

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

In Reply Refer To:
Office of Enforcement
Docket No. PA19-3-000

January 28, 2021

El Paso Electric Company
Attention: Cynthia M. Henry
Vice President and General Counsel
P.O. Box 982
El Paso, Texas 79960

Dear Ms. Henry:

1. The Division of Audits and Accounting (DAA) within the Office of Enforcement of the Federal Energy Regulatory Commission (the Commission) has completed an audit of El Paso Electric Company (El Paso). The audit covered the period from January 1, 2016 to June 30, 2020.
2. The audit evaluated El Paso's compliance with: (1) the approved terms, conditions, and rates of its Open Access Transmission Tariff (OATT); (2) the accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101; (3) the reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. § 141.1; and (4) the regulations regarding Open Access Same-time Information Systems prescribed in 18 C.F.R. Part 37. The enclosed audit report contains four findings and ten recommendations requiring El Paso to take corrective action, and one other matter.
3. On December 31, 2020, you notified DAA that El Paso does not contest the four findings of noncompliance and corresponding recommendations. A verbatim copy of your response is included as the last section of the enclosed audit report. I hereby approve the audit report.
4. El Paso should submit its implementation plan to comply with the recommendations within 30 days of this letter order. El Paso should make quarterly submissions to DAA describing the progress made to comply with the recommendations, including the completion date for each corrective action. As directed by the audit report,

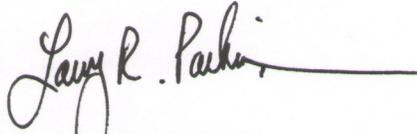
these submissions should be made no later than 30 days after the end of each calendar quarter, beginning with the first quarter after this audit report is issued, and continuing until all the corrective actions are completed.

5. The Commission delegated the authority to act on this matter to the Director of OE under 18 C.F.R. § 375.311. This letter order constitutes final agency action. El Paso may file a request for rehearing with the Commission within 30 days of the date of this order under 18 C.F.R. § 385.713.

6. This letter order is without prejudice to the Commission's right to require hereafter any adjustments it may consider proper from additional information that may come to its attention. In addition, any instance of noncompliance not addressed herein or that may occur in the future may also be subject to investigation and appropriate remedies.

7. I appreciate the courtesies extended to the auditors. If you have any questions, please contact Ms. Kristen Fleet, Acting Director and Chief Accountant, Division of Audits and Accounting at (202) 502-8063.

Sincerely,

A handwritten signature in black ink that reads "Larry R. Parkinson". The signature is written in a cursive style with a long horizontal line extending to the right.

Larry R. Parkinson
Director
Office of Enforcement

Enclosure



Federal Energy Regulatory Commission
Office of Enforcement
Division of Audits and Accounting

AUDIT REPORT

Audit of El Paso Electric Company's Compliance with:

- El Paso Electric Company's Open Access Transmission Tariff;
- The Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101;
- Reporting Requirements of the FERC Form No. 1 and FERC Supplemental Form 3-Q under 18 C.F.R. § 141.1; and
- The Regulations Regarding Open Access Same-time Information Systems Prescribed in 18 C.F.R. Part 37.

Docket No. PA19-3-000
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I. Executive Summary

A. Overview

The Division of Audits and Accounting (DAA) within the Office of Enforcement of the Federal Energy Regulatory Commission (Commission) has completed an audit of El Paso Electric Company (El Paso). The audit evaluated El Paso's compliance with: (1) the approved terms, conditions, and rates of its Open Access Transmission Tariff (OATT); (2) the accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101; (3) the reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. § 141.1; and (4) the regulations regarding Open Access Same-time Information Systems (OASIS) prescribed in 18 C.F.R. Part 37. The audit covered the period January 1, 2016 to June 30, 2020.

B. El Paso Electric Company

El Paso is a vertically integrated electric utility whose primary business is serving approximately 433,000 retail and wholesale customers in far west Texas and southern New Mexico in an area of 10,000 square miles of the Rio Grande valley. El Paso employs approximately 1,000 people who are involved in the generation, transmission, distribution, and sale of electricity at retail and wholesale. El Paso owns distribution facilities through which it provides service to its customers at retail rates and also owns transmission facilities. As a transmission service provider (TSP) in the Western Electricity Coordinating Council's (WECC) footprint, El Paso offers transmission service under a Commission approved OATT.¹

On June 1, 2019, El Paso entered into an Agreement and Plan of Merger pursuant to which El Paso will be purchased by an affiliate of the Infrastructure Investments Fund (IIF), an investment vehicle advised by J.P. Morgan Investment Management Inc. On August 13, 2019, El Paso filed with the Commission in Docket No. EC19-120-000 a joint application for authorization under section 203 of the Federal Power Act to complete the proposed merger transaction. On March 30, 2020, the Commission conditionally approved the purchase of El Paso by an indirect affiliate of IIF.²

¹ El Paso Electric Company, FERC Electric Tariff, 4th Rev., Vol. No. 1.

² *El Paso Electric Co. and Sun Jupiter Holdings LLC*, 170 FERC ¶ 61,280 (2020) (Order Conditionally Authorizing Disposition of Jurisdictional Facilities).

Transmission

El Paso owns and operates transmission lines in Texas, New Mexico, and Arizona. El Paso's transmission system is comprised of three key components:

- Local transmission – Several 345 kV, 115 kV, and 69 kV transmission lines that are interconnected within El Paso's local electrical grid;
- WECC Path 47 – Three major 345 kV transmission lines used to import/export power between WECC and El Paso (plus one 115 kV line wholly owned and utilized by Tri-State Generation and Transmission Association); and
- Eddy County DC Tie – A 200 MW High Voltage Direct Current (HVDC) terminal that interconnects El Paso's local transmission system to Southwestern Public Service Company, an Xcel Energy Company.

