UNITED STATES OF AMERICA 108 FERC ¶ 61,311
FEDERAL ENERGY REGULATORY COMMISSION

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

San Diego Gas & Electric Company,
Complainant

v. Docket Nos. EL00-95-098
EL00-95-109

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
Independent System Operator and the
California Power Exchange Docket Nos. EL00-98-086
EL00-98-096

ORDER DENYING REHEARING, CLARIFYING FUEL COST ALLOWANCE ISSUES, AND ACCEPTING IN PART COMPLIANCE FILING

(Issued September 24, 2004)

1. In this order, the Commission denies rehearing and grants clarification in part of the May 12 order addressing the fuel cost allowance issued in this proceeding.[1] The Commission accepts a compliance filing submitted by the California Independent System Operator Corporation (CAISO or ISO) in Docket Nos. EL00-95-109 and EL00-98-096 in part relevant to the issues raised in the rehearing requests.[2] We also deny a motion to

[1] San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services, *et al.*, 107 FERC ¶ 61,166 (May 12 Order), *clarified*, 108 FERC ¶ 61,219 (2004) (Clarification Order).

[2] The Commission will address remaining aspects of the CAISO's compliance filing in a separate proceeding.

lodge filed by the California Parties[3] on August 16, 2004. This order benefits customers by clarifying aspects of the fuel cost allowance methodology and bringing closure to this proceeding.

Background

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

3. On March 26, 2003, the Commission issued an order which, among other things, changed the methodology for calculating the MMCP for the Refund Period.[4] In recognition of the fact that the revised methodology would tend to reduce the MMCP and could potentially reduce it below sellers' actual fuel costs, the Commission provided sellers with the opportunity to make claims for a fuel cost allowance to recover the difference between their actual fuel costs for mitigated sales and the proxy for gas prices used in calculating the MMCP.

4. The March 26 Refund Order also provided guidance as to how to assign actual fuel costs to the mitigated transaction. In order to verify that generators paid spot gas prices, each generator was required to base its additional fuel cost allowance on its actual daily cost of gas incurred to make spot power sales in the PX and CAISO spot markets. Sellers were instructed to assign their shortest-term gas supplies to spot power sales, proceeding

[3] The California Parties are the People of the State of California *ex rel.* Bill Lockyer, Attorney General, the California Electricity Oversight Board, the California Public Utilities Commission (CPUC), Pacific Gas and Electric Company (PG&E), and Southern California Edison Company (SoCal Edison).

[4] *See* San Diego Gas & Electric Co., *et al*., 102 FERC ¶ 61,317 (March 26 Refund Order), *order on reh'g*, 105 FERC ¶ 61,066 (2003) (October 16 Rehearing Order).

sequentially to the next shortest term supply, until a generator's spot power demand for gas is met. The average cost of this portion of the generator's gas supply portfolio would serve as the cost of gas for the additional fuel cost allowance.[5]

5. In addition, the March 26 Refund Order directed parties to file their actual daily cost of gas information, using the prescribed methodology. Subsequently, 22 sellers submitted fuel cost allowance claims, and the California Parties filed a motion to reject those claims. On April 22, 2003, the Commission issued an order clarifying the methodology for calculating fuel cost allowances.[6] On May 22, 2003, the Commission's Staff held a technical conference to, among other things, permit parties to discuss the issues arising from the fuel cost allowance filings and the California Parties' motion to reject those filings. On October 16, 2003, the Commission issued an order addressing requests for rehearing of the March 26 Refund Order which further clarified the method for calculating refunds for electricity purchases made in the spot market of California. That order also established the gas proxy data series to be used as the baseline over which their fuel cost allowance claims will be calculated. Issues emanating from the technical conference together with additional issues raised on rehearing of the April 22 Order and pertinent issues raised on rehearing of the October 16 Rehearing Order were addressed in the May 12 Order.

6. The following parties sought rehearing and/or clarification of the May 12 Order: California Parties, Arizona Electric Power Cooperative, Inc. (AEPCO), Mirant,[7] Duke Energy North America, LLC and Duke Energy Trading and Marketing, L.L.C. (Duke), Hafslund Energy Trading, LLC (Hafslund), and Silicon Valley Power of the City of Santa Clara, California (SVP). Several contend that the Commission failed to address other issues raised in earlier-filed requests for rehearing. On June 29, 2004, the Northern California Power Agency (NCPA) filed an answer to California Parties' rehearing request. In addition, parties raised questions about the implementation of the audit in separate pleadings.

---

[5] *See* March 26 Refund Order at 62,071.

