

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

San Diego Gas & Electric Company,)	
Complainant,)	
)	
v.)	Docket Nos. EL00-95-045
)	
Sellers of Energy and Ancillary Services)	
Into Markets Operated by the California)	
Independent System Operator and the)	
California Power Exchange,)	
Respondents.)	
)	
Investigation of Practices of the California)	Docket Nos. EL00-98-069
Independent System Operator and the)	
California Power Exchange)	

**MOTION FOR CLARIFICATION OF THE CALIFORNIA INDEPENDENT
SYSTEM OPERATOR CORPORATION CONCERNING THE
PROCESSING OF FUEL COST ALLOWANCE CLAIMS**

Pursuant to Rule 213 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.213 (2005), the California Independent System Operator Corporation (“ISO”) respectfully requests that the Commission provide clarification concerning the resolution of certain issues identified by Ernst & Young in its audit reports on fuel cost allowance claims. Specifically, the ISO requests that the Commission clarify that the ISO need only process those claims that have been approved without qualification by either Ernst & Young or the Commission. Moreover, the ISO requests that the Commission clarify that it will not be required to complete the processing of fuel cost claims, and begin interest calculations, until the issues raised by Ernst & Young regarding certain claims

are resolved by the Commission, and that the ISO's proposed two-track process for allocating fuel cost allowance claims is appropriate.

I. STATEMENT OF ISSUES

The CAISO requests that the Commission act on the following issues:

A. The Commission should clarify that the ISO will not be responsible for validating fuel cost allowance data, or determining whether any of the issues raised by Ernst & Young in its fuel cost audit reports results in a deficient claim.

B. The Commission should clarify that the ISO will not be required to complete the processing of fuel cost allowance offsets, and begin the calculation of interest, until the issues identified by Ernst & Young in its audit reports are resolved, and that the ISO's proposed process for allocating fuel cost allowance claims is appropriate.

II. BACKGROUND

As the noted in its last several status reports on rerun activity,¹ the ISO received on August 30, 2005 fuel cost data from eleven entities to support their claims for fuel cost offsets against their refund obligations.² On that date, the ISO also received copies of the audit reports prepared by Ernst & Young with respect

¹ As filed in Docket Nos. EL03-746-000, *et al.* on September 12, 2005, October 11, 2005, and November 10, 2005.

² The ISO received fuel cost claims from the City of Anaheim ("Anaheim"), City of Burbank ("Burbank"), Duke, Dynegy, Los Angeles Department of Water and Power ("LADWP"), Midway Sunset Cogeneration ("Midway Sunset"), Mirant, Nevada Power Company ("Nevada Power"), Puget Sound Energy ("Puget"), City of Redding ("Redding"), and Reliant. These claims were submitted pursuant to the schedule established by the Commission in its Notice of Extension of Time," issued in Docket Nos. EL00-95-098, *et al.* on July 28, 2005 ("July 28 Notice"),²

to ten of these fuel cost claims.³ In seven of those reports, Ernst & Young reported outstanding issues that prevented it from unconditionally approving the claims. Subsequently, the ISO received supplemental reports from Ernst & Young with respect to several of the entities as to which it had identified outstanding issues. As explained in greater detail below, the ISO now understands that Ernst & Young has audited ten claims, and continues to have outstanding issues with five of them. The unresolved issue on three of the claims concerns verification of heat rates for units outside the ISO Control Area.

In the initial audit reports received by the ISO on August 30, 2005, Ernst & Young indicated that it was unable to unconditionally approve seven of the fuel cost claims – those of Burbank, Duke, LADWP, Mirant, Nevada Power, Puget Sound, and Sempra. Ernst & Young noted that these claims evidence “potential departures” from the Commission’s orders, but stated that it believed it lacked authority to determine whether these issues render the relevant fuel cost claims “deficient.” Ernst & Young stated that it would attempt to resolve these issues in the 30-day period running from August 30 to September 30, 2005, and issue supplemental reports detailing its efforts.

On September 28, 2005, Ernst & Young notified the Commission that, because of the adverse weather affecting the southeastern United States, it would not be able to issue all of its supplemental reports by September 30, 2005. Instead, Ernst & Young stated that it anticipated issuing some of the

³ The ISO did not receive a report with respect to Dynegy’s fuel cost claim, which is consistent with the settlement approved by the Commission concerning Dynegy’s fuel cost claim. *San Diego Gas & Electric Co., et al.*, 112 FERC ¶ 61,032 (2005) at P 13.

supplemental reports no later than 10 days after the September 30, 2005 deadline, *i.e.* by October 10, 2005.

By October 12, 2005, the ISO received supplemental reports from Ernst & Young relating to claims of Sempra, Duke, Mirant, and Puget Sound. With respect to Sempra and Duke, Ernst & Young reported that it had resolved all of the exceptions relating to these two entities. With respect to Mirant and Puget Sound, however, Ernst & Young reported that it continued to have exceptions with these entities' claims.⁴ Finally, the ISO did not receive supplemental reports from Ernst & Young with respect to the three other entities as to which Ernst & Young originally identified exceptions – LADWP, Nevada Power, and Burbank.⁵ Therefore, the ISO assumes that the issues raised by Ernst & Young in its September 30 reports on these companies continue to exist as detailed in those reports.

Of the five claims with outstanding issues,⁶ the sole issue raised by Ernst & Young with respect to three – those of LADWP, Nevada Power and Puget Sound – is claimants' use of heat rates that are not on file with the ISO. With respect to LADWP and Nevada Power, Ernst & Young stated that “the data on which the heat rate calculations are based appear reasonable,” and that these entities appear to have performed the calculations with professional care, but noted that the heat rates “are not based on objective third-party evidence similar

⁴ On November 9, 2005, the ISO received a second supplemental report concerning Mirant, which did not indicate the resolution of any of the outstanding issues identified by Ernst & Young in its original supplemental report on Mirant.

⁵ As discussed below, Ernst & Young indicated to the ISO that it was still in the process of auditing Burbank's fuel cost claim.

⁶ The Ernst & Young reports for these entities are included with this filing as Attachment A.

to what [Ernst & Young has] received to verify other issues in the FCA calculation.”⁷ Ernst & Young noted that these two entities represented that their FCA claims and supporting workpapers would be provided to the ISO and that “[t]his will enable the ISO to undertake appropriate validation of the heat rate information.” *Id.* With respect to Puget Sound, Ernst & Young stated that, according to Puget Sound, no objective third party evidence is available to verify the heat rate calculations, and recommended that this “potential departure” is best resolved by agreement between the parties or Commission order.⁸

Concerning Mirant’s claim, Ernst & Young identified six issues in its original report, but in its supplemental report notes that two issues have been resolved, leaving four issues: (1) amounts claimed for affiliate financial gas transactions, (2) completeness of documentation supporting financial transactions, (3) whether Mirant has considered all necessary Canadian gas purchases in its weighted average cost of gas calculations, and (4) certain discrepancies between price and quantity data provided by Mirant and corresponding ISO data.⁹

Finally, Ernst & Young noted that it had not had sufficient time to review Burbank’s data, which was resubmitted on August 22, 2005, but would attempt to do so by September 30.¹⁰ In early October, a representative of Ernst & Young indicated to the ISO that Ernst & Young was still in the process of auditing

⁷ LADWP Report at 2; Nevada Power Report at 2.

⁸ Puget Supplemental Report at 2.

⁹ Mirant Supplemental Report at 2-4.

¹⁰ Burbank Letter at 1.

Burbank's claim, and would provide a report to the ISO upon completion of that process.

III. DISCUSSION

A. The Commission Should Clarify that the ISO Should Process Only Those Fuel Cost Allowance Claims That Are Validated by Ernst & Young or the Commission

As noted above, in two of its reports (LADWP and Nevada Power), Ernst & Young stated that claimants will provide the heat rate data to the ISO so as to allow the ISO to validate this data.¹¹ The ISO believes such a process is inconsistent with the Commission's established process for resolving fuel cost claims, and the ISO is in no better position to verify this data than Ernst & Young. More generally, it is unclear who Ernst & Young and/or parties expect to resolve the potential discrepancies identified by Ernst & Young. The ISO respectfully requests that the Commission clarify that the ISO will not be responsible for validating claimants' heat rate (or any other) data, or for resolving whether any of the issues raised by Ernst & Young results in a deficient claim; instead, the ISO should allocate only those claims that have unqualified approval from Ernst & Young or the Commission.

The ISO's understanding, based on the Commission's orders, is that the ISO's role in this process is limited to allocating those fuel cost claims that are certified as having been prepared in a manner consistent with the Commission's fuel cost allowance methodology, and that the ISO should only allocate those claims that have been so certified by the auditor, Ernst & Young. For instance,

¹¹ LADWP and Nevada Power provided this data to the ISO.

the Commission has stated that the auditor is responsible for “review[ing] and verify[ing] 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 directive.” *San Diego v. Sellers of Energy and Ancillary Services, et al.*, 107 FERC ¶ 61,160 at P 74 (2004). The Commission directed that claims verified by the auditor were to be submitted to the ISO directly to enable it to allocate the costs of the claims to the entities that participated in the ISO’s markets during the Refund Period. *Id.* at Ordering Paragraph C. Based on these directives, it would be inappropriate to require the ISO to resolve questions as to whether particular claims were prepared in a manner consistent with the Commission’s methodology, or whether the data underlying these claims is valid. Moreover, practically speaking, the ISO is in no better position to resolve the issues identified by Ernst & Young, than is Ernst & Young itself. For instance, the ISO has no means of verifying the accuracy of the heat rates used by LADWP and Puget Sound, entities outside of the ISO’s Control Area. The ISO has exactly the same information already made available to Ernst & Young, nothing more; having the ISO “validate” this data would simply be to substitute the ISO’s judgment for Ernst & Young’s. Finally, the ISO does not have sufficient resources, either personnel or financial, to perform such a task.