Through its 345 kV transmission system, El Paso is able to import and export power to and from its control area. In order to deliver energy from its remote generation at Palo Verde Nuclear Generating Station (Palo Verde Generating Station) to its service area, El Paso has to move power through Tucson Electric Company's and Salt River Project's (SRP) transmission systems to reach El Paso's 345 kV system. To facilitate the energy delivery, El Paso has transmission and power exchange agreements with those two neighboring utilities.

El Paso provides transmission services over its transmission system to eligible customers under a Commission-approved OATT.

El Paso's transmission customers are able to reserve transmission capacity through El Paso's OASIS. El Paso currently has only one NITS customer (Rio Grande Electric Cooperative, Inc.) under El Paso's OATT.

Generation and Purchased Power

El Paso owns or has significant ownership interests in five electric generating facilities providing it with a net dependable generating capability of approximately 2,157 megawatts (MW). Included in the five generating facilities is Palo Verde Generating Station, which is physically located in the Arizona Public Service Company (APS) balancing authority area, and of which El Paso owns 633 MW or 15.8 percent of the combined generation capacity of Palo Verde Units 1, 2, and 3. El Paso formerly owned a 7 percent stake in the Four Corners coal-fired power plant (Four Corners Generating Station) near Farmington, New Mexico, but sold its complete ownership stake to a subsidiary (4C Acquisitions, LLC) of Pinnacle West Capital Corporation in 2016.

In addition to these power plants, El Paso owns six small solar photovoltaic (PV) systems located in Sunland Park, New Mexico, and El Paso, Texas. El Paso has also used long-term purchase power contracts for serving its load.

C. Summary of Compliance Findings

Audit staff's compliance findings are summarized below. A detailed discussion of audit staff's findings is in section IV. Audit staff found four areas of noncompliance:

1. *Posting of Available Transfer Capability (ATC)/Total Transfer Capability (TTC) on Interconnection Paths* – El Paso did not post the ATC and TTC for nine control area to control area interconnection paths on its OASIS as required by the Commission's OASIS posting requirements. This practice may potentially hinder customers from obtaining transmission service on these paths.
2. *Use of Designated Network Resource (DNR) to Make Firm Off-System Sales* – El Paso incorrectly used a DNR to make firm off-system sales, which was inconsistent with its OATT requirements.
3. *Accounting for Joint Owner Billing* – El Paso did not functionalize portions of third-party billings characterized as administrative and general (A&G) expenses for the operation and maintenance of the Palo Verde Generating Station, the Four Corners Generating Station, and the Palo Verde Transmission Switchyard. As a result, El Paso overstated A&G expenses and understated expenses in the generating and transmission operation and maintenance (O&M) accounts.
4. *Application of Nonapproved Depreciation Rates* – El Paso applied state-approved depreciation rates to assets included in its wholesale production formula rate from 2016 through 2018, but did not file these updated depreciation rates with the Commission and obtain Commission approval prior to using them in wholesale formula rate determinations.

Other Matter

El Paso's transmission function created Transmission Service Numbers (TSN) and assigned these TSNs to its merchant function to facilitate scheduling of transmission service, which is less transparent than assigning Transmission Service Requests (TSR) created in OASIS because TSNs are manually created outside of OASIS.

D. Summary of Recommendations

Audit staff's recommendations to remedy the findings are summarized below. Detailed recommendations are included in Section IV.

Posting of ATC/TTC on Interconnection Paths

1. Update policies and procedure on posting ATC and TTC on any control area to control area interconnection path.
2. Provide training on the updated policies and procedures to employees in charge of the process of posting ATC and TTC on OASIS.
3. Apply to the Commission for guidance on or a determination of the requirement that TSPs define any control area to control area interconnection as a posted path, set forth in 18 C.F.R. § 37.6(b)(1)(i), based on El Paso's own individual circumstances, or alternatively, post ATC and TTC for all such interconnection paths in accordance with 18 C.F.R. § 37.6(b) within 30 days of the issuance of this audit report.

Use of DNRs to Make Firm Off-System Sales

4. Conduct a study to determine the cause of the error that led to the improper functioning of the macro software program that El Paso used to submit DNR terminations.
5. Develop controls based on the study conducted in response to Recommendation 4 to ensure that the software program correctly handles each DNR termination.
6. Develop policies and procedures to prevent the manual data entry errors that caused undesignation errors. Train the appropriate staff to ensure they are fully aware of the new policies and procedures.

Accounting for Joint Owner Billing

7. Review and revise policies and procedures governing the methods used to account for, track, report, and review general and administrative costs associated with joint owner billings from third parties to comply with the Commission's accounting regulations.
8. Communicate joint owner billing accounting policies and procedures to El Paso employees and provide training as necessary, to ensure that the proper

accounting procedures are followed.

Application of Nonapproved Depreciation Rates

9. Strengthen processes and procedures to ensure the use of only Commission-approved depreciation rates in the calculation of Commission-jurisdictional rates, including training for employees performing accounting functions and formula rate input calculations.
10. Strengthen processes and procedures to report changes in, and seek Commission approval to use, new or revised depreciation rates, if El Paso intends to use these rates for Commission-approved formula rates.

F. Compliance and Implementation of Recommendations

El Paso should also:

- Submit for audit staff's review El Paso's plans for implementing audit staff's recommendations. El Paso should provide these plans to audit staff within 30 days of the issuance of the final audit report in this docket.
- Submit quarterly reports to the Office of Enforcement describing El Paso's progress in completing each corrective action recommended in the final audit report in this docket. El Paso should make these nonpublic quarterly reports no later than 30 days after the end of each calendar quarter, beginning with the first quarter after the final audit report in this docket is issued, and continuing until El Paso completes all recommended corrective actions.
- Submit copies of any written policies and procedures developed in response to recommendations in the final audit report. They should be submitted for audit staff's review in the first quarterly filing after El Paso completes these products.

