108 FERC ¶ 61, 219
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, and Joseph T. Kelliher.

San Diego Gas & Electric Company

v. Docket Nos. EL00-95-098
EL00-95-102

Sellers of Energy and Ancillary Services
Into Markets Operated by the California
Independent System Operator and the
California Power Exchange

Investigation of Practices of the California
Independent System Operator and the
California Power Exchange

Docket Nos. EL00-98-086
EL00-98-090

ORDER ON AUDITOR SELECTION AND REQUEST FOR WAIVER
AND CLARIFYING AUDIT ISSUES

(Issued September 2, 2004)

1. In this order, the Commission assigns an independent auditor to review data from fuel cost allowance claimants and grants in part and denies in part certain parties' request for waiver from filing requirements established in the order issued May 12, 2004 in this proceeding.[1] The Commission also agrees to build in more time for the audit process to be completed and clarifies allocation of the costs of the audit. These actions benefit customers by allowing the audit to proceed quickly and cost-effectively while minimizing the burden to those whose participation may not be necessary.[2]

[1] San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services, *et al*., 107 FERC ¶ 61,166 (2004), *reh'g pending* (May 12 Order).

[2] We intend to act on other issues raised in the pleadings in a later order.

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Background

2. Early in this proceeding, the Commission determined that the California electric market structure and rules for wholesale sales of electric energy were seriously flawed and that, along with other factors, they caused unjust and unreasonable rates.[3] To remedy this, the Commission held that prices for the period October 2, 2000 through June 20, 2001 must be reset to just and reasonable levels. The Commission adopted a mitigated market clearing price (MMCP) that would serve as a proxy for competitively set market clearing prices and ruled that any excess over the MMCP would be refunded to buyers.[4] The formula to determine the MMCP is based on the marginal cost of the last unit dispatched to meet the load of the California Independent System Operator Corporation (CAISO) in its real time market in each hour for the refund period. For the purpose of identifying the gas price portion of the formula, the Commission originally relied on published natural gas spot prices but later concluded that the prices established in the California gas spot market were unreliable, and the Commission modified the MMCP formula to use natural gas producing-area prices plus a tariff rate transportation allowance.[5]

3. The Commission also adopted a cost allowance option for individual generators to reflect any gas prices generators actually paid above the production area index plus transportation costs. The Commission directed generators that wished to recover fuel costs above the index price for spot gas purchases made during the refund period to submit information on their actual daily cost of gas. In the alternative, as the Commission first stated in June 2001, sellers have the option of recovering certain gas costs by proposing in a section 205 filing their cost-based rates for their entire portfolio of generating facilities (with support for these costs) in the region of the Western Electricity Coordinating Council.[6] In the May 12 Order, the Commission addressed concerns about the fuel cost allowance raised on rehearing of earlier orders and directed parties to have their fuel cost allowance claims verified by an independent auditor, attested to by a responsible company official, and submitted directly to the CAISO.

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[3] San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services, *et al*., 93 FERC ¶ 61,121 at 61,349-50, 61,366 (2000).

[4] San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services, *et al*., 96 FERC ¶ 61,120 (2001).

[5] *See* San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services, *et al*., 102 FERC ¶ 61,317 at P 59 (2003).

[6] *See* San Diego Gas & Electric Company, *et al*., 95 FERC ¶ 61,418 at 62,564 (2001).

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Auditor Selection

4. The May 12 Order provided that the parties must all agree on the choice of the independent auditor and inform the Commission of their choice. In the event the parties were unable to agree, the Commission directed that they should submit a list of no more than three proposed auditors, and the Commission itself would choose the auditor for the parties.[7] The parties report that their attempts to reach agreement on an auditor were unsuccessful.

5. A large number of parties, calling themselves Designated Claimants,[8] propose Ernst & Young as the sole independent fuel cost allowance auditor. Designated Claimants assert that Ernst & Young is qualified to perform the audit function, is already familiar with the refund proceeding, and has the resources to complete the task.

