include the associated transmission costs in the Cost Calculator Program; (3) change the treatment of costs associated with Displacement Transactions for GenBook; (4) clarification of the pricing rules for transfers between Gen and Prop Book; and (5) change the Cost Calculator to address generating unit minimum issues. The Company also proposes to remove footnote 1 in order to change the 2000 Trading Stipulation that prohibits Public Service from including gains/losses from trading power plant fuels. Finally, the Company proposes to change the way margins are shared. Public Service provided two alternatives to the Commission.

20. The first alternative would establish a Defined Trading Benefit (DTB) in which ratepayers would receive a guaranteed and predefined level of trading margins, regardless of the actual margins achieved. For 2005, the DTB amount would be \$2.02 million and, for 2006, the DTB amount would be \$1.3 million. The DTB dollars would flow through the ECA as a reduction in costs. The second alternative is, after the first \$2.74 million of trading margins has been achieved (this amount represents the amount the parties removed from allowable expenses in settling the trading issues), any excess margins from the aggregated Gen and Prop Books would be shared 50/50 between customers and the Company. In no event would negative margins be shared with customers.

21. Staff and OCC filed testimony in the case. Staff opposes the continued use of the Company developed Cost Calculator Program and instead suggests that Public Service use an

industry-accepted program such as PROSYM or WinCougar; opposes a Business Rule change which would allow a generation resource to be started to make short-term sales because this is contrary to the notion of preserving or improving the system's reliability; does not oppose the other proposed Business Rule changes so long as there is a verifiable and auditable recordkeeping process; opposes transfers between Gen and Prop Book until there is a clear policy in place to allow for audit and verification; proposes to change the sharing percentages for Gen and Prop Book to 70 percent customer and 30 percent shareholder, and 30 percent customer and 70 percent shareholder, respectively; limit GenBook trades to 12 months or less; allow Public Service to recover the costs of a new Automated Deal Capturing Program; and recommends that Public Service file within 18 months of a final decision in this case a third-party report demonstrating that cost calculations have been addressed and an auditable accounting trail established. If the third-party report indicates no problems with cost assignment of trading costs, Staff would allow the removal of footnote 1 in the Trading Stipulation and allow for transfers between Gen and Prop Books. Finally Staff recommends creating a "Capital Charge" to reward ratepayers for the use of regulatory capital to support PropBook trading.

22. Within its testimony, the OCC recommended that the Commission allow the parties to conduct settlement discussions.

D. The Settlement Agreement

23. Under the Settlement Agreement, Public Service would continue to conduct electric commodity trading. The Company would allocate and record costs and share margins in accordance with the 2000 Trading Stipulation as modified by the rate case settlement agreement and this Settlement Agreement. There would be no automatic sunset or other automatic regulatory deadline on the Company's electric commodity trading operations. However, the

Company would file an application with the Commission by April 1, 2006, addressing the Company's proposed regulatory treatment of energy costs incurred after December 31, 2006. The Company's application would also address the mechanism for returning the customer's share, if any, of the trading margins earned in calendar year 2006.

24. In allowing for the continuation of electric trading, the Settlement Agreement provides that:

a) The A&G/non-production O&M adjustment established in the rate case settlement agreement and the formulae and mechanisms for the sharing of positive trading margins from the GenBook and the PropBook set forth in the rate case settlement agreement will both continue through calendar year 2006.

b) Beginning November 15, 2004, Public Service will conduct its electric commodity trading operations in accordance with the revised Business Rules. The revised Business Rules address areas concerning: reliable system operations; interruptibility of short-term wholesale sales; operation of Cabin Creek; assignment of reliability costs; priority to GenBook operations; the role of PropBook operations; transfers between Gen and Prop Books; purchase/sale criteria; displacement transactions; natural gas hedging; assignment and allocation of transmission costs; a commitment to document retention; improvements to be made to the Cost Calculator Program, additional tools and information to be provided to the Staff on the Cost Calculator Program; monitoring by the Company's Risk Management Department for compliance with its risk management policy; and a framework for making subsequent amendments to the Business Rules.

c) The proposed Settlement Agreement also provides that plans would be developed to assist Staff in the audit of the Company's compliance with the revised Business Rules. The audit plans will specify the specific records that would be maintained by the Company and other aspects to the Company's trading operations. Public Service would present to Staff for its review the audit plans within 60 days of the signing of the Settlement Agreement. Public Service agrees to incorporate Staff input into the audit plans and to provide Staff with the final plans within 90 days of the signing of the Settlement Agreement. The Parties recognize that the trading process is dynamic and changes over time. Consequently, the Parties agree to work to modify the audit plans and recognize that nothing in the Settlement Agreement shall be construed to limit in any way the statutory audit powers of the Staff.