In addition to the heat rate data used by certain entities, Ernst & Young identified, in its reports on Mirant, more theoretical questions concerning interpretation of the Commission’s methodology. On these questions, there is

certainly no reason to substitute the ISO's judgment for the auditor's. The ISO asks the Commission to clarify that the ISO should process only those fuel cost allowance claims that have unqualified approval from either Ernst & Young or the Commission ¹²

B. The Commission Should Clarify that the ISO Will Not Be Required to Begin Processing Fuel Cost Allowance Offsets Until the Issues Identified by Ernst & Young Are Resolved

The ISO also requests that the Commission clarify that the ISO will not be required to complete the process of allocating fuel cost allowance claims, and begin interest calculations, until the issues identified by Ernst & Young are resolved. The allocation of offsets, including offsets relating to fuel cost allowances, cannot be done on an entity-by-entity basis. That is, *all* of the offsets relating to fuel cost allowances, emissions, and cost-of-service recovery must be finalized before the ISO can allocate those offsets to Market Participants that participated in the ISO's markets during the Refund Period. In addition, all of the offsets must be allocated before the ISO can accurately determine the appropriate amount of interest owed and owing for the Refund Period. Therefore, if any of the individual offset claims are found deficient after the ISO completes the financial adjustment phase and makes its compliance filing, then the ISO will have no alternative but to re-do the allocation of the affected offset(s), re-calculate interest, and prepare new invoices reflecting updated

¹² Ernst & Young appears to agree that it is appropriate for the Commission to resolve these outstanding issues. In its supplemental reports, Ernst & Young states that it recognizes that "only the Commission is in a position to opine on the validity of the methodology used by [the claimants]." Mirant Supplemental Report at 4; Puget Sound Supplemental Report at 2.

calculations of who owes what to whom during the Refund Period. For this reason, to the maximum extent possible, the ISO wishes to avoid submitting a compliance filing based on fuel cost data that may not have been calculated in accordance with the Commission's methodology.

As explained in its last status report, the ISO is proposing to resolve this situation by employing a two-track process for allocation of the fuel cost allowances. First, the ISO will calculate, for each entity that participated in the ISO's markets during the Refund Period (*i.e.*, October 2, 2000 through June 20, 2001), the percentage of the total fuel cost claim amounts to be allocated to these entities for each hour, consistent with the methodology approved by the Commission for doing so. The ISO can accomplish this step without a resolution of the issues identified by Ernst & Young, because this step does not require the actual dollar amounts of the fuel cost allowance claims, but rather, only data concerning the activity of each party in the ISO's markets during that period, which will not be affected by the issues raised by Ernst & Young. Next, the ISO will distribute those allocation percentages to the parties for their review, and provide a three-week period for parties to dispute the ISO's calculations. The ISO will then await Commission resolution of the issues raised by Ernst & Young. After the Commission rules on these issues, and claimants make any necessary modifications to their claims based on the Commission's ruling, the ISO will apply the total approved amount of the fuel cost allowances to the parties based on their respective allocation percentages. Finally, the ISO will distribute the final allocation data to parties for a brief, one week, review period.

The ISO believes that this process is the most efficient way of addressing this situation. Given that Ernst & Young has already explicitly identified certain discrete issues that represent potential departures from the Commission's methodology, the ISO respectfully submits that it would be most appropriate for the Commission to address and resolve them before the ISO finalizes the fuel cost claim offsets, calculates interest, and makes its refund compliance filing. As explained above, if the Commission waits to address these issues and finds the ISO's compliance filing deficient as a result of *any* of these issues, the ISO would have to perform a complete re-allocation of the costs of the fuel cost claims, and then re-calculate all of the interest and all of the amounts owed and owing for the Refund Period. Therefore, it would be far more efficient, and should accelerate the conclusion of this proceeding, if the Commission were to resolve these issues prior to the ISO completing the financial adjustment phase and making its compliance filing, rather than running the risk that the ISO will have to perform significant additional, and redundant, work, in the future if the Commission determines that any of the issues identified by Ernst & Young results in a deficient fuel cost allowance claim after the ISO makes its compliance filing. Nevertheless, the ISO's two-track process will allow the ISO to make significant progress in allocating the fuel cost claims prior to the Commission resolving these issues, because the ISO will be going forward with a major portion of the allocation process (*i.e.* the determination of allocation percentages for each party, and review of those calculations) without regard to the timing of the Commission's resolution of the issues identified by Ernst & Young.

Finally, with respect to Burbank, as the ISO indicated in its last status report, if the ISO receives Burbank's audited claim at least four business days prior to beginning the calculation to apply the total amount of approved fuel cost claims to parties, then the ISO is confident that including Burbank's claim will not cause a delay in the overall process. However, if the ISO does not receive Burbank's audited claim in this timeframe, then the ISO proposes not to reflect a fuel cost claim for Burbank.

For the aforementioned reasons, the ISO requests that the Commission clarify that the ISO will not be required to begin allocating fuel cost allowance offsets until the Commission resolves the issues identified by Ernst & Young, by determining whether any of these issues results in a deficient fuel cost allowance claim, and that the ISO's proposed process for allocating fuel cost allowance amounts is appropriate. Moreover, the ISO requests that if the Commission does conclude that a claim is deficient, that the Commission will either (1) require the applicable entity to modify its fuel cost allowance claim by a date certain, or (2) indicate that that claim is rejected.

IV. CONCLUSION

The ISO respectfully requests that the Commission clarify the resolution of the issues identified in the Ernst & Young audit reports, consistent with the discussion above.

Respectfully submitted,

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Dated: November 22, 2005

ATTACHMENT A



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August 26, 2005

BY FACSIMILE

Terry Stevenson, Esq.
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City of Burbank
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Fuel Cost Allowance Claim—City of Burbank

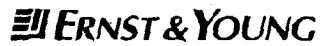
Ernst & Young LLP (“E&Y”) was selected by the Federal Energy Regulatory Commission (the “Commission”) to test and report on the fuel cost allowance (“FCA”) claims of sellers into the markets (collectively the “Claimants”) operated by the California Independent System Operator (“CAISO”) and the California Power Exchange (“PX”) for the period from October 2, 2000 to June 20, 2001 (the “Refund Period”). Our selection was described in paragraph 10 of the September 2, 2004 Order on Auditor Selection and Request for Waiver and Clarifying Audit Issues, 108 FERC ¶ 61,219 (“September 2 Order”).

The presentation of City of Burbank’s (“Burbank’s”) FCA claim is the responsibility of Burbank. It is our responsibility to perform testing procedures on that claim and report our conclusions to you.

We previously reviewed Burbank’s FCA claim, and communicated to you several matters requiring modification and/or correction before we could complete our work and report our conclusions. We understand that you have incorporated those modifications into the revision to your claim submitted to us on August 22, 2005. We further understand that Burbank is submitting that FCA claim, in the amount of \$367,963 to CAISO contemporaneously with the issuance of this letter.

Disclaimer of opinion

Because we have not had adequate time to review Burbank’s submission, as of the date of this letter we have no opinion as to whether the source data used are correct and comprehensive, or whether the calculation performed conforms to the Commission’s directives.



■ Ernst & Young LLP

Terry Stevenson, Esq.
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However, the Commission's September 24 and December 20 Orders provide for a 30-day dispute resolution period following the deadline for submission of verified FCA claims, and we will endeavor to resolve this situation with Burbank during that period.

Very truly yours,
ERNST & YOUNG LLP

A handwritten signature in black ink that reads 'Warren Nicholson'. The signature is written in a cursive style and is underlined with a single horizontal line.

Warren Nicholson, Partner

Copy to Jon R. Stickman, Esq., Duncan & Allen

ACCOUNTANTS' REPORT – FUEL COST ALLOWANCE CLAIM

Los Angeles Department of Water and Power
August 26, 2005

 ERNST & YOUNG

August 26, 2005

Mr. Enrique Martinez
Ms. Marcia Kamine
Los Angeles Department of Water & Power
111 North Hope Street, Room 340
Los Angeles, California 90012

Accountants' Report — Fuel Cost Allowance Claim —
Los Angeles Department of Water and Power

Dear Mr. Martinez and Ms. Kamine:

Ernst & Young LLP (“E&Y”) was selected by the Federal Energy Regulatory Commission (the “Commission”) to test and report on the fuel cost allowance (“FCA”) claims of sellers into the markets (collectively the “Claimants”) operated by the California Independent System Operator (“CAISO”) and the California Power Exchange (“PX”) for the period from October 2, 2000 to June 20, 2001 (the “Refund Period”). Our selection was described in paragraph 10 of the September 2, 2004 Order on Auditor Selection and Request for Waiver and Clarifying Audit Issues, 108 FERC ¶ 61,219.

You have acknowledged to us that the presentation of Los Angeles Department of Water and Power’s (“LADWP’s”) FCA claim is the responsibility of LADWP. It is our responsibility to perform testing procedures on that claim and report our conclusions to you.

We have reviewed LADWP’s FCA claim, and our procedures and conclusions are set forth herein. We understand that LADWP is submitting its FCA claim in the amount of **\$31,152,559** to CAISO contemporaneously with the issuance of this report.

This letter was prepared for use in conjunction with LADWP’s fuel cost allowance submission before the Commission, including any disputes that may ensue, and should not be used for any other purpose. It was prepared in accordance with standards set forth by the American Institute of Certified Public Accountants for engagements of this nature.

Summary of conclusions

Our tests on LADWP’s calculation are described below.

Based on our review and analysis, it is our opinion with respect to LADWP’s FCA calculation that the source data used are correct and comprehensive, and that the calculation performed conforms to the Commission’s directives, within immaterial differences, with the exception of the following:

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Heat rates not on file with CAISO

LADWP is located outside of the CAISO control area and did not have heat rates on file. The heat rates used in the FCA claim are calculated based upon the heat rate coefficients for each unit. LADWP has represented that the heat rates used in the FCA calculation are accurate. LADWP based the heat rate coefficients on tests conducted for the units. Both incremental and average heat rates are calculated for the generation level of each plant during each interval to rank the plants and calculate the fuel burned for sales to CAISO and PX.

The data on which the heat rate calculations are based appear reasonable. It appears that LADWP has performed the heat rate calculations using professional care. However, the heat rates are not based on objective third-party evidence similar to what we have received to verify other issues in the FCA calculation.

LADWP has represented that its FCA claim and supporting work papers will be provided to the CAISO, as required by the Commission. This will enable the CAISO to undertake appropriate validation of the heat rate information.

Resolution of exceptions

Although it is our responsibility to disclose the issue described above, we do not believe that we have the authority to determine whether or not LADWP's FCA claim is "deficient" in the eyes of the Commission. We submit this issue recognizing that only the Commission is in a position to opine on the validity of the methodology used by LADWP.

Responsibilities of Ernst & Young

The Commission described its directive to us in its May 12, 2004 Order Addressing Fuel Cost Allowance Issues, 107 FERC ¶61,160 ("May 12 Order"), paragraph 74. Per the Commission, we are 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 directives.”

The Commission further directed in its September 24, 2004 Order Denying Rehearing, Clarifying Fuel Cost Allowance Issues, and Accepting In Part Compliance Filing, 108 FERC ¶61,311 ("September 24 Order") that:

“. . . if during its review of the claims the independent auditor determines that a filing is inaccurate, incomplete, or not in conformance with our orders, the claim should be found deficient.”