6. California Parties[9] propose that Ernst & Young and Potomac Economics, Ltd. (Potomac Economics) work collaboratively together on the audit. Under this proposal, Ernst & Young would verify the accuracy and completeness of the input data, while Potomac Economics would "be responsible for testing the logic and accuracy of the models the generators use to compute the various components of the fuel cost allowance in order to ensure that the models are working as intended and that the methodology the generators use is consistent with the Commission's orders."[10] The California Parties oppose the sole use of Ernst & Young because they believe that the firm does not have the necessary level of expertise, is not sufficiently independent, and is not the most cost-effective alternative.

7. The Arizona Electric Power Cooperative, Inc. (AEPCO) submitted separate comments proposing a team of the economics/energy consulting firm of Energy Ventures Analysis, Inc. (EVA) and the CPA firm of Morgan Franklin Corporation (Morgan Franklin). AEPCO prefers this approach because, although it believes Ernst & Young is

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[7] *See* May 12 Order at P 75.

[8] Designated Claimants represent 13 parties who support the designation of Ernst & Young as the independent auditor and 3 additional parties who are not supporting, but do not oppose, the selection of Ernst & Young.

[9] The California Parties are the People of the State of California *ex rel*. Bill Lockyer, Attorney General, the California Electricity Oversight Board, the California Public Utilities Commission, Pacific Gas and Electric Company, and Southern California Edison Company.

[10] California Parties' Proposal for the Independent Auditor at 2.

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qualified, it is concerned that its costs will be high. AEPCO states that retaining any of the "big four" auditing firms would be very expensive, and requests that it be able to use a different auditor than the other sellers. To support its proposed use of EVA and Morgan Franklin, AEPCO contends that its allowance "will be factually and even conceptually distinct from those of other sellers"[11] as it is the only non-jurisdictional out-of-state claimant, and thus its using a different firm should not be objectionable.

8. AEPCO and Designated Claimants both believe that the California Parties' two-firm proposal would incur unnecessary, duplicative costs and would create inefficiencies that would delay the audit process. AEPCO further argues that California should not have equal standing in choosing the auditor.

9. In light of their request for a waiver, discussed below, Williams Power Company, Inc. (Williams) and Dynegy Parties[12] state that they take no position on the selection of an independent auditor, but Williams notes that it would be unable to use Ernst & Young due to potential conflict issues. Three parties chose not to submit an auditor preference.

Commission Determination

10. We will accept Designated Claimants' proposal to select Ernst & Young as the sole independent fuel cost allowance auditor. We reject the California Parties' proposal to hire Potomac Economics in addition to the chosen auditor. The Commission directed the use of a single, independent auditor[13] because the auditing evaluation to be performed requires one consistent interpretation by an independent entity with expertise in the area. Our intent in establishing the independent auditor and other requirements was to streamline this proceeding and to make sure that the claims filed meet the standards set in our May 12 Order and that the models are consistent with the methodology laid out in that and earlier orders. We note that in addition to a staff with considerable utility industry experience, Ernst & Young's credentials include previous experience auditing a fuel cost allowance claim.

11. For the same reasons as described above, we will reject AEPCO's proposal to use a separate consulting firm. Notwithstanding AEPCO's claims of uniqueness, it is our belief that the use of one auditor, rather than many, will allow for increased efficiency and consistency in reviewing, verifying and evaluating these claims. Regarding

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[11] Comments of Arizona Electric Power Cooperative, Inc. Regarding Independent Auditor Selection at 3.

[12] Dynegy Parties include Dynegy, Inc. and NRG Energy, Inc.

[13] May 12 Order at P 77-78.

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AEPCO's concerns about the costs of retaining Ernst & Young, we note that as AEPCO represents one of the smallest claimants, their pro-rata share of the costs should be similarly small.[14] We further note that AEPCO states that its concerns would be largely ameliorated if they were assured that the audited results "would be subject to at most an expedited review by the Commission without further procedural delay and skirmishing."[15] We direct AEPCO's attention to ordering paragraph (C) of the May 12 Order which states that parties are directed to submit their fuel cost allowance claims "directly to the CAISO."