II. Background

A. Open Access Transmission Tariff

El Paso maintains a Commission-approved OATT that provides the terms, conditions, and rates under which El Paso provides transmission services. Under its OATT, El Paso offers two types of transmission service: point-to-point transmission service and NITS. Point-to-Point transmission service allows El Paso customers to deliver capacity and energy at designated point(s) of receipt and transfer such capacity and energy to designated point(s) of delivery on either a firm or non-firm basis. NITS allows El Paso network customers to deliver capacity and energy, either from designated network resources to serve designated network load on a firm basis or from non-designated resources to serve designated network load on a non-firm basis. The latter is termed as secondary network transmission service and has a higher curtailment priority than any non-firm point-to-point transmission service.

B. Open Access Same-time Information System

El Paso's OASIS is a web-based system that provides transmission customers information regarding El Paso's transmission system necessary for customers to make prudent business decisions. Open Access Technology International, Inc. hosts El Paso's OASIS.

The Commission adopted rules for creating and operating an OASIS in 1996 in Order No. 889.³ The Commission codified its OASIS regulations in 18 C.F.R. Part 37. Since issuing Order No. 889, the Commission has amended its OASIS regulations with new posting requirements adopted in subsequent orders including, but not limited to,

³ *Open Access Same-Time Information System and Standards of Conduct*, Order No. 889, FERC Stats. & Regs. ¶ 31,035 (1996) (cross-referenced at 75 FERC ¶ 61,078) (Order No. 889), *order on reh'g*, Order No. 889-A, FERC Stats & Regs. ¶ 31,049 (cross-referenced at 78 FERC ¶ 61,221) (Order No. 889-A), *reh'g denied*, Order No. 889-B, 81 FERC ¶ 61,253 (1997).

Order Nos. 889-A, 605,⁴ 2004,⁵ 890, and 890-A.⁶ Order No. 889 also established Standards of Conduct (SOC), which require a TSP to separate its internal or affiliated marketing function employees from its transmission function employees. The SOC regulations are found in 18 C.F.R. Part 358. Most recently, Order No. 1000 requires TSPs to include regional transmission planning data as part of their current transmission planning OASIS postings.⁷

El Paso's OASIS is the mechanism by which El Paso can offer, and its customers can reserve transmission and ancillary services in compliance with El Paso's OATT. The OASIS is the Commission-mandated control by which El Paso is to ensure that all of its transmission customers have equal access to information about El Paso's transmission system and services at the same time and in a nondiscriminatory manner.

⁴ *Open Access Same-Time Information System*, Order No. 605, FERC Stats. & Regs. ¶ 31,075 (cross-referenced at 87 FERC ¶ 61,224) (1999).

⁵ *Standards of Conduct for Transmission Providers*, Order No. 2004, 105 FERC ¶ 61,248 (2003), *order on reh'g*, Order No. 2004-A, 107 FERC ¶ 61,032, *order on reh'g*, Order No. 2004-B, 108 FERC ¶ 61,118, *order on reh'g*, Order No. 2004-C, 109 FERC ¶ 61,325 (2004), *order on reh'g*, Order No. 2004-D, 110 FERC ¶ 61,320 (2005), *vacated and remanded as it applies to natural gas pipelines sub nom. National Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831 (D.C. Cir. 2006); *see Standards of Conduct for Transmission Providers*, Order No. 690, 118 FERC ¶ 61,012, *order on reh'g*, Order No. 690-A, 118 FERC ¶ 61,229 (2007).

⁶ *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, 118 FERC ¶ 61,119 (Order No. 890), *order on reh'g*, Order No. 890-A, 121 FERC ¶ 61,297 (2007) (Order No. 890-A), *order on reh'g*, Order No. 890-B, 123 FERC ¶ 61,299 (2008), *order on reh'g*, Order No. 890-C, 126 FERC ¶ 61,228, *order on clarification*, Order No. 890-D, 129 FERC ¶ 61,126 (2009).

⁷ *Transmission Planning and Cost Allocation by Transmission Owning and Operating Public Utilities*, Order No. 1000, 136 FERC ¶ 61,051(2011), *order on reh'g*, Order No. 1000-A, 139 FERC ¶ 61,132, *order on reh'g and clarification*, Order No. 1000-B, 141 FERC ¶ 61,044 (2012), *aff'd sub nom. S.C. Pub. Serv. Auth. v. FERC*, 762 F.3d 41 (D.C. Cir. 2014).

C. Wholesale Marketing and Trading

El Paso participates in the wholesale power market, and it actively trades in the desert southwest region of the Western Interconnection through its own merchant function. El Paso's merchant function develops El Paso's generation schedules each day by optimizing El Paso's power supply portfolio, which includes El Paso's owned generation resources, long-term power purchase agreements, and power purchased in the forward, day-ahead, and real-time wholesale markets. The optimization of El Paso's supply portfolio may result in the opportunity to sell any excess energy and capacity from generation not needed to serve El Paso's native load to third parties outside of El Paso's control area when market conditions warrant. El Paso makes third-party off-system sales primarily at the Palo Verde trading hub, some at the Four Corners trading hub, and the remainder at the Greenlee trading hub. El Paso is required to undesignate any of its network resources if such a resource is used to support firm off-system sales.

D. Eddy County HVDC Tie

El Paso connects with SPS at the Eddy County HVDC Terminal near Artesia, New Mexico and has a 67% ownership in the HVDC Terminal and accompanying 345 kV transmission line connecting to the El Paso system along with the joint owner, Public Service Company of New Mexico. Through this HVDC Terminal, El Paso can access resources, when available, in the Southwest Power Pool for delivery to El Paso loads.

El Paso posts its business practices for operations of the Eddy County HVDC Terminal on its OASIS. Under its current business practices, El Paso only offers non-firm transmission service on and through the Eddy County HVDC interconnection path. El Paso performs system evaluations for each request for such non-firm service, including requests from its own merchant function for transmission service, to assess the impact on the Eddy County HVDC interconnection path.