In performing our work, we relied upon the rulings of the Commission in this docket, including the following:

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- March 26, 2003 Order on Proposed Findings on Refund Liability, 102 FERC ¶61,317
- April 22, 2003 Order Clarifying Fuel Cost Allowance, 103 FERC ¶61,078
- October 16, 2003 Order on Rehearing, 105 FERC ¶61,066
- May 12, 2004 Order Addressing Fuel Cost Allowance Issues, 107 FERC ¶61,160 ("May 12 Order")
- September 24, 2004 Order Denying Rehearing, Clarifying Fuel Cost Allowance Issues, 108 FERC ¶61,311
- December 20, 2004 Order Addressing Compliance Filing, Emergency Motion, and Comments Following Technical Conference, 109 FERC ¶61,297
- March 18, 2005 Order Granting In Part and Denying In Part Rehearing, Providing Clarification, and Extending Deadline for Submission of Fuel Cost Allowance Claims 110 FERC ¶61,293

We also referred to the templates approved for submitting fuel cost information that were developed by CAISO. These templates were included in the following filings with the Commission:

- Motion for Leave to File Answer and Answer of the California Independent System Operator Corporation to Comments and Protests on Compliance Filing, filed September 14, 2004
- Answer of the California Independent System Operator Corporation ("CAISO") to Indicated Generators' Motion to Reject the CAISO's Fuel Cost Submission Template, filed October 5, 2004
- Comments of the California Independent System Operator Corporation Following the October 7, 2004 Technical Conference, filed October 15, 2004
- Seventeenth Status Report of the California Independent System Operator Corporation on Settlement Re-run Activity, filed June 10, 2005

Testing performed

We performed tests for data accuracy and completeness to comply with the Commission's directive to verify that the source data incorporated into the FCA calculation is correct and comprehensive. We performed tests of the logic of the FCA calculation model to comply with the Commission's directive to verify that the FCA calculation conforms to the Commission's directives.

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Tests for accuracy

Our tests for accuracy verified that the data inputs in LADWP's FCA calculation are correct by identifying and obtaining supporting source documentation and agreeing the calculation inputs back to this source data. For example, when reviewing the physical gas purchases and transportation costs included in the FCA calculation, we verified their accuracy by comparing the data included in LADWP's FCA calculation to third-party invoices.

Other data elements, including sales volumes, market clearing prices ("MCPs"), mitigated market clearing prices ("MMCPs"), and Harris prices, are on file with CAISO and PX. We obtained this data electronically from CAISO and PX for each day during the Refund Period and compared the information in these data files to LADWP's FCA calculation to assess that the data used in the FCA calculation is correct.

Because LADWP is outside of the CAISO system, no metered generation data is on file with CAISO. Metered generation used in the FCA calculations was a direct output from LADWP's generation SCADA system.

Tests for completeness

During the Refund Period, LADWP purchased all of its gas from three vendors. LADWP included only gas purchased and used for the generation of electricity sold into the CAISO and PX markets in its FCA calculation. In general, monthly gas purchases made specifically and identified on the vendor invoice for the City of Los Angeles and the airport as well as purchases delivered outside of California were excluded.

In reviewing the gas purchases and transportation costs included in LADWP's FCA calculation, we performed tests for completeness to assess that LADWP considered for inclusion its entire population of transactions relevant to the FCA calculation.

We tested physical gas purchases and transportation costs by agreeing the dollar amount of gas purchases and transportation costs in LADWP's general ledger during the Refund Period to the universe of gas purchases and transportation costs subject to consideration for inclusion in the FCA calculation.

LADWP did not engage in any hedging or other financial transactions that would offset the cost of physical gas purchases.

Tests for logic

We designed our tests for model logic and methodology to:

- Assess that the formulas used in LADWP's FCA calculation are working properly and as intended, and
- Determine that LADWP's overall FCA calculation methodology is in accordance with our understanding of the Commission's orders.

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These tests involved physically reviewing the calculation, testing calculation formulas to identify any errors in calculation, mapping out the calculation methodology, and comparing the methodology used to the methodology set forth in the Commission's orders.

We reviewed the formulas incorporated into the FCA calculation to assess that they are free of mechanical errors. In doing so, we manually tested the output of the formulas on a sample basis. We also reviewed the calculation of the daily average cost of fuel, among others.

Format of the FCA Calculation

As discussed by the Commission in Paragraph 68 of the December 20, 2004 Order, the proposed FCA template does not cover all circumstances. With respect to these additional circumstances, the Commission directed the CAISO to work with sellers and the auditor to develop appropriate templates for the submission of fuel cost information needed for the CAISO to complete the refund process.

LADWP determined that their FCA claim required adjustments to the proposed template. These revised templates were provided to and discussed with the CAISO. The CAISO responded that the revised template appears to be sufficient in terms of providing the CAISO with enough information to determine the approved FCA for mitigated sales of spot energy in the CAISO spot market and to allocate these costs to purchasers of spot energy. We believe LADWP's approach, though different from the method chosen by other claimants, shows a reasonable effort to comply with the Commission's orders.

LADWP submitted its FCA claim to us for testing in the format approved by the CAISO in two Excel files named "LADWP FCA_ISO 7-05-05.xls" and "LADWP FCA_PX 7-05-05," respectively. That format provides for electronic spreadsheets for generating units as follows:

- FCA submissions for mitigated **ISO Instructed Energy ("IE")** sales [Table I-3]
- FCA submissions for mitigated **Day Ahead and Hour Ahead PX Energy** sales [Table P-3 (Forward)]
- FCA submissions for mitigated **Real Time PX Energy** sales [Table P-3 (Real Time)]

Additionally, in accordance with the May 12 Order, we reviewed the following required components of LADWP's FCA submission. We tested these components as part of our overall analysis and review of the FCA calculation:

- Fuel purchases ranked by term from shortest to longest indicating price, term, date and quantity for each transaction. This information is contained in a file called "LADWP FCA 7-05-2005.xls" in LADWP's submission.
- Marginal heat rate by unit. This information is contained in a file called "LADWP FCA 7-05-2005.xls" in LADWP's submission.

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- Megawatt-hours by unit sold to the ISO/PX over the applicable interval. This information is contained in a file called "LADWP FCA 7-05-2005.xls" in LADWP's submission.
- Average daily fuel cost per MMBtu, a demonstration of how this calculation was derived based on the fuel supply stack, and supporting workpapers. This information is contained in a file called "LADWP FCA 7-05-2005.xls" in LADWP's submission.
- Overall fuel cost allowance amount, on a monthly basis, to offset the refund owed by each generator. This information is contained in a file called "Summary_1.pdf" in LADWP's submission.

Other disclosures

The Commission approved LADWP's inclusion of a fuel cost claim associated with fuel used to generate thermal electricity that was then supplied to the pumps at LADWP's Castaic facility. In calculating its FCA claim, LADWP's fuel cost model identifies, calculates, and claims those fuel costs incurred by LADWP's own natural gas fired generation resources that were used to supply energy used for forced-pumping at Castaic. LADWP stated that it uses a weekly average methodology in calculating its FCA claim for the Castaic facility, and the Commission found it to be reasonable.

We reviewed LADWP's calculation in order to understand the overall methodology employed. This included the review of schedules and supporting documentation of the methodology for identifying, calculating, and claiming fuel costs associated with forced-pumping at Castaic. We found the calculation to be reasonable and the documentation provided to us supported the information contained in LADWP's model.

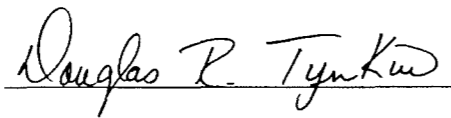
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We performed those procedures that we believe were necessary to comply with the Commission's directives. While those procedures were the same as or similar to those performed in a financial statement audit, we were not engaged to, and did not, perform an audit for the purpose of expressing an opinion on historical financial statements. Accordingly, we do not express such an opinion or any form of assurance on the historical financial statements of LADWP.

We reserve the right to supplement or amend our report upon receipt of additional information.

Very truly yours,
ERNST & YOUNG LLP



Douglas R. Tymkiw, Partner

Copy to: California Independent System Operator

SUPPLEMENTAL ACCOUNTANTS' REPORT – FUEL COST ALLOWANCE CLAIM
Mirant Corporation
October 10, 2005



October 10, 2005

Mr. John Hogan
Mirant Corporation
1155 Perimeter Center West
Atlanta, Georgia 30338

Supplemental Accountants' Report—
Fuel Cost Allowance Claim—Mirant Corporation

Dear Mr. Hogan:

In our Accountants' Report dated August 26, 2005 ("Accountants' Report"), we described the results of our analysis of Mirant Corporation's ("Mirant's") fuel cost allowance ("FCA") claim. In that report, we noted certain instances in which we believe that source data used in the FCA claim is not correct and/or comprehensive, or the calculations performed in the FCA claim do not conform to the Commission's directives.

We also noted our intent to work with Mirant to resolve those identified exceptions within the 30-day dispute resolution period following the issuance of our Accountants' Report. This Supplemental Report addresses the results of that resolution process and describes one issue that has not been fully resolved. We will supplement this report as expeditiously as possible with our final conclusion on that one issue.

Mirant has submitted a revised claim to Ernst & Young, in the amount of **\$50,443,136**. We have reviewed that claim, and our procedures and conclusions are set forth herein. We understand that Mirant is submitting this revised claim to the California Independent System Operator contemporaneously with the issuance of this Supplemental Accountants' Report.

Superseding summary of conclusions

In consideration of the revised claim, the work performed through August 26, 2005 and the additional work we have performed since the issuance of our Accountants' Report on that data, the conclusion set forth on page 1 of our Accountants' Report remains unchanged as not all previously identified exceptions have been resolved. Our previous and current conclusion is as follows:

Based on our review and analysis, it is our opinion with respect to Mirant's FCA calculation that the source data used are correct and comprehensive and that the calculations performed conform to the Commission's directives, within immaterial differences, with the exception of the following:

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Inclusion of affiliate financial gas transactions

Mirant's FCA claim includes financial transactions settled by the California Assets book of Mirant Americas Energy Marketing, LP during the Refund Period. A **net loss** of \$25.3 million for third-party financial gas transactions is included in Mirant's FCA calculation while a **net gain** of \$182.8 million is included for affiliate transactions. The net gain for affiliate financial transactions is approximately 15% of Mirant's cost for physical gas deliveries to their generating facilities and ultimately lowers Mirant's FCA claim.