12. We are not convinced by California Parties' assertion that Ernst & Young is not sufficiently independent to perform the functions assigned to the independent auditor in this proceeding. California Parties do not substantiate this claim, other than to point out that Ernst & Young was involved in auditing Reliant's May 2003 submission. The Commission finds that the earlier work does not prejudice Ernst & Young and in fact provides them with experience in auditing generators' submissions. The auditor is an independent firm bound by professional accounting standards. The Commission has clearly spelled out the methodology in its May 22 Order and the auditors are merely verifying the data and format of the generators' submissions. California Parties also argue that Ernst & Young made a mistake in its earlier audit of Reliant's fuel cost allowance claim. We note that making a mistake (which it subsequently corrected) does not amount to a lack of objectivity. To the contrary, to the degree that Ernst & Young has previous experience performing an audit of similar function, we believe this will help provide expertise in efficiently and appropriately applying the directives of our May 12 Order.

Costs Of Audit Procedure

13. The City of Los Angeles Department of Water and Power (LADWP), Mirant Generators,[16] and AEPCO all argue that the sellers should not bear the full (if any) costs

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[14] Ernst & Young has estimated their audit fees to be 1 to 3 percent of the total fuel cost allowance claim. Excluding any possible settlements, total audit fees would range from at least $5 to $15 million. Factoring the recently approved Williams settlement, this figure is reduced to $4 to 12 million. Any further settlements would similarly reduce overall audit costs.

[15] Comments of Arizona Electric Power Cooperative, Inc. Regarding Independent Auditor Selection at 2, n. 1.

[16] Mirant Generators include: Mirant Generators California LLC, Mirant Generators Delta, LLC, Mirant Generators Potrero LLC, and Mirant Americas Energy Marketing, LP.

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of the audit. LADWP requests clarification that the Commission intended for the costs of the audit to be allocated in the same manner as the recovery of the fuel cost allowance. LADWP submits that this would be consistent with the purpose of the fuel cost allowance, *i.e.*, allowing sellers to recover their individual fuel cost allowance as a dollar-for-dollar offset against their individual refund liability. The result is that the costs would be recovered from the buyers that participated in the California energy markets. Mirant Generators argue similarly that since the California Parties seek the audit, they alone should bear the costs associated with verifying the generators' claims, or at least the cost should be shared by the California Parties. Finally, AEPCO argues that California Parties received equal voice in the selection of the auditor and thus should bear an equal portion of the audit cost. AEPCO further contends that the sellers' cost of the audit should be included in the allowance as a "lump-sum additive," noting that otherwise, sellers would not be made entirely whole for the costs they incurred.

14. The California Parties respond[17] that the fuel cost allowance is an offset to the remedy for the unjust and unreasonable prices paid for electricity. They note that the purpose of the audit is to provide assurances of the validity of the claimants' requests to recover their actual costs and that placing the costs of justifying the proposed cost recovery on anyone other than the claimants would be unjustified. They continue that the sellers should bear their own litigation costs, just as they bear any other costs of litigation. They argue that it is unreasonable to expect the victims of market dysfunction and price manipulation to "pay for an audit that will allow sellers to recover revenues even greater than the mitigated market prices."[18] In addition, California Parties assert that assessing the audit costs on the basis of service that was taken in the past violates the filed rate doctrine and the rule against retroactive ratemaking.

Commission Determination

15. We agree with California Parties' position that all audit costs should be borne by the generators. The use of an independent auditor provides third party verification that benefits generators by enabling them to fully demonstrate and receive payment for the costs of fuel they incurred to make mitigated electricity sales. As such, the cost of an auditor is a litigation expense, which is generally borne by the filing entity. We also note that any generators that would incur greater preparatory and auditor costs than the benefits they would receive from submitting their claims are free to forego their fuel cost allowance claims.

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[17] Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2004), prohibits an answer to a request for rehearing unless otherwise ordered by the decisional authority. We will accept California Parties' answer because it has provided information that assisted us in our decision-making process.

[18] California Parties Answer to Requests for Clarification at 4.

16. Contrary to Mirant Generators' assertion that California Parties have sought this audit, it was the Commission, in its May 12 Order, that directed the use of an independent auditor in order to resolve the fuel cost allowance claims in an efficient and equitable manner. California Parties had in fact argued the need for a full evidentiary hearing. The fact that California Parties played a role selecting the auditor has no bearing on who should pay the costs of the audit. California Parties have an interest in ensuring a qualified auditor is chosen, but the expense of the audit rightfully falls on the generators.