El Paso confirmed that its practice was not to make firm transmission service over the Eddy County HVDC interconnection path available to the market even on an hourly basis.⁸ According to El Paso, the instability of the Eddy County HVDC Terminal due to aging terminal equipment prevents El Paso from offering firm transmission service over the HVDC tie. El Paso expressed concerns that terminal equipment cannot be cycled on/off frequently, and that offering firm transmission service might potentially accelerate the deterioration of the terminal's parts.

⁸ EPE does offer hourly firm transmission service under its OATT.

III. Introduction

A. Objectives

The objectives of the audit were to determine whether El Paso complied with: (1) the approved terms, conditions, and rates of its OATT; (2) the accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101; (3) the reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. § 141.1; and (4) the regulations regarding OASIS prescribed in 18 C.F.R. Part 37.

B. Scope and Methodology

Audit staff performed these actions to facilitate testing and evaluation of El Paso's compliance with Commission requirements relevant to audit objectives:

- *Reviewed Public Information* – Conducted an extensive review of public information before commencing the audit. The review provided audit staff with an understanding of El Paso's operations and finances, mergers, significant contracts, prior audit issues and other key regulatory and business activities. Examples of materials reviewed include El Paso's annual reports and SEC Forms 10-K and 10-Q, FERC Form No. 1 filings, prior FERC audit reports, company-related websites, and other relevant regulatory and media sources.
- *Identified Audit Criteria* – Identified audit criteria including Commission rules, regulations, and other requirements necessary to evaluate compliance with the audit objectives.
- *Issued Data Requests* – Issued data requests to collect audit evidence and information. The information related to internal policies, transmission operations, procedures and controls, business practices, risk management, corporate structure, contractual agreements, financial accounting and reporting activities, corporate compliance, regulatory filings, and other pertinent information. The evidence and information were used to test and evaluate compliance with Commission requirements relevant to audit objectives.
- *Conducted Teleconferences* – Held multiple teleconferences with El Paso employees to discuss audit objectives, testing, data request responses, technical and administrative matters, and compliance concerns.

- *Attended Site Visits* – Made two site visits to El Paso’s headquarters in El Paso, Texas to discuss and observe controls and procedures related to audit objectives.
- *Internal Commission Collaboration* – Conferred with other Commission staff on compliance issues to ensure audit findings were consistent with Commission precedent and policy.

Audit staff also performed several specific actions to evaluate El Paso’s compliance with all relevant requirements of this audit’s objectives including reviews of:

- *Transmission Service Offerings* – Reviewed a sample of ATC postings on El Paso’s OASIS to determine whether El Paso followed the algorithm described in the ATC calculation methodology in El Paso’s OATT. Further, reviewed El Paso records to determine whether El Paso maintained all records needed to justify its ATC calculations.
- *Transmission Service Requests (TSRs)* – Reviewed a sample of point-to-point and NITS TSRs obtained from El Paso’s OASIS to determine whether El Paso approved or denied TSRs on a nonpreferential and nondiscriminatory basis. Further, reviewed El Paso’s processing of deficient TSRs to determine whether El Paso followed the procedures in its OATT to communicate with customers to remedy such deficient TSRs.
- *Network Resource Designation/Undesignation Process* – Reviewed a sample of network resource designation/undesignation records to determine whether El Paso received and reviewed all the information that its OATT requires be submitted by network customers, including from its own wholesale power merchant function. Further, reviewed the controls and procedures that El Paso used to process requests for designation and undesignation.
- *NITS* – Reviewed a sample of NITS requests to determine whether network customers used NITS only to serve designated load.
- *Generation Interconnection Requests* – Reviewed generation interconnection requests submitted to El Paso during the audit period to determine whether El Paso met its obligations to establish each queue position and timely communicate with customers pertaining to their requests consistent with the generation interconnection procedures contained in El Paso’s OATT Attachments M and N.

- *Ancillary Services* – Reviewed El Paso’s processes and procedures for customers to obtain ancillary services to determine whether El Paso allowed its customers to make comparable arrangements themselves (self-supply) for certain ancillary services specified in the OATT.
- *Transmission Capacity Reassignments* – Examined reassignments of transmission capacity on El Paso’s transmission system to determine whether El Paso executed service agreements memorializing such reassignments and reported contracts/transactions pertaining to transmission capacity reassignments in its Electric Quarterly Reports filings.
- *OASIS* – Reviewed information posted on El Paso’s OASIS to determine whether El Paso complied with Part 37 of the Commission’s regulations, including:
 - *Posted Paths* – Reviewed all applicable transmission paths posted on OASIS.
 - *Practices for Capacity Benefit Margin Reevaluation* – Reviewed El Paso’s practices for reevaluating its CBM needs.
 - *Daily Load Postings* – Reviewed El Paso’s daily load forecast, including underlying assumptions, and actual daily peak load for the prior day.
 - *Transmission Service Products and Prices* – Reviewed El Paso’s posted prices and a summary of the terms and conditions associated with all transmission products offered to transmission customers.
 - *Ancillary Service Offerings and Prices* – Reviewed El Paso’s posted ancillary services provided or offered under the OATT and the prices of those services.
 - *Posting and Retention of Requests for the Designation/Termination of Network Resources* – Reviewed requests made on El Paso’s OASIS to determine whether: (1) requests are made on the OASIS; (2) the related information and support is retained by El Paso on its OASIS; and (3) the actual designation or termination of a network resource is noted or made on the OASIS.
 - *Justification for Denied Service Requests* – Reviewed posted reasons for any denied service request.
 - *Transmission Study Performance Metrics Reports* – Reviewed reports to

determine whether El Paso provided accurate and complete information in its quarterly transmission study performance metrics reports.