The Commission's May 12, 2004 Order Addressing Fuel Cost Allowance Issues, 107 FERC ¶61,160, paragraph 21, requires claimants who purchased fuel from marketing affiliates to "pierce the corporate veil" and present the cost of fuel for the combined corporate entity. Paragraph 28 of that Order also clarifies that any hedging instruments or other financial transactions should be reflected in the fuel cost allowance claims if they are tied to the gas purchases attributed to spot power sales under the Commission's methodology.

Based on representations from Mirant personnel and our limited analysis of data for November and December 2000, we have determined that it is not possible to conclusively link affiliate transactions to third-party transactions using the electronic data available in Mirant's accounting system. In addition, an affiliate transaction may have been executed without any corresponding third-party transaction.

While this is a departure from the Commission's guidance, it appears that Mirant has used the electronic data available in its accounting records to comply with the Commission's directives to the closest extent possible. The inclusion of the affiliate financial transactions is conservative as a net gain is included which ultimately reduces the FCA claim. As of this date, we have performed all of our expected procedures related to this exception as we understand no additional information is forthcoming.

Documentation supporting completeness and accuracy of financial transactions

We requested supporting documentation to verify the completeness and accuracy of the financial transactions included in Mirant's FCA claim. Mirant has not been able to provide this data. Mirant personnel have represented to us that certain hard-copy documents cannot be located and other necessary electronic files have been compromised by a virus. Based on our discussions with Mirant personnel, efforts were made to provide us additional information related to this exception during the 30-day resolution period. However, Mirant was unable to provide us any additional documentation. Therefore, we are unable to conclude whether the financial transaction data in the FCA claim is correct or comprehensive.

In addition, Mirant has identified certain errors in the pricing data of the financial transactions included in the FCA calculation. Mirant has provided us with a revised FCA claim which we understand incorporates the corrected data. Due to the timing of the receipt of the revised FCA claim, we have not completed our procedures at this time but we will do so as expeditiously as possible. Our procedures will verify that the FCA claim has been

properly revised to include the corrected financial transaction data. However, we have performed all of our other expected procedures related to completeness and accuracy testing as we understand that no additional information is forthcoming.

Completeness of Canadian physical gas purchase

Mirant's physical gas purchases in the FCA calculation include purchases made by its Canadian office. The Canadian physical gas purchases account for approximately \$350 million (or 23%) of Mirant's total portfolio of physical gas purchases of over \$1.5 billion during the Refund Period. This portfolio of gas purchases is used to determine Mirant's weighted average cost of gas for volumes delivered to its generating facilities.

We compared the Canadian physical gas purchases in the FCA claim to Mirant's Canadian general ledger. We have not been able to reconcile the two sets of data due to limitations on the detail of information contained in the general ledger. Therefore, we are unable to conclude on whether Mirant has considered all necessary Canadian gas purchases in its weighted average cost of gas calculation. For informational purposes, we estimate that approximately 7% of the volumes delivered to Mirant's generating facilities in November and December 2000 could have originated as Canadian purchases.

As of this date, we have performed all of our expected procedures related to this exception as we understand that no additional data is forthcoming.

CAISO data comparison discrepancies

During our testing of Mirant's FCA claim, we noted that certain quantities and prices for electricity sales included in Mirant's FCA claim did not agree to electronic pricing and quantity data provided to us by CAISO for testing purposes. Mirant provided us supporting documentation for the quantities and prices used in its FCA calculation, on a sample basis.

We asked CAISO to re-affirm the supporting documentation which was originally provided to Mirant by CAISO. CAISO identified one exception within the sample. This exception was as a result of Mirant interpreting the manual record differently than CAISO and incorrectly adjusting the quantity of electricity sold within a certain interval. This one exception is immaterial to Mirant's FCA claim. However, we also noted that the response provided to us by CAISO regarding the one exception was different from the electronic data that had been previously provided to us by CAISO.

We asked Mirant to identify if there are other intervals in which the same type of adjustment was made in order to determine if the impact of all adjustments could be material to the FCA claim. Mirant is not able to determine this without an extensive manual review of all adjustments that were made since the CAISO calculation appears to use information beyond that available in the settlement data.

We estimate that the impact on Mirant's FCA claim would be a decrease of approximately \$3 million, or approximately 6%, if the source data for the calculation that is in question was modified to match the electronic pricing and quantity data provided to us by CAISO. It is not

Mr. John Hogan
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clear whether this adjustment would be appropriate given the discrepancies in the CAISO data noted above. If it was deemed necessary for this issue to be resolved further, an extensive manual reconciliation process of quantities and prices would be required.

As of this date, we have performed all of our expected procedures related to this exception as we understand that no additional data is forthcoming.

Previously identified exceptions resolved since issuance of our Accountants' Report

Completeness of physical gas purchases

The following two exceptions related to completeness noted in our Accountants' Report have been resolved.

- Certain physical gas purchases on a pipeline were excluded from Mirant's FCA claim. Mirant has provided us with information regarding the impact that this exclusion has on its weighted average cost of gas. We have reviewed this data and determined that the impact on Mirant's weighted average cost of gas is immaterial.
- We compared the physical gas purchases in the FCA claim that were made by Mirant's domestic office to Mirant's general ledger. Mirant has provided us with additional information that has allowed us to complete the reconciliation of the purchases made by its domestic office.

Heat rate for oil-fired units

In its FCA claim filed on August 30, 2005, Mirant calculated a heat rate for its three oil-fired units. This appeared to be an average heat rate calculation. Mirant subsequently revised its FCA calculation to incorporate an incremental heat rate.

We have reviewed Mirant's incremental heat rate along with the revised FCA calculation. We agreed the incremental heat rate to the supporting data, performed tests of the calculation formulas to ensure that they are working as intended, and reviewed the methodology to ensure that it is consistent with the methodology set forth in the Commission's orders. We found no discrepancies in this testing and consider this exception to be resolved.

Resolution of exceptions

Although it is our responsibility to disclose the issues described above, in our opinion, we do not have the authority to determine whether Mirant's FCA claim is, or is not, "deficient" in the eyes of the Commission. We submit these issues as potential departures, while recognizing that only the Commission is in a position to opine on the validity of the methodology used by Mirant.

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All other element of Accountants' Report incorporated by reference

In consideration of the revised claim, and the additional work described immediately above, all content on pages 2 through 4 of our Accountants' Report of August 26, 2005 up to the section "Responsibilities of Ernst & Young" should be deleted.

Unless a change is specifically noted herein, all other elements of our Accountants' Report remain in effect, and are incorporated herein by reference. A copy of our Accountants' Report is attached as an Appendix to this Supplemental Report.

We reserve the right to supplement or amend our report upon receipt of additional information.

Very truly yours,
ERNST & YOUNG LLP



Sheri L. Toivonen, Partner

Appendix: Accountants' Report of August 26, 2005
Copy to: California Independent System Operator
Debra Bolton, Mirant Corporation
Michael Yuffee, McDermott Will & Emery LLP

August 26, 2005

Mr. John Hogan
Mirant Corporation
1155 Perimeter Center West
Atlanta, Georgia 30338

Accountants' Report—
Fuel Cost Allowance Claim—Mirant Corporation

Dear Mr. Hogan:

Ernst & Young LLP (“E&Y”) was selected by the Federal Energy Regulatory Commission (the “Commission”) to test and report on the fuel cost allowance (“FCA”) claims of sellers into the markets (collectively the “Claimants”) operated by the California Independent System Operator (“CAISO”) and the California Power Exchange (“PX”) for the period from October 2, 2000 to June 20, 2001 (the “Refund Period”). Our selection was described in paragraph 10 of the September 2, 2004 Order on Auditor Selection and Request for Waiver and Clarifying Audit Issues, 108 FERC ¶ 61,219 (“September 2 Order”).

You have acknowledged to us that the presentation of Mirant Corporation’s¹ (“Mirant’s”) FCA claim is the responsibility of Mirant. It is our responsibility to perform testing procedures on that claim and report our conclusions to you.

We have reviewed Mirant’s FCA claim, and our procedures and conclusions are set forth herein. We understand that Mirant is submitting its FCA claim in the amount of **\$50,516,816** to CAISO contemporaneously with the issuance of this report.

This letter was prepared for use in conjunction with Mirant’s fuel cost allowance submission before the Commission, including any disputes that may ensue, and should not be used for any other purpose. It was prepared in accordance with professional standards set forth by the American Institute of Certified Public Accountants for engagements of this nature.

Summary of conclusions

Our tests on Mirant’s calculation are described below.

Based on our review and analysis, it is our opinion with respect to Mirant’s FCA calculation that the source data used are correct and comprehensive and that the calculation performed conforms to the Commission’s directives, within immaterial differences, with the exception of the following:

¹ Mirant’s FCA claim is being filed by its Mirant Potrero, LLC, Mirant Delta, LLC, and Mirant Americas Energy Marketing, LP, subsidiaries.

Mr. John Hogan
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Inclusion of affiliate financial gas transactions

Mirant's FCA includes financial transactions settled by the California Assets book of Mirant Americas Energy Marketing, LP ("MAEM"), during the Refund Period. A net loss for third-party financial gas transactions is included in Mirant's FCA claim while a net gain is included for affiliate transactions.

Mirant personnel represented to us that it would not be possible to link an affiliate transaction to a third-party transaction. The data recorded provides no link between affiliate and third-party transactions and there may have been no third-party transaction executed at the time the affiliate transaction was executed. We performed a limited analysis of transactions settled in November 2000 for all MAEM books that had transactions with the California Assets and determined that Mirant's representations appear to be valid.

The Commission's May 12, 2004 Order Addressing Fuel Cost Allowance Issues, 107 FERC ¶61,160, paragraph 21, requires claimants who purchased fuel from marketing affiliates to "pierce the corporate veil" and present the cost of fuel for the combined corporate entity.

We will perform procedures on any additional information that can be provided by Mirant during the 30-day dispute resolution period discussed below in an effort to resolve this exception. Ultimately, the amounts included in Mirant's FCA claim for affiliate transactions may understate the FCA claim as net gains from affiliate transactions are included throughout the Refund Period.

Documentation supporting completeness of financial transactions

We requested supporting documentation to verify the completeness of the financial transactions included in Mirant's FCA claim. Mirant has not been able to provide this data. Mirant personnel have represented to us that certain hard-copy documents cannot be located and other necessary electronic files have been compromised by a virus.

The Commission's guidance requires that we verify that the source data used in Mirant's FCA calculation is complete. We will perform procedures on any additional information that can be provided by Mirant during the 30-day dispute resolution period discussed below in an effort to resolve this exception.