17. We are not persuaded that generators should be spared the costs of the audit, arguing that otherwise they will not be made whole for the fuel costs they incurred. If the Commission had granted California Parties' request for an evidentiary hearing, or instituted another process for the verification of the fuel cost allowance claims, then the generators would have had to incur other litigation expenses in the place of the auditor costs in order to pursue their claims. While the Commission will not entertain the recovery of audit costs as an offset or additional claim in the refund proceeding, we note that generators have the opportunity to seek to recover these costs through their future power sales, whether at cost or market.

Request For Waiver And Process For Claimants Who Settle

18. Williams, the Dynegy Parties, and the California Parties filed an Expedited Joint Request that the Commission waive the application of the May 12 Order for Williams and Dynegy Parties. They note that they are in various stages of settling their refund-related issues, including the fuel cost allowance claims, as between the settling parties. They state that, once the settlements are finalized and approved, the respective parties will withdraw their opposition to the fuel cost allowance claims. The filing parties note that California Parties were the only parties that challenged the fuel costs allowance claims of the Dynegy Parties, and the California Utilities[19] were the only parties to challenge the fuel cost allowance claim of Williams. They contend that it would be inefficient and unduly burdensome for the Commission to require compliance with the auditing procedures set forth in the May 12 Order by the Dynegy Parties and Williams. By granting the request, they state that the Commission would enable them to focus their attention on settlement. Although the filing parties do not anticipate that any non-settling parties will continue to litigate fuel cost allowance issues with either Dynegy Parties or Williams, they note that should this occur the Commission could take appropriate action at that time to require compliance with some or all of the requirements of the May 12 Order.

[19] The California Utilities include: Pacific Gas & Electric Company, Southern California Edison Company, and San Diego Gas & Electric Company.

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19. The Northern California Power Agency (NCPA) filed an answer to the Expedited Joint Request. NCPA states that it does not oppose a limited waiver with respect to just the settling parties but would oppose a broader waiver that would release Dynegy Parties and Williams from all requirements of the May 12 Order. NCPA notes that it has not yet decided whether to join in either settlement and asserts that it would be inappropriate for the Commission to approve a general waiver unless Dynegy Parties and Williams are willing to forego any fuel cost allowance claim with respect to entities that do not opt-in to their settlements. Finally, NCPA notes that the Williams settlement offer "includes a fuel cost allowance for the period from October 2, 2000 to June 20, 2001, that is 50 percent of the amount Williams claimed in its May 12, 2003 fuel cost allowance filing. . . . If the Commission were to grant Dynegy and Williams a general waiver of the independent auditor and other requirements established by the [May 12 Order], then the Commission should itself perform the same sort of detailed audit of the fuel cost allowance claims that Dynegy and Williams have submitted."[20]

20. On July 20, 2004, Duke Energy North America, LLC and Duke Energy Trading and Marketing L.L.C. (Duke) and the California Parties jointly filed a motion for waiver of the fuel cost allowance filing requirements with respect to Duke's claim. They explain that they have reached a settlement of the refund proceeding as between the settling parties, including resolution of Duke's fuel cost allowance claim, and request that the Commission waive the application of the May 12 Order as to Duke. They assert that granting the motion will facilitate the settlement and avoid wasteful and counterproductive filings and audits.

21. On July 27, 2004, the City of Vernon, California (Vernon) filed a motion for leave to answer one day out-of-time and answer in opposition to join motion for waiver of fuel costs allowance filing requirements. Vernon asserts that it would be unduly discriminatory for the Commission to find that the verification procedures are only necessary if fuel costs at issue are to be charged to California Parties and are not necessary if the costs at issue are to be charged solely to other parties. Vernon requests that the Commission deny Duke and California Parties' request for waiver and that the Commission require that whether or not a Duke settlement is eventually submitted and approved as to California Parties, any fuel costs Duke seeks to collect from non-settling parties must be appropriately supported, verified, and reviewed.