[6] San Diego Gas & Electric Co., *et al*., 103 FERC ¶ 61,078 (2003) (April 22 Order).

[7] Mirant includes: Mirant Generators California LLC, Mirant Generators Delta, LLC, Mirant Generators Potrero LLC, and Mirant Americas Energy Marketing, LP (MAEM).

7. On July 26, 2004, the Commission convened a technical conference on refund procedures and accepted comments on outstanding issues that have implications for the refund process. Several parties filed comments mentioning issues related to the fuel cost allowance which are addressed in other parts of this order. In addition, parties raise an issue that is not pending rehearing. Specifically, they request additional clarification regarding recovery of fuel costs during instances in which a unit is mitigated (due to the existence of soft caps in CAISO markets) even when the MMCP was greater than the original clearing price. This order responds to those comments.

8. On August 16, 2004, the California Parties filed a third supplemental motion to lodge (August 2004 Motion to Lodge) certain Commodity Futures Trading Commission (CFTC) orders and a consent order issued by the United States District Court for the Southern District of Texas Houston Division (District Court Order). California Parties explain that these orders contain findings of fact concerning the manipulation of gas markets and price misreporting, and that such findings are relevant because they provide additional support for Commission determinations that gas price indices were unreliable, and lend support to California Parties' proposition that entities which manipulated the gas markets should not be eligible to receive a fuel cost allowance. One group of parties filed in opposition to the motion, as described below.

9. On August 26, 2004, Puget Sound Energy, Inc. (Puget) filed a request for waiver of the August 30, 2004 deadline. The Commission issued a notice of extension of the deadline on August 27, 2004, indicating that the deadline would be extended until further action by the Commission in this proceeding.

10. On September 2, 2004, the Commission issued an order selecting the firm of Ernst & Young to conduct the independent review of the fuel cost allowance claims[8] and acting on certain parties' requests for waiver from the audit requirements. The Commission explained that a general waiver of the requirements was not possible, but a seller could choose not to pursue its fuel cost allowance claim and thus avoid the cost of an audit, or if no party opposes an entity's claim, then that claim would not require the verification of the auditor.[9] The Commission also agreed to build in more time for the audit process to be completed and clarified other aspects of the audit process, such as the allocation of the costs of the audit, the scope of the auditor's review, and the role of the auditor.

---

[8] Clarification Order, 108 FERC ¶ 61,219 at P 10-12.

[9] *Id.* at P 22-24.

Compliance Filing

11. On August 17, 2004, the CAISO filed a proposed methodology for allocating fuel cost allowance amounts in compliance with the May 12 Order. Briefly, the CAISO proposes to allocate the fuel cost allowance through a five-step process that will occur outside of the ISO settlement rerun process and will be applied before the calculations of interest and final net amounts owed by and owing to each participant are determined. The CAISO also recommends that the Commission direct generators to file their fuel cost data on an hourly basis.

12. Notice of the compliance filing was published in the *Federal Register*, 69 Fed. Reg. 52,500 (2004), with comments and protests due on or before August 30, 2004. Protests were filed by: Constellation NewEnergy, Inc. (Constellation), NCPA, California Parties, Sempra Energy Trading Corp. (Sempra), Enron Power Marketing, Inc., Reliant Energy Power Generation, Inc., AEPCO, the Competitive Supplier Group,[10] and jointly by several Dynegy affiliates and Williams Power Company, Inc.

Discussion

Procedural Matters

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

Does the Fuel Cost Allowance Improperly Intermingle Cost-Based and Market-Based Rates?

14. California Parties argue on rehearing of the March 26 Refund Order and the May 12 Order that generators should not be permitted to recover both the market-based MMCP and a cost-based adder to that rate. California Parties reason that, since the MMCP is based on the marginal unit, for all units but the marginal unit there is a premium that flows to the generator equal to the difference between its own marginal cost and the rate calculated using the MMCP. California Parties believe that when a fuel cost allowance is added to the MMCP, there will be a double assessment of costs to consumers, yielding, they allege, a *per se* unjust and unreasonable rate. Further, they note that earlier the Commission permitted sellers to file for cost of service rates covering all their generating units in the event the MMCP does not sufficiently cover their costs.

[10] The Competitive Supplier Group consists of: Avista Energy, Inc., Constellation Power Source, Inc. Coral Power, L.L.C., IDACORP Energy L.P., Portland General Electric Company, Powerex Corp., and Puget Sound Energy, Inc.

According to California Parties, this portfolio-based approach, which does not intermingle different rate paradigms, is consistent with precedent and should be all that sellers require should they determine the MMCP does not provide adequate recovery of costs; they contend that allowing the fuel cost allowance does not reflect reasoned decision making nor is based on substantial evidence, but is arbitrary and capricious.