- *TSR Metrics Reports* – Reviewed reports to determine whether El Paso provided accurate and complete information in its monthly TSR metrics reports.
- *Transmission Planning Information* – Reviewed El Paso’s OASIS and other information to determine whether El Paso posted its transmission planning practices consistent with OATT requirements.
- *Generation Interconnection Queue* – Reviewed El Paso’s queue to determine whether El Paso posted a list of all interconnection requests consistent with OATT requirements and kept the list up-to-date.
- *Transmission Planning Process* – Reviewed El Paso’s transmission planning process to determine whether El Paso met the planning requirements in Attachment K of its OATT requiring El Paso to conduct its local transmission planning in a particular manner and coordinate its transmission planning with other transmission providers and stakeholders through its participation in the WestConnect region’s planning process.
- *Transmission Service Billings* – Reviewed a sample of transmission customers’ invoices to ensure El Paso charged its customers in accordance with the rates specified in El Paso’s OATT.
- *Accounting and Financial Reporting* – Reviewed El Paso’s accounting and financial reporting for select items included in El Paso’s Annual Transmission Revenue Requirement (Attachment H of El Paso’s OATT), including:
 - *FERC Form No. 1 Reporting Process and Procedures* – Reviewed El Paso’s accounting policies and procedures to comply with the financial reporting requirements contained in the FERC Form No. 1.
 - *Account Variance Analysis* – Performed analyses of those accounts reported in the FERC Form No. 1 filings with large balances, unusual activity, and/or significant year-to-year fluctuations.
 - *Significant Accounting Matters* - Tested selected accounts to ensure the nature of the costs recorded in those accounts complied with the Commission’s accounting regulations. For example, audit staff performed selected testing of these accounting matters:

- *AROs* – Reviewed El Paso’s accounting treatment for ARO-related items recorded in selected 300 series or plant-in-service accounts.
- *Depreciation* – Reviewed El Paso’s depreciation expense calculation to determine whether El Paso derived monthly depreciation expenses using approved depreciation rates on file with the Commission.
- *Income Taxes* – Reviewed supporting documentation to validate the calculation of tax accruals and deferred income taxes. Reviewed El Paso’s accounting for regulatory liability/assets for excess/deficient accumulated deferred income taxes created due to the passage of the 2017 Tax Cuts & Jobs Act.
- *Electricity Sales and Expenses* – Reviewed El Paso’s accounting for electricity sales and expenses to determine whether they were properly recorded in appropriate accounts in accordance with the Commission’s Uniform System of Accounts.

IV. Findings and Recommendations

1. Posting of Available Transfer Capability/Total Transfer Capability on Interconnection Paths

El Paso did not post the ATC and TTC for nine control area to control area interconnection paths on its OASIS as required by the Commission's OASIS posting requirements. This practice may hinder customers from obtaining transmission service on these paths.

Pertinent Guidance

- 18 C.F.R. § 37.6(b) (2020) states, in part:

Posting transfer capability. The available transfer capability on the Transmission Provider's system (ATC) and the total transfer capability (TTC) of that system shall be calculated and posted for each Posted Path as set out in this section.

- 18 C.F.R. § 37.6(b)(1)(i) (2020) states:

Posted path means any control area to control area interconnection; any path for which service is denied, curtailed or interrupted for more than 24 hours in the past 12 months; and any path for which a customer requests to have ATC or TTC posted. For this last category, the posting must continue for 180 days and thereafter until 180 days have elapsed from the most recent request for service over the requested path. For purposes of this definition, an hour includes any part of an hour during which service was denied, curtailed or interrupted.

- 18 C.F.R. § 37.6(b)(1)(iv) (2020) states:

The word *interconnection*, as used in the definition of "posted path", means all facilities connecting two adjacent systems or control areas.

Background

During the first site visit, audit staff inquired about an interconnection path, ARROYO-WM345, which was not posted on El Paso's OASIS. El Paso posted the path shortly after audit staff's inquiry. Subsequently, audit staff identified the following eight additional interconnection paths that El Paso did not define as posted paths on El Paso's OASIS:

- LUNA345-DIABLO345

- NEWMAN345-AFTON345
- LASCRC115-ARROYO115
- LASCRC115-SALOPEK115
- AIRPORTTAP115-AIRPORT115
- LARGO115-HOLLOMAN115
- AMRAD115-OROGRANDE115
- CHAPARRAL115-OROGRANDE115

Upon further discussion, El Paso acknowledged that all of the above paths are interconnection paths. El Paso explained that it did not post those interconnection paths because it does not believe there is a prospect for commercial activity on those interconnection paths. El Paso's explanation does not justify its practice of not posting these paths on OASIS. Under 18 C.F.R. § 37.6(b)(1)(i), any control area to control area interconnection path is defined as a posted path. There is nothing in Commission regulations or precedent that allows a TSP discretion to not post ATC/TTC on any interconnection path based on its belief that there is no prospect for commercial activity.

Furthermore, El Paso explained that it can only post a path where the point of receipt (POR) is a point where power can be received into the El Paso system for delivery, and the corresponding point of delivery (POD) is a point at which any third party is capable of receiving power. In fact, El Paso has registered with North American Energy Standards Board (NAESB) most of the points associated with the transmission paths at issue as either POR, POD, or both. As a TSP, El Paso should post these paths, and determine and post ATC/TTC for these paths, on its OASIS to allow its customers to decide where to receive and deliver power.

If El Paso believes that, given its own individual circumstances, there is not any potential need or usefulness in defining any one or more of these interconnection paths as a posted path, it should consider applying to the Commission for guidance on or a determination of the posting requirements set forth in 18 C.F.R. § 37.6(b).

Recommendations

We recommend that El Paso:

1. Update policies and procedure on posting ATC and TTC on any control area to control area interconnection path.
2. Provide training on the updated policies and procedures to employees in charge of the process of posting ATC and TTC on OASIS.
3. Apply to the Commission for guidance on or a determination of the requirement

that TSPs define any control area to control area interconnection as a posted path, set forth in 18 C.F.R. § 37.6(b)(1)(i), based on El Paso's own individual circumstances, or alternatively, post ATC and TTC for all such interconnection paths in accordance with 18 C.F.R. § 37.6(b) within 30 days of the issuance of this audit report.