Documentation supporting accuracy of third-party financial transactions

We requested supporting documentation to verify the accuracy of the third-party financial transactions included in Mirant's FCA claim. Mirant has not been able to provide this data. Mirant personnel have represented to us that the third-party invoices cannot be located and the amounts paid to the counterparties cannot be traced to bank statements without these documents.

The Commission's guidance requires that we verify that the source data used in Mirant's FCA calculation is accurate. We will perform procedures on any additional information that

Mr. John Hogan
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can be provided by Mirant during the 30-day dispute resolution period discussed below in an effort to resolve this exception.

Completeness of physical gas purchases

Certain physical gas purchases on a pipeline were excluded from Mirant's FCA claim. Mirant has recently provided documentation to support this exclusion. Due to the timing of the receipt of this data, we have not completed our completeness or accuracy testing on the data.

We compared the physical gas purchases in the FCA claim to Mirant's general ledgers; however, we were not able to completely reconcile the two sets of data due to limitations on the detail of information contained in the general ledgers.

The Commission's guidance requires that we verify that the source data used in Mirant's FCA calculation is complete. We will complete our procedures on this data during the 30-day dispute resolution period discussed below in an effort to resolve this exception.

Heat rate for oil-fired units

Mirant's FCA claim calculates a heat rate for its three oil-fired units by dividing actual oil consumption (in MMBtu) in any given hour by generation output (in MegaWatt-hours) in the same hour. This appears to be an average heat rate calculation.

The Commission's September 24, 2004 Order Denying Rehearing, Clarifying Fuel Cost Allowance Issues, and Accepting In Part Compliance Filing, 108 FERC ¶61,311, paragraph 51, requires that, where possible, Claimants use incremental heat rates in their FCA calculations. The Commission states that an average heat rate may be used only if all electricity sales are mitigated and all sales are to the CAISO and PX.

Mirant has provided us with a revised FCA claim which we understand corrects this exception. Due to the timing of receipt of the revised FCA claim we have not completed our testing procedures at this time. We will complete our procedures on this data during the 30-day dispute resolution period discussed below in an effort to resolve this exception.

CAISO data comparison discrepancies

For certain intervals, quantities and prices for electricity sales included in Mirant's FCA claim do not agree to electronic pricing and quantity data provided to us by CAISO for testing purposes. Further investigation and discussion with CAISO has revealed that some retroactive adjustments are not properly reflected in CAISO's electronic data, and CAISO has identified these specific instances to us.

However, we also noted discrepancies in intervals that were not specifically identified by CAISO. For these intervals, we have asked CAISO to re-affirm the supporting documentation provided by Mirant on a sample basis. This documentation—originally provided to Mirant by CAISO—appears reasonable, based on our review, with one exception.

Mr. John Hogan
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The Commission's guidance requires that we verify that the source data used in Mirant's FCA calculation is accurate. We are working with Mirant to resolve this discrepancy.

As noted above, Mirant has recently provided us with a revised FCA claim upon which we need to complete our procedures. This revised calculation includes a lower FCA claim. We will complete our procedures on this data during the 30-day dispute resolution period.

Resolution of exceptions

Although it is our responsibility to disclose the issues described above, in our opinion, we do not have the authority to determine whether Mirant's FCA claim is, or is not, "deficient" in the eyes of the Commission. We submit these issues as potential departures, while recognizing that only the Commission is in a position to opine on the validity of the methodology used by Mirant. The September 24 and December 20 Orders provides for a 30-day dispute resolution period following submission of this report, and we will endeavor to resolve these exceptions with Mirant during that period.

Responsibilities of Ernst & Young

The Commission described its directive to us in its May 12, 2004 Order Addressing Fuel Cost Allowance Issues, 107 FERC ¶61,160 ("May 12 Order"), paragraph 74. Per the Commission, we are 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 directives.”

The Commission further directed in its September 24, 2004 Order Denying Rehearing, Clarifying Fuel Cost Allowance Issues, and Accepting In Part Compliance Filing, 108 FERC ¶61,311 ("September 24 Order") that:

“. . . if during its review of the claims the independent auditor determines that a filing is inaccurate, incomplete, or not in conformance with our orders, the claim should be found deficient.”

In performing our work, we relied upon the rulings of the Commission in this docket, including the following:

- March 26, 2003 Order on Proposed Findings on Refund Liability, 102 FERC ¶61,317
- April 22, 2003 Order Clarifying Fuel Cost Allowance, 103 FERC ¶61,078
- October 16, 2003 Order on Rehearing, 105 FERC ¶61,066

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- May 12, 2004 Order Addressing Fuel Cost Allowance Issues, 107 FERC ¶61,160 (“the May 12 Order”)
- September 24, 2004 Order Denying Rehearing, Clarifying Fuel Cost Allowance Issues, 108 FERC ¶61,311
- December 20, 2004 Order Addressing Compliance Filing, Emergency Motion, and Comments Following Technical Conference, 109 FERC ¶61,297
- March 18, 2005 Order Granting In Part and Denying In Part Rehearing, Providing Clarification, and Extending Deadline for Submission of Fuel Cost Allowance Claims 110 FERC ¶61,293

We also referred to templates approved for submitting fuel cost information that were developed by CAISO. These templates were included in the following filings with the Commission:

- Motion for Leave to File Answer and Answer of the California Independent System Operator Corporation to Comments and Protests on Compliance Filing, filed September 14, 2004
- Answer of the California Independent System Operator Corporation (“CAISO”) to Indicated Generators’ Motion to Reject the CAISO’s Fuel Cost Submission Template, filed October 5, 2004
- Comments of the California Independent System Operator Corporation Following the October 7, 2004 Technical Conference, filed October 15, 2004
- Seventeenth Status Report of the California Independent System Operator Corporation on Settlement Re-run Activity, filed June 10, 2005

Testing performed

We performed tests for data accuracy and completeness to comply with the Commission’s directive to verify that the source data incorporated into the FCA calculation is correct and comprehensive. We performed tests of the logic of the FCA calculation model to comply with the Commission’s directive to verify that the FCA calculation conforms to the Commission’s directives.

Tests for accuracy

Our tests for accuracy verified that the data inputs in Mirant’s FCA calculation are correct. These tests included identifying and obtaining supporting source documentation and agreeing the calculation inputs back to this source data. For example, when reviewing the physical gas purchases and transportation costs included in the FCA calculation, we verified their

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accuracy by comparing the data included in Mirant's FCA calculation to third-party invoices and/or other supporting documentation.

Other data elements, including metered generation volumes, sales volumes, market clearing prices ("MCPs"), mitigated market clearing prices ("MMCPs"), heat rates, and Harris prices, are on file with CAISO and PX. We obtained this data electronically from CAISO and PX for each day during the Refund Period and compared the information in these data files to Mirant's FCA calculation to assess that the data used in the FCA calculation is correct.

Tests for completeness

Mirant's California power generators purchased all gas from an affiliate company. For the FCA calculation, Mirant identified all third-party purchases at producing basins on pipelines that Mirant had transportation contracts on, so that gas could flow to the California plants. Once Mirant arrived at the third-party purchases made at the producing basins, Mirant brought forward the volumes and prices through all the various levels, adding-in transportation costs, fuel percentages, and other costs and credits if applicable, to the third-party purchase prices as the gas moved towards California. When moving gas forward from one level to the next, Mirant assumed that daily purchases were first moved to the next interconnection point.²

In reviewing the gas purchases included in Mirant's FCA calculation, we performed tests for completeness to assess that Mirant considered for inclusion its entire population of transactions relevant to the FCA calculation and that the subset of transactions ultimately included in the calculation is appropriate.

We tested physical gas purchases by agreeing the universe of gas purchases transactions subject to consideration for inclusion in the FCA model to the dollar amounts of gas purchases in Mirant's general ledger. This was done for all months in the Refund Period.

We then verified that the subset of gas purchases ultimately included in Mirant's FCA calculation is proper.

² For example, if purchases at the basin level totaled 100,000 MMBtus and were 2/3 daily and 1/3 monthly, then assuming only 80,000 MMBtus moved to the next level, the 80,000 MMBtus moved forward were considered to be 66,667 MMBtus of daily gas and 13,333 MMBtus of monthly gas. As a result, as additional purchases were made at various points on the pipeline, the average daily cost of fuel for the various tranches of gas changed as the mix of various tranches of gas changed.

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Tests for logic

We designed our tests for model logic and methodology to:

- Assess that the formulas used in Mirant's FCA calculation are working properly and as intended, and
- Determine that Mirant's overall FCA calculation methodology is in accordance with our understanding of the Commission's orders.

These tests involved physically reviewing the calculations, testing calculation formulas to identify any errors in calculation, mapping out the calculation methodology, and comparing the methodology used to the methodology set forth in the Commission's orders.

We reviewed the formulas incorporated into the FCA calculation to assess that they are free of mechanical errors. In doing so, we manually tested the output of the formulas on a sample basis.

We also reviewed the methodology used to allocate electricity sales to the PX on an individual-unit basis (i.e., economic dispatch method) and the calculation of the daily average cost of fuel, among others.

Format of the FCA calculation

Mirant submitted its FCA claim to us for testing in the format set forth by CAISO. That format provides for electronic spreadsheets for generating units within the CAISO system:

- FCA submissions for mitigated PX energy sales (Table 1)
- FCA submissions for mitigated ISO instructed energy ("IE") sales (Table 2)
- FCA submissions for mitigated ISO uninstructed energy ("UE") sales at the scheduling coordinator ("SC") portfolio level (Table 3)
- FCA submissions for mitigated ISO UE sales at the unit level (Table 4)

Based on discussions with representatives from CAISO, we understand that claimants will be permitted to file separate schedules for the first item above—one table for hour-ahead PX energy sales and one table for day-ahead PX energy sales ("Table 1HA" and "Table 1DA").

CAISO also makes provision for formats for generating units outside of the ISO system, but these are not applicable to Mirant.

Additionally, in accordance with the May 12 Order, we reviewed the following required components of Mirant's FCA submission. We tested these components as part of our overall analysis and review of the FCA calculation:

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- Fuel purchases ranked by term from shortest to longest, which indicates price, term, date, and quantity for each transaction. This information is contained in a spreadsheet called Attachment 7.pdf in Mirant's submission.
- Marginal heat rate by unit. This information is contained in Tables 1a, 1b, 2, and 4 of Mirant's submission.
- Megawatt-hours by unit sold to the ISO/PX over the applicable interval. This information is contained in Tables 1a, 1b, 2, 3, and 4 of Mirant's submission.
- Average daily fuel cost per MMBtu, a demonstration of how this calculation was derived based on the fuel supply stack, and supporting workpapers. Certain information related to this item was provided to us in a variety of Excel spreadsheets underlying Mirant's FCA calculation. We understand that Mirant will be submitting its "SAS" programming language queries to CAISO in support of its calculation of average daily fuel cost.
- Overall fuel cost allowance amount, on a monthly basis, to offset the refund owed by each generator. This information is contained in a document called FCA Filing Methodology – Mirant.pdf in Mirant's submission.