Commission Determination

15. To the extent California Parties object to any portion of the refund calculation intermingling cost-based and market-based elements, we find this to be a collateral attack on the orders establishing the MMCP, which has from the start allowed sellers a cost-based operation and maintenance (O&M) adder. The United States Court of Appeals for the Ninth Circuit (Ninth Circuit) has exclusive jurisdiction over the matters in those orders for which rehearing was sought and a petition for review was filed,[11] and this Commission cannot entertain further challenges to establishment of the MMCP.

16. The Commission stands by its decision to limit refunds to the extent of allowing sellers to at least recover their fuel costs. The fuel cost allowance is not an assessment of costs to customers, but is instead an offset to refunds available. This offset is available only when generators can demonstrate clearly that they would not be made whole for the costs they incurred to make mitigated because of a "difference between their actual fuel costs for mitigated sales and the proxy for gas prices used in calculating the MMCP."[12] Sellers are not benefiting twice by receiving a fuel cost allowance. Moreover, the effect of the fuel cost allowance is to act as a floor under which the fuel portion of the simulated market rate (the MMCP) may not fall. This is consistent with the Commission's policy not to establish a refund so high as to prevent a seller from recovering its variable costs.[13] That policy applies regardless whether the underlying rate is cost-based or market-based. The availability of another route for sellers to recover their costs (*i.e.*, the opportunity to submit the entire portfolio of costs and revenues and seek cost-based recovery) does not render the fuel cost allowance unreasonable.

---

[11] *See* Public Utilities Commission of the State of California, *et al.* v. FERC, No. 01-71051 (9th Cir. Aug. 21, 2002).

[12] May 12 Order at P 3.

[13] *See* Carolina Power & Light Company, 87 FERC ¶ 61,083 (1999) (limiting the application of the penalty for selling in violation of the FPA to an amount that permits the seller to recover variable costs, *i.e.*, fuel costs and variable O&M expenses). *See also* Coastal Oil & Gas Corp. v. FERC, 782 F.2d 1249 at 1253 (5th Cir. 1986) (ruling that disgorgements must still let a seller recover its costs).

Adequate Justification for Fuel Cost Allowance

17. According to California Parties, the Commission placed considerable reliance on a study[14] commissioned by a group of California generators to justify the need for a fuel cost allowance mechanism. California Parties state that they were provided no opportunity to examine or challenge the study and that they continue to have concerns with the validity of evidence presented in the study. California Parties conclude that the Commission's reliance on an "untested and possible flawed report" is in error, and thus the Commission should reject the fuel cost allowance mechanism. Among the concerns they identify are: there was no independent verification of the data selection process; the data used were not comparable among the gas traders that supplied the data; there was inadequate explanation for the filtering of outliers; and circular comparisons were made between index transactions and index prices.

Commission Determination

18. In the March 26 Refund Order, the Commission found that there was no way to precisely replicate the levels that spot gas prices would have reached in a competitive market. To emulate a competitive market as closely as possible, the Commission adopted the gas proxy data series based on producing-area prices plus a tariff rate transportation allowance that was developed by California Parties; the use of this data series was for the most part unopposed by sellers. However, the Commission recognized that in addition to market dysfunction and price manipulation, the effects of scarcity were also a factor in the high prices of California spot gas paid by generators and would not be reflected in the gas proxy price. The study identified by California Parties merely reaffirms this fact.

19. In order to ensure that generators are made whole for the fuel costs they incurred to supply power into spot markets whose prices were subsequently mitigated, the Commission provided generators the opportunity to file for a fuel cost allowance. We note that a fuel cost allowance for each generator is not guaranteed; rather, the burden is upon the generator to prove that its fuel costs actually exceeded the gas proxy series in order to claim an offset to the refund obligation. We therefore reject rehearing on this issue.

How, if at all, should an affiliate's gas costs be reflected in the fuel cost allowance?

20. The May 12 Order determined that intra-corporate transfer prices do not necessarily reflect "actual" fuel costs and directed that claimants who purchased fuel

[14] *See* Study by Drs. Wang and Reihus filed by the Generator Group (Mirant, Dynegy, Williams, Duke Energy and Reliant Energy) as a comment on the Initial Staff Report in Docket No. PA02-2-000.

from marketing affiliates must present the actual cost of fuel incurred by the affiliate who first obtained the fuel.