2. Use of Designated Network Resource to Make Firm Off-System Sales

El Paso incorrectly used a DNR to make firm off-system sales, which was inconsistent with its OATT requirements.

Pertinent Guidance

- OATT Section 30.1, Designation of Network Resources, states:

Network Resources shall include all generation owned, purchased or leased by the Network Customer designated to serve Network Load under the Tariff. For purposes of temporary termination under Section 30.3, all or part of such generation associated with a NERC-registered Point of Receipt, behind which there are no transmission constraints, may be treated as a single Network Resource. Network Resources may not include resources, or any portion thereof, that are committed for sale to nondesignated third party load or otherwise cannot be called upon to meet the Network Customer's Network Load on a non-interruptible basis, except for purposes of fulfilling obligations under a reserve sharing program. Any owned or purchased resources that were serving the Network Customer's loads under firm agreements entered into on or before the Service Commencement Date shall initially be designated as Network Resources until the Network Customer terminates the designation of such resources.

Background

Audit staff analyzed the hourly transactional data for a randomly selected period from June 1, 2017 through August 31, 2018. This analysis identified hours in which El Paso incorrectly used a DNR to facilitate firm off-system sales. Audit staff found that this error occurred because El Paso's software program did not function as designed when automating its submission of DNR termination requests and human input errors caused a duplicate designation that under-calculated the level of termination. The total number of hours in which improper transactions occurred accounted for approximately 4 percent of total operational hours in the period from June 1, 2017 through August 31, 2018.

According to its OATT, Section 30.1, El Paso is not allowed to use any portion of a DNR to support firm off-system sales except for purposes of fulfilling obligations under a reserve sharing program. El Paso should have undesignated the portion of the network resource necessary to make firm off-system sales. The use of a DNR for firm off-system sales can prevent El Paso from calling upon the DNR if power is needed to meet El Paso's native load. Audit staff's review of the transmission service request data for this period revealed that these improper transactions did not cause adverse impacts on other customer's requests for transmission service on affected paths.

Recommendations

We recommend that El Paso:

4. Conduct a study to determine the cause of the error that led to the improper functioning of the macro software program that El Paso used to submit DNR terminations.
5. Develop controls based on the study conducted in response to Recommendation 4 to ensure that the software program correctly handles each DNR termination.
6. Develop policies and procedures to prevent the manual data entry errors that caused undesignation errors. Train the appropriate staff to ensure they are fully aware of the new policies and procedures.

3. Accounting for Joint Owner Billing

El Paso did not functionalize portions of third-party billings characterized as A&G expenses for the operation and maintenance of the Palo Verde Generating Station, the Four Corners Generating Station, and the Palo Verde Transmission Switchyard. As a result, El Paso overstated A&G expenses and understated expenses in the generating and transmission O&M accounts.

Pertinent Guidance

- 18 C.F.R. Part 101, Account 524, Miscellaneous nuclear power expenses (Major only), states in relevant part:

This account shall include the cost of labor, materials used and expenses incurred which are not specifically provided for or are not readily assignable to other nuclear generation operation accounts.

- 18 C.F.R. Part 101, Account 549, Miscellaneous Other Power Generation Expenses (Major Only), states in relevant part:

This account shall include the cost of labor, materials used and expenses incurred in the operation of other power generating stations which are not specifically provided for or are not readily assignable to other generation expense accounts.

- 18 C.F.R. Part 101, Account 566, Miscellaneous Transmission Expenses (Major Only), states in relevant part:

This account shall include the cost of labor, materials used and expenses incurred in transmission map and record work, transmission office expenses, and other transmission expenses not provided for elsewhere.

- 18 C.F.R. Part 101, Account 930.2, Miscellaneous General Expenses, states in relevant part:

This account shall include the cost of labor and expenses incurred in connection with the general management of the utility not provided for elsewhere.

- 18 C.F.R. Part 101, Operating Expense Instruction No. 2(A), Maintenance, states:

A. The cost of maintenance chargeable to the various operating expense and clearing accounts includes labor, materials, overheads and other expenses incurred in maintenance work. A list of work operations applicable generally to utility plant is included hereunder. Other work operations applicable to specific classes of plant are listed in functional maintenance expense accounts.

Background

Audit staff reviewed the expenses recorded in various A&G accounts in El Paso's FERC Form No. 1 filings to determine whether it used appropriate accounting. Based on this review, audit staff identified several instances where El Paso incorrectly recorded expenses associated with two power generating stations⁹ and a transmission facility¹⁰ in Account 930.2, Miscellaneous General Expenses. Audit staff found that these were costs from invoices received from third parties for El Paso's share of the costs related to operating and maintaining jointly-owned generating stations and a transmission facility.

During the audit period, El Paso owned a 15.8 percent interest in the Palo Verde Generating Station and a seven percent interest in Units 4 and 5 at Four Corners Generating Station. APS is the operating agent of both the Palo Verde and Four Corners Generating Stations. El Paso also has joint ownership of a transmission switchyard located at the Palo Verde Generating Station, which is operated and maintained by SRP.

On a monthly basis, El Paso received billings from APS and SRP for El Paso's pro rata share of the operating expenses associated with operating and maintaining the generating stations and transmission switchyard. APS and SRP provided invoices that listed the O&M expenses and A&G expenses incurred for the generating and transmission facilities by FERC Uniform System of Accounts account. El Paso recorded these costs in the same FERC accounts that were listed by APS and SRP in their invoices.

However, the billings from APS and SRP are third-party costs directly attributable to supporting the operation and maintenance of the Palo Verde and Four Corners generating stations and of the transmission switchyard. Under Commission regulations,

⁹ The expenses were associated with the Palo Verde Generating Station and the Four Corners Generating Station.