Commission Determination

22. We cannot approve a general waiver of the requirements established by the May 12 Order for any claimant because at least one party has decided not to opt-into the

[20] Answer of NCPA to Expedited Joint Request at 4-5.

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Williams settlement,[21] and others may choose the same course with respect to other pending settlements. There are still active parties in this proceeding and their right to object to these entities' fuel cost allowance claims cannot be overlooked.

23. However, if no party chooses to oppose an entity's fuel cost allowance claim, that claim does not require the additional verification of an independent auditor. The claimant at that point may file its claim directly to the CAISO, with an attestation by a responsible company official of the following:

> I have examined the facts underlying this claim, and hereby declare under penalty of law, 18 U.S.C. § 1001, that all statements of fact contained herein are true, correct, and complete to the best of my knowledge, information, and belief, and are made in good faith.

Any entity deciding not to opt-in to a settlement approved by the Commission must notify the Commission, within 10 days of the Commission order approving the settlement, of its decision whether to oppose or not to oppose that claimant's fuel cost allowance claim. Such notifications regarding the Williams claim shall be filed within 10 days of the issuance of this order.

24. With regard to Duke's request for waiver, we note that Duke's settlement has not yet been filed with the Commission for approval. While settlement talks are underway, however, we will grant Duke a temporary stay of the requirements of the May 12 Order, *i.e.*, Duke may delay refiling its fuel cost allowance claim while the settlement is pending. Once that settlement is filed and approved by the Commission, or if parties do not ultimately agree to a settlement, Duke and other parties must then comply with the directives laid out in the present order and the May 12 Order, as described above.

Scope Of Auditor's Review And Role Of Auditor

25. We will also address LADWP's request for clarification regarding the scope of the independent auditor's review of sellers' fuel cost allowance claims. According to LADWP, there appear to be conflicting interpretations of the Commission's direction in its May 12 Order, with some parties interpreting our direction to be that the auditor should calculate each seller's fuel cost allowance claim *de novo*. LADWP requests that we clarify that the independent auditor is to "review and verify that the source data used in fuel cost calculations are correct and comprehensive, and that the calculations performed to determine a fuel cost allowance claim conform to the Commission's

[21] Parties had been directed to notify the Commission to indicate their intention not to opt-in to the settlement by July 12, 2004. For example, NCPA did not submit a notification, indicating that it has chosen to opt out of the Williams settlement.

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directives."[22] AEPCO requests that the Commission clarify that there may be ongoing communications between claimants and the auditor.

Commission Determination

26. We will grant LADWP's request for clarification, noting that we directed fuel cost allowance claims to be independently reviewed by, not conducted by, an outside auditor. Our intent is for the auditor to perform the function of verifying the application of the formulaic procedures as directed in our May 12 Order. While parties should not be subject to substantially redundant costs in undergoing this review, we note that it is not our intent to limit the auditor's independent analysis if the auditor finds significant need for further evaluation of data. Further, we find reasonable and grant AEPCO's request for clarification that there may be ongoing communications between claimants and the auditor.

Deadline For Audit Complement

27. The California Parties request that the Commission postpone the August 30, 2004 date for completion of the audit. They note that that original deadline was based on the anticipated date for the CAISO's completion of the refund rerun calculations, and that the CAISO's process is currently expected to continue until December 2004 at the earliest. Further, they point out that the fuel cost allowance cannot be completed until the CAISO determines which hours and units will be mitigated, and report that the auditors believe the audit can be conducted more thoroughly and cost-effectively if more time is allowed. California Parties also propose specific dates for submitting, commenting on, and approving an interim report by Ernst & Young, prior to final approval of the claims. AEPCO also raises concerns about the time frame contemplated in the May 12 Order, stating that requiring the audits to be performed in such a short period of time will increase their cost.

28. On August 26, 2004, Puget Sound Energy, Inc. filed a request for waiver of the August 30, 2004 deadline.[23] Puget requests that the Commission allow it to submit its

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[22] LADWP at 5, *citing* May 12 Order at P 77.