Other disclosures

For certain intervals, quantities and prices for electricity sales included in Mirant's FCA claim do not agree to electronic pricing and quantity data provided to us by CAISO for testing purposes. Further investigation and discussion with CAISO has revealed that some retroactive adjustments are not properly reflected in CAISO's electronic data, and CAISO has identified these specific instances to us. On a sample basis, Mirant provided E&Y with documentation—originally provided to Mirant by CAISO—supporting the prices and quantities used in its calculation model for these intervals. This documentation appears reasonable, based on our review.

Mirant has elected to forego an FCA claim associated with two units at a plant in San Bernardino, CA. Per discussion with Mirant personnel, Mirant did not own the San Bernardino plant; however, Mirant had an arrangement with the owner whereby Mirant was allowed to generate and sell electricity from those units, and these units are classified under Mirant's CAISO SC ID.

* * * * *

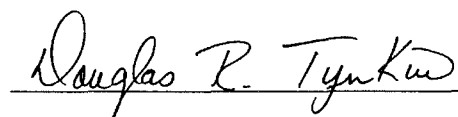
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We performed those procedures that we believe were necessary to comply with the Commission's directives. While those procedures were the same as or similar to those performed in a financial statement audit, we were not engaged to, and did not, perform an audit for the purpose of expressing an opinion on historical financial statements. Accordingly, we do not express such an opinion or any form of assurance on the historical financial statements of Mirant.

We reserve the right to supplement or amend our report upon receipt of additional information.

Very truly yours,
ERNST & YOUNG LLP



Douglas R. Tymkiw, Partner

Copy to: California Independent System Operator
Debra Bolton, Mirant Corporation
Michael A. Yuffee, McDermott Will & Emery LLP

ACCOUNTANTS' REPORT – FUEL COST ALLOWANCE CLAIM
Nevada Power Company
August 26, 2005

 ERNST & YOUNG

August 26, 2005

Mr. Duane Nelson
Nevada Power Company
P.O. Box 10100
Reno, Nevada 89520

Accountants' Report—
Fuel Cost Allowance Claim—Nevada Power

Dear Mr. Nelson:

Ernst & Young LLP (“E&Y”) was selected by the Federal Energy Regulatory Commission (the “Commission”) to test and report on the fuel cost allowance (“FCA”) claims of sellers into the markets (collectively the “Claimants”) operated by the California Independent System Operator (“CAISO”) and the California Power Exchange (“PX”) for the period from October 2, 2000 to June 20, 2001 (the “Refund Period”). Our selection was described in paragraph 10 of the September 2, 2004 Order on Auditor Selection and Request for Waiver and Clarifying Audit Issues, 108 FERC ¶ 61,219 (“September 2 Order”).

You have acknowledged to us that the presentation of Nevada Power Company’s (“Nevada Power’s”) FCA claim is the responsibility of Nevada Power. It is our responsibility to perform testing procedures on that claim and report our conclusions to you.

We have reviewed Nevada Power’s FCA claim, and our procedures and conclusions are set forth herein. We understand that Nevada Power is submitting its FCA claim in the amount of **\$5,965,920** to CAISO contemporaneously with the issuance of this report.

This letter was prepared for use in conjunction with Nevada Power’s fuel cost allowance submission before the Commission, including any disputes that may ensue, and should not be used for any other purpose. It was prepared in accordance with professional standards set forth by the American Institute of Certified Public Accountants for engagements of this nature.

Summary of conclusions

Our tests on Nevada Power’s calculation are described below.

Based on our review and analysis, it is our opinion with respect to Nevada Power’s FCA calculation that the source data used are correct and comprehensive, and that the calculation performed conforms to the Commission’s directives, within immaterial differences, with the exception of the following:

Mr. Duane Nelson
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Heat rates not on file with CAISO

Nevada Power is located outside of the CAISO control area and did not have heat rates on file. The heat rates used in the FCA claim are calculated based upon the heat rate coefficients for each unit. Nevada Power has represented that the heat rates used in the FCA calculation are accurate. We understand that Nevada Power based the heat rate coefficients on tests conducted for the majority of units during 1998 and uses them currently to dispatch their plants. Both incremental and average heat rates are calculated for the generation level of each plant during each interval to rank the plants and calculate the fuel burned for sales to CAISO and PX.

The data on which the heat rate calculations are based appear reasonable. It appears that Nevada Power has performed the heat rate calculations using professional care. However, the heat rates are not based on objective third-party evidence similar to what we have received to verify other issues in the FCA calculation.

Nevada Power has represented that its FCA claim and supporting work papers will be provided to the CAISO, as required by the Commission. This will enable the CAISO to undertake appropriate validation of the heat rate information.

Resolution of exceptions

Although it is our responsibility to disclose the issue described above, we do not believe that we have the authority to determine whether or not Nevada Power's FCA claim is "deficient" in the eyes of the Commission. We submit this issue recognizing that only the Commission is in a position to opine on the validity of the methodology used by Nevada Power. The Commission's September 24 and December 20 Orders provide for a 30-day dispute resolution period following submission of this report and we will endeavor to resolve this exception during that period.

Responsibilities of Ernst & Young

The Commission described its directive to us in its May 12, 2004 Order Addressing Fuel Cost Allowance Issues, 107 FERC ¶61,160 ("May 12 Order"), paragraph 74. Per the Commission, we are 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 directives.”

The Commission further directed in its September 24, 2004 Order Denying Rehearing, Clarifying Fuel Cost Allowance Issues, and Accepting In Part Compliance Filing, 108 FERC ¶61,311 ("September 24 Order") that:

“. . . if during its review of the claims the independent auditor determines that a filing is inaccurate, incomplete, or not in conformance with our orders, the claim should be found deficient.”

Mr. Duane Nelson
Accountants' Report
August 26, 2005

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In performing our work, we relied upon the rulings of the Commission in this docket, including the following:

- March 26, 2003 Order on Proposed Findings on Refund Liability, 102 FERC ¶61,317
- April 22, 2003 Order Clarifying Fuel Cost Allowance, 103 FERC ¶61,078
- October 16, 2003 Order on Rehearing, 105 FERC ¶61,066
- May 12, 2004 Order Addressing Fuel Cost Allowance Issues, 107 FERC ¶61,160 (“the May 12 Order”)
- September 24, 2004 Order Denying Rehearing, Clarifying Fuel Cost Allowance Issues, 108 FERC ¶61,311
- December 20, 2004 Order Addressing Compliance Filing, Emergency Motion, and Comments Following Technical Conference, 109 FERC ¶61,297
- March 18, 2005 Order Granting In Part and Denying In Part Rehearing, Providing Clarification, and Extending Deadline for Submission of Fuel Cost Allowance Claims 110 FERC ¶61,293

We also referred to templates approved for submitting fuel cost information that were developed by CAISO. These templates were included in the following filings with the Commission:

- Motion for Leave to File Answer and Answer of the California Independent System Operator Corporation to Comments and Protests on Compliance Filing, filed September 14, 2004
- Answer of the California Independent System Operator Corporation (“CAISO”) to Indicated Generators’ Motion to Reject the CAISO’s Fuel Cost Submission Template filed October 5, 2004
- Comments of the California Independent System Operator Corporation Following the October 7, 2004 Technical Conference, filed October 15, 2004
- Seventeenth Status Report of the California Independent System Operator Corporation on Settlement Re-run Activity, filed June 10, 2005

Testing performed

We performed tests for data accuracy and completeness to comply with the Commission’s directive to verify that the source data incorporated into the FCA calculation is correct and comprehensive. We performed tests of the logic of the FCA calculation model to comply with the Commission’s directive to verify that the FCA calculation conforms to the Commission’s directives.

Mr. Duane Nelson
Accountants' Report
August 26, 2005

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Tests for accuracy

Our tests for accuracy verified that the data inputs in Nevada Power's FCA calculation are correct. These tests included identifying and obtaining supporting source documentation and agreeing the calculation inputs back to this source data. For example, when reviewing the physical gas purchases, financial gas transactions, and transportation costs included in the FCA calculation, we verified their accuracy by comparing the data included in Nevada Power's FCA calculation to third-party invoices and/or other supporting documentation.

Other data elements, including sales volumes, market clearing prices ("MCPs"), mitigated market clearing prices ("MMCPs"), and Harris prices, are on file with CAISO and PX. To the extent possible, we obtained this data electronically from CAISO and PX for each day during the Refund Period and compared the information in these data files to Nevada Power's FCA calculation to assess that the data used in the FCA calculation is correct.

Because Nevada Power is outside of the CAISO system, no metered generation data is on file with CAISO. Metered generation used in the FCA calculations was compared to direct output from Nevada Power's generation SCADA systems.

Tests for completeness

During the Refund Period, Nevada Power purchased all of its gas for electrical generation from 28 vendors. All purchases from those vendors have been properly considered for inclusion in Nevada Power's FCA calculation.

In reviewing the gas purchases, transportation, and financial transactions included in Nevada Power's FCA calculation, we performed tests for completeness to assess that Nevada Power considered for inclusion its entire population of transactions relevant to the FCA calculation and that the subset of transactions ultimately included in the calculation is appropriate.

We tested physical gas purchases, transportation, and financial transactions by agreeing the universe of gas purchases, transportation, and financial transactions subject to consideration for inclusion in the FCA model to the dollar amounts of gas purchases, transportation, and financial transactions in Nevada Power's general ledger.

We then verified that the subset of gas purchases, transportation, and financial transactions ultimately included in Nevada Power's FCA calculation are proper.

Tests for logic

We designed our tests for model logic and methodology to:

- Assess that the formulas used in Nevada Power's FCA calculation are working properly and as intended, and
- Determine that Nevada Power's overall FCA calculation methodology is in accordance with our understanding of the Commission's orders.

Mr. Duane Nelson
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August 26, 2005

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These tests involved physically reviewing the calculations, testing calculation formulas to identify any errors in calculation, mapping out the calculation methodology, and comparing the methodology used to the methodology set forth in the Commission's orders.