¹⁰ The transmission facility was the Palo Verde Transmission Switchyard.

expenses should be assigned to their specific functions when applicable.¹¹ Therefore, the costs from APS's billings for the operation and maintenance of the Palo Verde and Four Corners Generating Stations should be functionalized to the appropriate generation expense account, rather than to an A&G expense account. El Paso should have used Account 524 for expenses incurred at Palo Verde Generating Station and Account 549 for expenses incurred at Four Corners Generating Station. The costs from SRP's billings for the operation and maintenance of the Palo Verde Transmission Switchyard should be functionalized to the appropriate transmission expense account.

Recommendations

We recommend that El Paso:

7. Review and revise policies and procedures governing the methods used to account for, track, report, and review general and administrative costs associated with joint owner billings from third parties to comply with the Commission's accounting regulations.
8. Communicate joint owner billing accounting policies and procedures to El Paso employees and provide training as necessary, to ensure that the proper accounting procedures are followed.

¹¹ 18 C.F.R. Part 101, Operating Expense Instruction 2.

4. Application of Nonapproved Depreciation Rates

El Paso applied state-approved depreciation rates to assets included in its wholesale production formula rate from 2016 through 2018, but did not file these updated depreciation rates with the Commission and obtain Commission approval prior to using them in wholesale formula rate determinations.

Pertinent Guidance

- 18 C.F.R. § 35.1(e) (2020) states:

No public utility shall, directly or indirectly, demand, charge, collect or receive any rate, charge or compensation for or in connection with electric service subject to the jurisdiction of the Commission, or impose any classification, practice, rule, regulation or contract with respect thereto, which is different from that provided in a rate schedule required to be on file with this Commission unless otherwise specifically provided by order of the Commission for good cause shown.

- In Order No. 618, footnote 25, the Commission states that:

[It] authorizes utilities to change their method of depreciation for accounting purposes *only*; it does not authorize any utility to change prices charged for power sales or transmission services (whether determined by stated rates or formula rates) to reflect a change in depreciation.

To change prices charged for power sales or transmission services (whether determined by stated rates or formula rates) to reflect a change in depreciation, a utility would first have to make a filing with us, pursuant to section 205 or 206 [of the Federal Power Act], as appropriate, to that effect.¹²

Background

Audit staff found that El Paso applied state-approved updated depreciation rates to its wholesale production formula rate during the audit period. The state-approved depreciation rates were approved by both the Public Utility Commission of Texas and the New Mexico Public Regulation Commission, as part of a depreciation study undertaken

¹² *Depreciation Accounting*, Order No. 618, 92 FERC ¶ 61,078, at n.25 (2000).

for El Paso's retail rates, and went into effect on January 1, 2016. El Paso subsequently reported these state-approved depreciation rates in its FERC Form No. 1 filings from 2016 through 2018, but did not seek the Commission's approval for the application of such updated rates to a Commission-approved formula rate. Consistent with Order No. 618, El Paso should have filed these updated depreciation rates with the Commission and obtained Commission approval prior to using them for a wholesale formula rate.

After several discussions with audit staff, El Paso filed updated depreciation rates with the Commission in Docket No. ER19-2893-000 on September 27, 2019, and subsequently amended its filing on November 20, 2019. On January 10, 2020, the Commission issued a delegated letter order that accepted El Paso's updated depreciation rates, but advised El Paso to file updated depreciation rates in a more timely manner in the future.¹³

Recommendations

We recommend that El Paso:

9. Strengthen processes and procedures to ensure the use of only Commission-approved depreciation rates in the calculation of Commission-jurisdictional rates, including training for employees performing accounting functions and formula rate input calculations.
10. Strengthen processes and procedures to report changes in, and seek Commission approval to use, new or revised depreciation rates, if El Paso intends to use these rates for Commission-approved formula rates.

¹³ *El Paso Elec. Co.*, Docket No. ER19-2893-001, at n.3 (Jan. 10, 2020) (delegated letter order) ("In the future, El Paso should file updated depreciation rates in a more timely manner.").

V. Other Matter

1. Use of Transmission Service Numbers

El Paso's transmission function created TSNs and assigned these TSNs to its merchant function to facilitate scheduling of transmission service, which is less transparent than assigning TSRs created in OASIS because TSNs are manually created outside of OASIS.

Background

In Order No. 889, the Commission stated that open access non-discriminatory transmission service requires that information about the transmission system must be made available to all transmission customers at the same time.¹⁴ This means that public utilities must make available to others the same transmission information that is available to their own employees, including their own merchant function, and that is pertinent to decisions they make involving the sale or purchase of electricity.

During the audit, audit staff learned that El Paso's transmission function created a number of TSNs and assigned them to its own merchant function to facilitate scheduling of transmission service. Although audit staff did not have evidence to show El Paso's merchant function misused these TSNs, audit staff is concerned about the transparency of TSNs, and questioned the need for creating TSNs, instead of using TSRs.

Compared to TSNs, TSRs provide more transparency in two primary ways. First, TSRs are automatically posted on OASIS. Second, while all transmission schedules are posted on OASIS, postings for schedules associated with TSRs include more information than postings for schedules associated with TSNs. El Paso neither posted its TSN practice nor listed its TSNs on its OASIS. Accordingly, by using TSNs, El Paso scheduled transmission service that was not made available to all transmission customers at the same time.

In addition, audit staff noticed that El Paso's transmission function created a few TSNs that its merchant function should have reserved through OASIS like nonaffiliated transmission customers would be required to do. For example, El Paso's transmission function created the following TSNs for El Paso's merchant function to use for secondary network service to move power from various locations to serve El Paso's native load:

¹⁴ Order No. 889, 75 FERC ¶ 61,078 at section III.A (1996), *order on reh'g*, Order No. 889-A, 78 FERC ¶ 61,221, *reh'g denied*, Order No. 889-B, 81 FERC ¶ 61,253 (1997).