21. On rehearing Duke argues that it did not, as asserted in the May 12 Order, rely on intra-corporate valuation at the spot price to calculate its gas cost allowance. Duke argues that the Commission decided to reject the seller's methodology for calculating gas costs based on this misunderstanding. Duke states that "while [gas purchasing transactions] are documented mostly by intra-corporate transactions between the electricity group and the gas group, the transactions were done in transparent markets where the fact is verifiable."[15]

22. Mirant argues in its rehearing request that the Commission offered no explanation as to why its approach to account for affiliate purchases does not represent the true cost of the fuel purchased. Mirant makes a distinction between its generator subsidiary and its gas marketing affiliate and provides four reasons why it should be allowed to recover the fuel costs paid to the gas marketing affiliate. First, Mirant argues that, absent a showing of undue preference, there is no reason to treat an affiliate sale to its generator any differently than a sale by the affiliate to a third party. Second, Mirant states the record reflects that its affiliate is a separate corporate entity in Mirant's bankruptcy proceeding. Third, Mirant argues its gas marketing affiliate is not seeking to recover fuel costs as part of Mirant's submission nor is the Commission seeking to impose refunds on the natural gas sales that the affiliate made during the refund period. Thus, its gas marketing affiliate's fuel costs are not relevant in this proceeding. Fourth, Mirant states that the Commission's decision to allow generators to recover fuel costs only up to the price that their affiliate paid is tantamount to imposing confiscatory refunds on its generator subsidiary. Mirant believes in this situation its generator subsidiary will not be able to recover the price it paid for fuel.

23. Mirant further asserts that the Commission has previously pierced the corporate veil only after finding that the entities in question: (1) were each other's "alter ego;" (2) were dominated by the same individual or shareholder; or (3) acted in concert to thwart Commission policy. Mirant contends that none of these conditions have been met, and thus Mirant should not be required to pierce the corporate veil to arrive at its fuel costs. Mirant also argues that "pierc[ing] the corporate veil amounts to a de facto partial substantive consolidation of the estates of separate debtor entities, i.e., MAEM and Mirant Generators – a remedy which lies within the exclusive jurisdiction of the bankruptcy court."[16] According to Mirant, by requiring the use of fuel costs incurred by the affiliate who initially obtained the fuel, the Commission is exercising control over the

---

[15] Duke Request for Rehearing at 19.

[16] Mirant at 12, cite omitted.

assets and liabilities of Chapter 11 estates to the exclusion of the bankruptcy court, which has exclusive jurisdiction over the property of the estate.

Commission Determination

24. Duke's request for rehearing is denied. In the May 12 Order, the Commission neither rejected nor accepted Duke's method for calculating its gas costs. Duke's argument that it did not rely on intra-corporate valuation at spot price to calculate its fuel cost allowance is thus immaterial.[17] Accordingly, we again direct Duke and all other applicable sellers to present the actual costs of fuel incurred by their affiliate who first obtained ownership of the fuel for the combined corporate entity.

25. We find Mirant's arguments to treat its various affiliates separately to be unpersuasive in the context of calculating refunds. The purpose of ignoring intra-corporate transactions or valuations is to best determine each claimant's actual fuel costs by eliminating any issues of potential affiliate abuse. Our decision to utilize the cost of fuel incurred by the affiliate who first obtained ownership of the fuel has no bearing on any entity's liability and does not require that any particular corporate assets be affected. It is not the case that the Commission is exercising control over the assets and liabilities of MAEM and Mirant Generators. The Commission requires this cost data for purposes of supporting the fuel cost allowance, but has not and does not intend to direct which affiliate will receive the allowance. All of the Mirant affiliates jointly filed a single fuel cost allowance claim; how the money will be apportioned or moved among them has thus not been placed before the Commission. As presented by Mirant, there is no risk that our ruling will amount to "a *de facto* partial substantive consolidation" of the debtors' estates. In any event, the Commission is not necessarily barred from prescribing the evidentiary burdens needed to justify rate claims made by debtors in bankruptcy or other sellers. As stated recently by the Fifth Circuit Court of Appeals, "[t]he Bankruptcy Code clearly anticipates ongoing governmental regulatory jurisdiction while a bankruptcy proceeding is pending."[18]

How, if at all, should other uses of gas be reflected in the fuel cost allowance calculations?

26. The May 12 Order responded to California Parties' arguments that generators (or their marketing affiliates) could have purchased short-term gas for reasons other than to

[17] We note that the May 12 Order at P 20 implied as fact (instead of identifying as a California Parties contention) that, "Duke…relied on intra-corporate valuation at the spot price." This was an oversight that we hereby correct.