We reviewed the formulas incorporated into the FCA calculation to assess that they are free of mechanical errors. In doing so, we manually tested the output of the formulas on a sample basis. We also reviewed the methodology used to allocate electricity sales to the PX on an individual-unit basis (i.e., economic dispatch method) and the calculation of the daily average cost of fuel, among others.

Format of the FCA calculation

Nevada Power submitted its FCA claim to us for testing in the format set forth by CAISO. That format provides for electronic spreadsheets for generating units within the CAISO system and for generating units outside of the ISO system. Since Nevada Power is outside the control area the electronic spreadsheets are as follows:

- FCA submissions for mitigated **Day Ahead PX** energy sales (Table I-1 (CALPX DAE Sales)) with the associated unit details (Table I-2 (CALPX DAE Unit Dtl))
- FCA submissions for mitigated **Hour Ahead PX** energy sales (Table I-1 (CALPX HAE Sales)) with the associated unit details (Table I-2 (CALPX HAE Unit Dtl))
- FCA submissions for mitigated **ISO instructed energy** ("IE") sales (Table I-3 (CAISO IE Sales)) with the associated unit details (Table I-4 (IE Unit Dtl))
- FCA submissions for mitigated **PXC1 instructed energy** ("IE") sales (Table I-3 (CALPX-IETP Sales)) with the associated unit details (Table I-4 (CALPX IETP Unit Dtl))
- FCA submissions for mitigated **PXC1 uninstructed energy** ("UE") sales (Table I-5 (CALPX-UIETP Sales)) with the associated unit details (Table I-6 (CALPX-UIETP Unit Dtl))

Additionally, in accordance with the May 12 Order, we reviewed the following required components of Nevada Power's FCA submission. We tested these components as part of our overall analysis and review of the FCA calculation:

- Fuel purchases ranked by term from shortest to longest, which indicates price, term, date, and quantity for each transaction. This information is contained in a spreadsheet called "Nevada Power Gas Costs - 6-27-05.xls" in Nevada Power's submission.
- Marginal heat rate by unit. This information is contained in a spreadsheet called "Nevada Power Gas Burn Model - Final 6-13-05.xls" in Nevada Power's submission.

Mr. Duane Nelson
Accountants' Report
August 26, 2005

Page 6

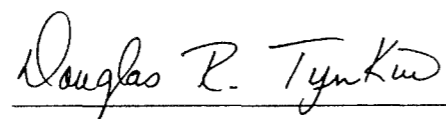
- Megawatt-hours by unit sold to the ISO/PX over the applicable interval. This information is contained in a spreadsheet called "Nevada Power Gas Burn Model - Final 6-13-05.xls" as well as the file named "CAISO & CALPX Submittals - CAISO Templates 7-7-05.xls" in Nevada Power's submission.
- Average daily fuel cost per MMBtu, a demonstration of how this calculation was derived based on the fuel supply stack, and supporting workpapers. This information is contained in a spreadsheet called "Nevada Power Gas Costs - 6-27-05.xls" in Nevada Power's submission.
- Overall fuel cost allowance amount, on a monthly basis, to offset the refund owed by each generator. This information is contained in a spreadsheet called "Monthly Fuel Allowance.xls" in Nevada Power's submission.

* * * * *

We performed those procedures that we believe were necessary to comply with the Commission's directives. While those procedures were the same as or similar to those performed in a financial statement audit, we were not engaged to and did not perform an audit for the purpose of expressing an opinion on historical financial statements. Accordingly, we do not express such an opinion or any form of assurance on the historical financial statements of Nevada Power.

We reserve the right to supplement or amend our report upon receipt of additional information.

Very truly yours,
ERNST & YOUNG LLP



Douglas R. Tymkiw, Partner

Copy to: California Independent System Operator

SUPPLEMENTAL ACCOUNTANTS' REPORT – FUEL COST ALLOWANCE CLAIM

Puget Sound Energy, Inc.
October 11, 2005



October 11, 2005

Julia M. Ryan, Esq.
Puget Sound Energy, Inc.
10885 NE 4th Street, Suite 1200
Bellevue, Washington 98004-5579

Supplemental Accountants' Report—
Fuel Cost Allowance Claim— Puget Sound Energy, Inc.

Dear Ms. Ryan:

In our Accountants' Report dated August 26, 2005 ("Accountants' Report"), we described the results of our analysis of Puget Sound Energy, Inc.'s ("Puget's") fuel cost allowance ("FCA") claim. In that report, we noted certain instances in which we believe that source data used in the FCA claim is not correct and/or comprehensive, or the calculations performed in the FCA claim do not conform to the Commission's directives.

We also noted our intent to work with Puget to resolve those identified exceptions within the 30-day dispute resolution period following the issuance of our Accountants' Report. This Supplemental Report addresses the results of that resolution process.

Puget has not submitted a revised claim to Ernst & Young, but has provided additional supporting documentation for our review. We have reviewed that data, and our procedures and conclusions are set forth herein.

Superseding summary of conclusions

In consideration of the additional supporting documentation, the work performed through August 26, 2005 and the additional work we have performed since the issuance of our Accountants' Report on that date, the conclusion set forth on page 1 of our Accountants' Report remains unchanged as the previously identified exception has not been fully resolved. Our previous and current conclusion is as follows:

Based on our review and analysis, it is our opinion with respect to Puget's FCA calculation that the source data used are correct and comprehensive, and that the calculations performed conform to the Commission's directives, within immaterial differences, with the exception of the following:

Julia M. Ryan, Esq.
October 11, 2005

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Heat rates not on file with CAISO

No heat rates were on file with CAISO for the four plants on which Puget's FCA claim is based. We reviewed the supporting documentation for the heat rates that were used by Puget. The supporting documentation previously provided included the Affidavit of Lloyd C. Reed in Support of Puget Sound Energy, Inc. Gas Cost Filing ("Affidavit") filed May 12, 2003, the supporting calculations, and a description of Puget's methodology. In this Affidavit, it is stated that Puget calculated incremental heat rates for three of the plants used in its gas burn module on "...an hourly basis from hourly temperature readings as recorded at Seattle-Tacoma airport..." These "baseload" heat rates were used in the FCA claim. In addition, during this 30-day period, Puget provided internally generated incremental heat rate curves which vary with unit loads. These heat rate curves indicate heat rates that are higher than those heat rates used in the FCA claim, which vary based upon outdoor air temperature.

For the fourth plant on which Puget's FCA claim is based, Puget provided a plant production report. For this plant, Puget used the "actual daily average incremental heat rates" for each day of the claim period in its FCA claim.

Although Puget has adopted a conservative approach (resulting in a lower FCA claim) based upon the documentation provided, the usage of heat rates that vary based upon outdoor air temperature is not consistent with the methodology employed by other claimants who varied heat rate based upon metered generation levels. In addition, objective third party evidence in the form of supporting documentation, similar to what we have received to verify other issues in the FCA calculation, was not provided and Puget has indicated it is not available, for the heat rate calculations.

We raise this as a potential departure which is best resolved by either agreement of the parties to this proceeding or Commission order. If no party objects to the heat rates or if the heat rates are accepted through either of these methods, we would withdraw this exception.

Resolution of exceptions

Although it is our responsibility to disclose the issue described above, we do not believe that we have the authority to determine whether or not Puget's FCA claim is "deficient" in the eyes of the Commission. We submit this issue as a potential departure, while recognizing that only the Commission is in a position to ultimately opine on the validity of the methodologies used by Puget.

All other elements of Accountants' Report incorporated by reference

In consideration of the additional supporting documentation, and the additional work described immediately above, all content on page 2 of our Accountants' Report of August 26, 2005 up to the section "Responsibilities of Ernst & Young" should be deleted.

Julia M. Ryan, Esq.
October 11, 2005

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Unless a change is specifically noted herein, all other elements of our Accountants' Report remain in effect, and are incorporated herein by reference. A copy of that Accountants' Report is attached as an Appendix to this Supplemental Report.

We reserve the right to supplement or amend our report upon receipt of additional information.

Very truly yours,

ERNST & YOUNG LLP



Sheri L. Toivonen, Partner

Appendix: Accountants' Report of August 26, 2005

Copy to: California Independent System Operator
Kendall Cammermeyer, Esq. – Puget Sound Energy
Mr. Eric M. Markell – Puget Sound Energy

August 26, 2005

Ms. Julia M. Ryan
Puget Sound Energy, Inc.
10885 NE 4th Street, Suite 1200
Bellevue, Washington 98004-5579

**Accountants' Report—
Fuel Cost Allowance Claim—Puget Sound Energy, Inc.**

Dear Ms. Ryan:

Ernst & Young LLP (“E&Y”) was selected by the Federal Energy Regulatory Commission (the “Commission”) to test and report on the fuel cost allowance (“FCA”) claims of sellers into the markets (collectively the “Claimants”) operated by the California Independent System Operator (“CAISO”) and the California Power Exchange (“PX”) for the period from October 2, 2000 to June 20, 2001 (the “Refund Period”). Our selection was described in paragraph 10 of the September 2, 2004 Order on Auditor Selection and Request for Waiver and Clarifying Audit Issues, 108 FERC ¶ 61,219 (“September 2 Order”).

You have acknowledged to us that the presentation of Puget Sound Energy, Inc.’s (“Puget’s”) FCA claim is the responsibility of Puget. It is our responsibility to perform testing procedures on that claim and report our conclusions to you.

We have reviewed Puget’s FCA claim, and our procedures and conclusions are set forth herein. We understand that Puget is submitting its FCA claim in the amount of \$ **3,387,795** to CAISO contemporaneously with the issuance of this report.

This letter was prepared for use in conjunction with Puget’s fuel cost allowance submission before the Commission, including any disputes that may ensue, and should not be used for any other purpose. It was prepared in accordance with professional standards set forth by the American Institute of Certified Public Accountants for engagements of this nature.

Summary of conclusions

Our tests on Puget’s calculation are described below.

Based on our review and analysis, it is our opinion with respect to Puget’s FCA calculation that the source data used are correct and comprehensive, and that the calculations performed conform to the Commission’s directives, within immaterial differences, with the exception of the following:

Ms. Julia M. Ryan
Accountants' Report
August 26, 2005

Heat rates not on file with CAISO

No heat rates were on file with CAISO for the four plants on which Puget's FCA claim is based. We reviewed the supporting documentation for the heat rates that were used by Puget. The supporting documentation included the Affidavit of Lloyd C. Reed in Support of Puget Sound Energy, Inc. Gas Cost Filing ("Affidavit") filed May 12, 2003, the supporting calculations, and a description of Puget's methodology. In this Affidavit, it is stated that Puget calculated incremental heat rates for three of the plants used in its gas burn module on "...an hourly basis from hourly temperature readings as recorded at Seattle-Tacoma airport ...". These "baseload" heat rates were used in the FCA claim. Puget presented heat rates for these plants that varied based upon outdoor air temperature, rather than metered generation.