- EPEAF6NN
- EPEHI6NN
- EPEWM6NN
- EPESP6NN

El Paso's merchant function could have reserved secondary network service directly through OASIS, just like nonaffiliated customers would have done.

We encourage El Paso to reduce the use of TSNs when possible.

VI. Company Response



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December 31, 2020

Kristen Fleet
Acting Director and Chief Accountant
Division of Audits and Accounting
Office of Enforcement
Federal Energy Regulatory Commission
888 First Street NE, Room 51-59
Washington, DC 20426

RE: El Paso Electric Company, Docket No. PA19-3-000

Dear Ms. Fleet:

El Paso Electric Company ("EPE") does not contest the findings and recommendations in the draft audit report sent by the Division of Audits and Accounting ("DAA") within the Office of Enforcement on December 23, 2020. However, as discussed more fully in Exhibit A, EPE has concerns with, and respectfully disagrees with, the finding and recommendations associated with transmission path posting. EPE appreciates the opportunity offered in the draft report to pursue guidance on the matter from the Commission.

Within 30 days of the issuance of a final audit report in this docket, EPE will submit, for DAA's review, an implementation plan identifying how the company will comply with the recommendations contained in the draft report. Compliance with the Commission's rules and regulations is a matter EPE takes seriously, and the recommendations offered in the draft audit report provide an opportunity to further improve EPE's FERC compliance programs.

Finally, we understand and appreciate the efforts that go into a Commission audit, and EPE thanks the entire audit team for their responsiveness and professionalism throughout the course of this audit.

Respectfully submitted,

/s/ Cynthia Henry

Cynthia Henry
VP - General Counsel
El Paso Electric Company

EXHIBIT A**Draft Finding #1: Posting of Available Transfer Capability/Total Transfer Capability on Interconnection Paths**

The draft audit report finds that EPE did not post the available transfer capability (“ATC”) and Total Transfer Capability (“TTC”) for several identified control area to control area interconnection paths on its OASIS.

Contrary to this finding, EPE believes that its path postings comply with the Commission’s rules and regulations. EPE’s identification of which paths should be posted is based on section 37.6(b) of the Commission’s regulations (where the Commission’s posted path requirements are found), which defines ATC in terms of the capability in the physical transmission network for further commercial activity. For each of the locations identified in the finding, there is no prospect for commercial activity within the meaning of the Commission’s regulations (*e.g.*, no power to be received into the EPE transmission system at that location and/or no load to deliver power to from the EPE transmission system at that location). EPE also notes that transmission customers seeking long-term firm point-to-point transmission service are required in Section 17.2(iii) of the EPE OATT (which is based on the Commission’s *pro forma* OATT), to identify the entity at the POR that is to deliver power to EPE for receipt into the EPE transmission system at that location and to identify the entity at the POD that is to receive power from EPE at that location, in order to have a Completed Application for service, which is a necessary prerequisite for EPE to process a customer’s transmission service request.

EPE’s transmission paths currently posted on OASIS already include many transmission paths to and from all points of interconnection between the EPE transmission system and interconnected transmission systems in adjacent control areas. However, the first line segment emanating from the interconnection point is not always posted by EPE as a stand-alone path. Consideration is given to whether there is a source of power to allow the point to serve as a Point of Receipt (“POR”) or a load or customer that would allow the point to serve as a Point of Delivery (“POD”).

ARROYO-WM345 EXAMPLE

Take, for example, the draft report’s identification of ARROYO-WM345 as a location that EPE should post as a path on OASIS:

- WM345 is a location where the EPE transmission system in the EPE control area interconnects at West Mesa with the Public Service Company of New Mexico (“PNM”) transmission system in the PNM control area at 345kV.
- EPE posts many transmission paths to and from West Mesa. Points at which power can be received into the EPE transmission system for delivery to West Mesa are posted as transmission paths. In addition, points at which power received into the EPE transmission system at West Mesa can be delivered from the EPE transmission system are posted as transmission paths.
- EPE has not historically posted ARROYO-WM345 as a path. Arroyo-to-West Mesa is a line segment. It is the first segment in the 345-kV transmission line to and from the

EPE/PNM interconnected interface at West Mesa. Arroyo is not a location at which EPE can sell point-to-point transmission service, since there is no source of power at Arroyo that could allow Arroyo to act as a POR. In other words, no power can be received into the EPE transmission system at Arroyo for delivery to a West Mesa POD. The same is true in the opposite direction: there is no load or customer at Arroyo that would allow Arroyo to serve as a POD for the sale of transmission services under EPE's OATT. Simply stated, no power can be physically delivered at Arroyo from a West Mesa Point of Receipt.

- During the course of the audit, Audit Staff strongly recommended that EPE begin posting ARROYO-WM345 as a transmission path on OASIS. EPE did so, even though EPE believes that the Commission's regulations do not require this and is concerned that such a posting presents the false impression that the EPE transmission system is capable of providing point-to-point transmission service under the OATT with Arroyo serving as a point of service. A POR is defined in the OATT as a point of interconnection on the Transmission Provider's Transmission System where capacity and energy will be made available to the Transmission Provider by the Delivering Party under Part II of the OATT. A POD is defined in the OATT as a point on the Transmission Provider's Transmission System where capacity and energy transmitted by the Transmission Provider will be made available to the Receiving Party under Part II of the OATT. ARROYO is not eligible as a POR and POD under these Commission definitions. The same is true with respect to the other locations identified in the draft audit report.

In short, EPE does not agree with the draft report's reliance on an interpretation of Section 37.6(b)(1)(i) (addressing control area to control area interconnections) to find that compliance with this requirement cannot be achieved without classifying, as a stand-alone transmission path, the first line segment that emanates to and from a third-party transmission system interconnection, without regard to the line segment's ability to be used as a point for the receipt or delivery of power under the OATT.