[23] CP Kelco, U.S., Inc (CP Kelco) also filed a motion for extension of the deadline. CP Kelco is not a party to this proceeding, as discussed below. Rule 212(a) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 3385.212(a) specifies that a motion may be filed by a participant or a person who has filed a timely motion to intervene which has not been denied. As CP Kelco is not a participant in this proceeding, and did not file a timely motion to intervene, the Commission will not entertain its motion for extension.

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claim after an auditor is selected and adequate time is permitted to review the claim by the auditor; Puget states that 90 days should be adequate.

Commission Determination

29. We will grant the California Parties' and Puget's requests for extension of the deadline for submission of verified fuel cost allowance claims. We agree that extension of the CAISO's rerun calculation process will allow more time for the completion of the fuel cost allowance audit. There is no need to potentially raise the cost of conducting the audit with unnecessary time constraints. The CAISO has indicated it will need the fuel cost allowance submissions by early November.[24] However, we are not willing to delay the refund process further by allowing submission of the fuel cost allowance claims beyond the end of October 2004. Therefore, we will extend the deadline for submission of verified fuel cost allowance claims to October 29, 2004.

30. If the parties agree among themselves that an interim report would be helpful, then that (and any other additional process or benchmarks) may be negotiated with Ernst & Young, but will not be required to be filed with the Commission in this proceeding. The parties should, as directed, submit the reviewed fuel cost allowance claims directly to the CAISO.

31. Additionally, the CAISO should make available within 10 days of the issuance of this order, either by posting on its website or making generally available to all generators who filed fuel cost allowance claims, the required format for the generators' fuel cost allowance submissions.

Late Intervention

32. On August 23, 2004, CP Kelco, U.S., Inc. (CP Kelco) filed a motion to intervene out-of-time and motion for extension of the deadline to submit fuel cost allowance filings beyond August 30, 2004. CP Kelco states that it owns a cogeneration facility from which it sells excess energy to San Diego Gas & Electric Company (SDG&E); SDG&E served as CP Kelco's scheduling coordinator during the refund period. According to CP Kelco, it became aware in February 2004 that SDG&E may seek refunds from it in connection with deliveries from CP Kelco during the refund period, and that it may be eligible for a fuel cost allowance. It now seeks to intervene in order to monitor developments, participate in future technical conferences, and, if necessary, submit justification for costs incurred during the refund period. The California Parties oppose CP Kelco's motion to intervene out-of-time.

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[24] As indicated by the CAISO in the July 26 meeting. *See* Notice of Meeting with the California Independent System Operator and the California Power Exchange, EL00-95-000, *et al.* (July 16, 2004).

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33. When late intervention is sought after the issuance of a dispositive order, the prejudice to other parties and burden upon the Commission of granting the late intervention may be substantial. Thus, movants bear a higher burden to demonstrate good cause for the granting of such late intervention. CP Kelco has not met this burden. It does not appear to have sold power directly into markets operated by CAISO or the California Power Exchange and, as such, is not a respondent in the complaint proceeding. Any adjustment of prior payments between SDG&E and CP Kelco are beyond the scope of this proceeding. Thus, CP Kelco has not shown that its interest may be directly affected by the outcome of this proceeding, and we will deny its motion to intervene.

The Commission orders:

(A) Ernst &Young is hereby designated the sole independent auditor for all parties pursuing fuel cost allowance claims.

(B) Williams', Dynegy Parties' and Duke's requests for waiver are hereby granted in part and denied in part, to the extent described in the body of this order.

(C) The audit requirements are hereby clarified, as discussed in the body of this order.

(D) The deadline for submission to the CAISO of fuel cost allowance claims is hereby extended to October 29, 2004.

(E) Any party deciding not to opt-in to a settlement approved by the Commission is hereby directed to notify the Commission, within 10 days of the Commission order approving the settlement, whether it will oppose the generator's fuel cost allowance claim. Such notifications regarding the Williams claim shall be filed within 10 days of the issuance of this order.

(F) The CAISO is hereby directed to make available to generators format requirements for the fuel cost allowance claims within 10 days of the issuance of this order, as discussed in the body of this order.

(G) CP Kelco's motion to intervene out-of-time is hereby denied.

By the Commission. Commissioner Kelly not participating.

(S E A L)

Magalie R. Salas,
Secretary.