d) In addition to the audit plans, Public Service would provide to Staff certain reports on a monthly basis within 45 days after the monthly close of the Company's books. All information provided to Staff under the Settlement Agreement with respect to the Company's electric commodity trading operation would be treated by Staff as commercially-sensitive, highly confidential information. Staff agrees to report immediately to Public Service any disclosure of confidential information to unauthorized persons. Finally, the Company agrees to consider whether additional automation of its operations is cost-effective. If the Company determines that further system improvements could be cost-effective, the Company would present its analyses to the Parties. If the Parties agree that the system improvements would be cost effective, the Parties would consider whether the margin sharing mechanisms set forth in this Settlement Agreement should be altered to permit the Company to recover the cost of the system improvements prior to calculating sharing margins. Should the Company wish to recover

the cost of system improvements by altering the margin sharing mechanism, the Company shall submit such request to the Commission for approval

E. Discussion on the Settlement Agreement

25. On the whole, the Commission believes the Settlement Agreement is in the public interest and should be approved. However, there is one aspect that the Commission believes should be modified—the issue of gas hedging for trades.

26. The revised Business Rules permit the Company to engage in natural gas transactions to hedge Generation Book Purchases for Resale, Generation Book Sales, Proprietary Book Purchases, and Proprietary Book Sales. The Rules do not permit hedging for forward purchase of energy for Native Load. Under the Settlement Agreement, natural gas hedging transactions would not become effective until the detailed audit plan for gas hedging is agreed to by the Parties and implemented. The Settlement Agreement also provided that the Parties agree to meet again within six months to determine whether an agreement can be reached on whether the Company should be permitted to engage in natural gas transactions to hedge the forward purchase of energy for Native Load.

27. The Commission believes that trading and associated hedging benefits ratepayers. Therefore, we modify the Settlement Agreement to allow Public Service to hedge natural gas for the forward purchase of energy for Native Load.

28. The Settlement Agreement also provides that the Company may not commence trades involving gas hedging until an agreed-upon audit plan is developed. The Commission is concerned that this condition does not provide a definitive date by which trades involving gas hedging will commence. Therefore, we modify the Settlement Agreement to allow Public Service to hedge natural gas for Generation Book Purchases for Resale, Generation Book Sales,

Proprietary Book Purchases, Proprietary Book Sales, and Native Load effective January 1, 2005 with the following condition.

29. Should the Parties not reach a consensus on the audit plans for the five different trading areas discussed above, Public Service will utilize its position on the elements of the audit plans for which consensus could not be reached. Prior to commencing trades that include gas hedging, Public Service will provide the Parties a copy of the audit plans it intends to follow for calendar year 2005. However, Public Service shall file monthly report(s) with the Commission in this docket and provide a copy of the monthly report(s) to the Parties for any of the five different trading areas in which consensus audit plans could not be reached. For example, if the Parties could not reach agreement on the audit plan for Native Load and for GenBook Purchases for Resale, the Company would have to file two separate reports each month for the entire calendar year 2005. For the other three general trading areas where an agreement is reached, that is, GenBook Sales, ProBook Sales, and PropBook Purchases, no monthly reports would be required.

30. These reports would include, at a minimum, the monthly aggregated number of trades for which gas was hedged; the criteria the Company used to determine why hedging was necessary; a statement on whether the hedging worked as intended; if the hedging did not work as intended, an explanation why it did not; and a statement on whether any of the Business Rules relating to gas hedging or the audit plans relating to gas hedging need modification on a going-forward basis. The Parties are encouraged to include other items in the monthly report(s) provided consensus can be reached on those additional report items.

31. At the conclusion of calendar year 2005, Staff and OCC will file a response within 45 days of the last monthly report. Their response shall include any suggestions on

changes to the Business Rules relating to gas hedging and/or the audit plans relating to gas hedging on a going-forward basis. Should any party propose a change to either the Business Rules or the audit plans, a docket would be opened and that party would carry the burden of proof.

32. Should the Parties be able to reach consensus on the audit plans for the five different trading areas discussed above prior to January 1, 2005, no monthly report(s) will be required unless they are agreed to by the Parties during the development of the consensus audit plans.

33. Finally, the Commission also approves the Unopposed Motion to Remove Restriction on Proprietary Book Trading upon Commission Approval of Stipulation and Settlement Agreement filed by Public Service.

II. ORDER

A. The Commission Orders That:

1. The Settlement Agreement filed by Public Service Company of Colorado is approved with the modifications discussed above.

2. The Unopposed Motion to Remove Restriction on Proprietary Book Trading upon Commission Approval of Stipulation and Settlement Agreement filed by Public Service Company of Colorado is approved.

3. The 20-day period to file applications for rehearing, reargument, or reconsideration, pursuant to § 40-6-114(1), C.R.S., begins on the day following the Mailed Date of this Decision.

4. This Order is effective on its Mailed Date.

**B. ADOPTED IN COMMISSIONERS' DELIBERATIONS MEETING
October 5, 2004.**

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

Commissioners