For the fourth plant on which Puget's FCA claim is based, Puget provided a plant production report. For this plant, Puget used the "actual daily average incremental heat rates" for each day of the claim period in its FCA claim.

Objective third party evidence in the form of supporting documentation, similar to what we have received to verify other issues in the FCA calculation, was not provided, and Puget has indicated it is not available, for the heat rate calculations. Therefore, we raise this as a potential departure which is best resolved by either agreement of the parties to this proceeding or Commission order. If no party objects to the heat rates or if the heat rates are accepted through either of these methods, we would withdraw this exception.

Resolution of exceptions

Although it is our responsibility to disclose the issue described above, we do not believe that we have the authority to determine whether or not Puget's FCA claim is "deficient" in the eyes of the Commission. We submit this issue as a potential departure, while recognizing that only the Commission is in a position to ultimately opine on the validity of the methodologies used by Puget. The Commission's September 24 and December 20 Orders provide for a 30-day dispute resolution period following submission of this report and we will endeavor to resolve this exception with Puget during that period.

Responsibilities of Ernst & Young

The Commission described its directive to us in its May 12, 2004 Order Addressing Fuel Cost Allowance Issues, 107 FERC ¶61,160 ("May 12 Order"), paragraph 74. Per the Commission, we are 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 directives."

Ms. Julia M. Ryan
Accountants' Report
August 26, 2005

Page 3

The Commission further directed in its September 24, 2004 Order Denying Rehearing, Clarifying Fuel Cost Allowance Issues, and Accepting In Part Compliance Filing, 108 FERC ¶61,311 (“September 24 Order”) that:

“ . . . if during its review of the claims the independent auditor determines that a filing is inaccurate, incomplete, or not in conformance with our orders, the claim should be found deficient.”

In performing our work, we relied upon the rulings of the Commission in this docket, including the following:

- March 26, 2003 Order on Proposed Findings on Refund Liability, 102 FERC ¶61,317
- April 22, 2003 Order Clarifying Fuel Cost Allowance, 103 FERC ¶61,078
- October 16, 2003 Order on Rehearing, 105 FERC ¶61,066
- May 12, 2004 Order Addressing Fuel Cost Allowance Issues, 107 FERC ¶61,160 (“the May 12 Order”)
- September 24, 2004 Order Denying Rehearing, Clarifying Fuel Cost Allowance Issues, 108 FERC ¶61,311
- December 20, 2004 Order Addressing Compliance Filing, Emergency Motion, and Comments Following Technical Conference, 109 FERC ¶61,297
- March 18, 2005 Order Granting In Part and Denying In Part Rehearing, Providing Clarification, and Extending Deadline for Submission of Fuel Cost Allowance Claims, 110 FERC ¶61,293
- June 27, 2005 Order Addressing Fuel Cost Allowance Calculation, 111 FERC ¶61,475 (related to Puget only)

We also referred to templates approved for submitting fuel cost information that were developed by CAISO. These templates were included in the following filings with the Commission:

- Motion for Leave to File Answer and Answer of the California Independent System Operator Corporation to Comments and Protests on Compliance Filing, filed September 14, 2004
- Answer of the California Independent System Operator Corporation (“CAISO”) to Indicated Generators’ Motion to Reject the CAISO’s Fuel Cost Submission Template and Answer in Support, filed October 5, 2004
- Comments of the California Independent System Operator Corporation Following the October 7, 2004 Technical Conference, filed October 15, 2004
- Seventeenth Status Report of the California Independent System Operator Corporation on Settlement Re-run Activity, filed June 10, 2005

Testing performed

We performed tests for data accuracy and completeness to comply with the Commission's directive to verify that the source data incorporated into the FCA calculation is correct and comprehensive. We performed tests of the logic of the FCA calculation model to comply with the Commission's directive to verify that the FCA calculation conforms to the Commission's directives.

Tests for accuracy

Our tests for accuracy verified that the data inputs in Puget's FCA calculations are correct. These tests included identifying and obtaining supporting source documentation and agreeing the calculation inputs back to this source data. For example, when reviewing the physical gas purchases and transportation costs included in the FCA calculation, we verified their accuracy by comparing the data included in Puget's FCA calculation to third-party invoices and/or other supporting documentation.

Other data elements, including sales volumes, market clearing prices ("MCPs"), mitigated market clearing prices ("MMCPs"), and Harris prices, are on file with CAISO. To the extent possible, we obtained this data electronically from CAISO for each day during the Refund Period and compared the information in these data files to Puget's FCA calculation to assess that the data used in the FCA calculation is correct.

Because Puget is outside of the CAISO system, no metered generation data is on file with CAISO. Metered generation data used in the FCA calculation was a direct output from Puget's generation LDEC system.

Tests for completeness

During the Refund Period, four generating plants provided electricity to the State of California; two of these plants operate on both natural gas and diesel fuel (distillate oil). In their FCA calculation, Puget is using a blended cost of fuel between oil and natural gas. The term for oil is based upon the number of days it took to burn the fuel purchased. Oil is converted from gallons to MMBtu's so that an average cost for each term in \$/MMBtu can be calculated. Similar terms of Oil and Natural Gas purchases are combined to come up with one fuel cost for that term. During the Refund Period, Puget purchased all of its gas for electrical generation from over 40 vendors of natural gas and three vendors of diesel fuel. All purchases during the Refund Period from those vendors have been properly considered for inclusion in Puget's FCA calculation.

In reviewing the gas purchases included in Puget's FCA calculation, we performed tests for completeness to assess that Puget considered for inclusion its entire population of transactions relevant to the FCA calculation and that the subset of transactions ultimately included in the calculation is appropriate.

Ms. Julia M. Ryan
Accountants' Report
August 26, 2005

We tested physical gas purchases by agreeing the dollar amount of gas purchases in Puget's general ledger during the Refund Period to the universe of gas purchases subject to consideration for inclusion in the FCA calculation. We then verified that the subset of gas purchases ultimately included in Puget's FCA calculation is proper.

We reviewed Puget's financial transactions in sufficient detail to determine how Puget distinguishes between financial transactions that are applicable to the FCA calculation and those that are not. We agree with this exclusion of financial transactions from the FCA.

Tests for logic

We designed our tests for model logic and methodology to:

- Assess that the formulas used in Puget's FCA calculation are working properly and as intended, and
- Determine that Puget's overall FCA calculation methodology is in accordance with our understanding of the Commission's orders.

These tests involved physically reviewing the calculations, testing calculation formulas to identify any errors in calculation, mapping out the calculation methodology, and comparing the methodology used to the methodology set forth in the Commission's orders.

We reviewed the formulas incorporated into the FCA calculation to assess that they are free of mechanical errors. In doing so, we manually tested the output of the formulas on a sample basis. We also reviewed the methodology used to calculate the daily average cost of fuel, among others.

Format of the FCA calculation

Puget submitted its FCA claim to us for testing in the format set forth by CAISO. That format provides for electronic spreadsheets for generating units outside the CAISO system:

- FCA submissions for mitigated ISO instructed energy ("IE") sales at the scheduling coordinator ("SC") portfolio level (Table I-3)
- FCA submissions for mitigated ISO IE sales at the unit level (Table I-4)

CAISO also makes provisions for formats for mitigated PX energy sales, but these are not applicable to Puget.

Additionally, in accordance with the May 12 Order, we reviewed the following required components of Puget's FCA submission. We tested these components as part of our overall analysis and review of the FCA calculation:

- Fuel purchases ranked by term from shortest to longest, which indicates price, term, date, and quantity for each transaction. This information is contained in files called "PSE FCA Gas Purchases Dec 8 - Dec 11 2000 080305.xls" and "PSE FCA Oil Purchases 072005.xls" in Puget's submission.

- Marginal heat rate by unit. This information is contained in a spreadsheet called “Inc Heat Rates - 10 Min” in the file called “PSE FCA Calc Dec 8-11 2000 080305.xls” in Puget’s submission.
- Megawatt-hours by unit sold to the ISO over the applicable interval. This information is contained in a spreadsheet called “PSE-CAISO FCA Template I-3” in the file called “PSE FCA Calc Dec 8-11 2000 080305.xls” in Puget’s submission.
- Average daily fuel cost per MMBtu, a demonstration of how this calculation was derived based on the fuel supply stack, and supporting workpapers. This information is contained in spreadsheets called “Daily Ave Fuel Costs” and “Fuel Allocation” in the file called “PSE FCA Calc Dec 8-11 2000 080305.xls” in Puget’s submission.
- Overall fuel cost allowance amount, on a monthly basis, to offset the refund owed by each generator. This information is contained in a spreadsheet called “FCA Daily Summary” in the file called “PSE FCA Calc Dec 8-11 2000 080305.xls” in Puget’s submission.

Other disclosures

CAISO data comparison discrepancies

For certain intervals, prices for electricity sales included in Puget’s FCA claim do not agree to electronic pricing data provided to us by CAISO for testing purposes. Further investigation and discussion with CAISO has revealed that some retroactive adjustments are not properly reflected in CAISO’s electronic data. On a sample basis, Puget provided E&Y with documentation—originally provided to Puget by CAISO— supporting the prices used in its calculation model for these intervals. We have asked CAISO to reaffirm the supporting documentation provided by Puget. The Puget supporting documentation appears reasonable based on our review.

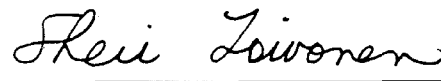
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Ms. Julia M. Ryan
Accountants' Report
August 26, 2005

We performed those procedures that we believe were necessary to comply with the Commission's directives. While those procedures were the same as or similar to those performed in a financial statement audit, we were not engaged to, and did not, perform an audit for the purpose of expressing an opinion on historical financial statements. Accordingly, we do not express such an opinion or any form of assurance on the historical financial statements of Puget.

We reserve the right to supplement or amend our report upon receipt of additional information.

Very truly yours,
ERNST & YOUNG LLP



Sheri Toivonen, Partner

Copy to: California Independent System Operator
Ms. Kendall Cammermeyer, Esq – Puget
Mr. Eric M. Markell – Puget

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list for the captioned proceeding, in accordance with Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Folsom, CA, on this 22nd day of November, 2005.

/s/ Daniel J. Shonkwiler
Daniel J. Shonkwiler