[18] In the Matter of: Mirant Corporation, No. 04-10001 (5th Cir. Aug. 4, 2004).

support sales to the ISO or PX and that a fuel cost allowance can only be granted if it is supported with information on the generator's entire gas portfolio. The Commission stated that this would introduce an unmanageable amount of complexity into an already complicated refund calculation. The May 12 Order stated that if a generator has sold one less MW of spot power in the ISO and PX markets, it would have bought one less unit of the shortest-term gas available, and it followed that all other uses of gas must be viewed as having been served using only the gas supplies that remained after these mitigated spot power sales were served. Thus, the Commission determined that there was no need to reflect other uses of gas in the fuel cost allowance claims.

27. In an expedited request for rehearing, California Parties continue to argue that fuel purchases must be offset by fuel sales of the same term in order to achieve the Commission's goal of allowing sellers to recover only their actual fuel costs. California Parties contend that the Commission's failure to order sellers to net fuel purchases and sales will result in inflated fuel cost allowance claims based on fuel purchases that never resulted in power being generated. Furthermore, California Parties note that failure to net fuel purchases and sales would allow sellers that engaged in wash trades, churning and other offsetting transactions to recover the cost of paper trades for which no gas was ever delivered.

28. To illustrate their point, California Parties provide an example whereby a seller of electricity buys 200 units of spot gas and also sells 190 units of spot gas. California Parties argue the seller should not be able to allocate 200 units of spot gas to spot electricity sales for the purpose of the fuel cost allowance.

29. In their separate request for rehearing, California Parties also continue to argue more broadly that each seller's complete gas portfolio must be evaluated to determine the actual availability of gas for electric generation. In addition to gas sales, California Parties re-list potential activities that they believe would lower the amount of shorter-term gas available for mitigated sales. These activities are: to serve other generation than mitigated sales; to address past gas imbalances; to meet obligations under long-term agency arrangements; and for injection into storage. Finally, in what they identify as a related matter, California Parties question whether sellers have adequately justified their California gas costs in conjunction with their (or their affiliates) trading activities in the producing basins.

Commission Determination

30. Regarding the offsetting of fuel purchases with fuel sales, we find no merit in the California Parties' arguments. First, the May 12 Order specifically addressed California Parties' concern with the resale of gas as part of its determination on other uses of gas:

> …[the Commission] assigned spot gas purchases to spot power sales first based on the principle of marginal purchase, which follows that: (1) spot

> power sales were made at the margin after the generators' longer-term power obligations were served, and (2) spot gas was bought to serve the spot power sales. If the generator has sold one less MW of spot power in the ISO and PX markets, it would have bought one less unit of the shortest-term gas available. Given that framework, it follows that other uses of gas [*e.g.*, resale of gas] must be viewed as having been served using only the gas supplies that remained after these mitigated spot power sales were served. Accordingly, there is no need to reflect other uses of gas in the fuel cost allowance claims.[19]

31. Second, we reiterate that this framework identified in the May 12 Order is entirely consistent with our finding in the Refund Proceeding that marginal heat rates should be used to determine the MMCP and that spot power sales to the ISO/PX were an incremental use of sellers' generation assets.

32. Third, in arguing their case, California Parties incorrectly assume that the gas provided in a spot sale must be the same gas that was originally obtained from a spot purchase. Consistent with our principle of marginal purchase, however, gas from a spot purchase is *not* the same gas that was sold in the spot market to the extent that the spot gas purchased was needed to make a mitigated electricity sale to the ISO or PX. Taking California Parties' example, to the extent a seller used 200 units of spot gas purchased to make a mitigated electricity sale, those 200 units are eligible for a fuel cost allowance. The 190 units of gas sold would then have originally come from other, longer-term gas purchases.

33. Regarding the issue of gas trading activities in the producing basins, we refer to the preceding section's determination on affiliates. With regard to all remaining points related to other uses of gas, we will deny rehearing and note that California Parties raise no new issues in their arguments that have not previously been addressed in the May 12 Order.

How, if at all, should hedging transactions be reflected in the fuel cost allowance calculations?

34. In response to the concern that many generators ignored the impact of hedging arrangements and other financial derivatives or contractual arrangements in their fuel cost allowance calculations and thus the generators' fuel cost allowances are overstated, the Commission clarified that any hedging instruments or other financial transactions should be reflected in the fuel cost allowance claims only if they are tied to the gas purchases attributed to spot power sales under our methodology. The Commission directed generators to allocate gas purchases by the term associated with the underlying hedge.

---

[19] *See* May 12 Order at P 25.

35. On rehearing California Parties continue to argue that short-term gas purchases are associated with a generator's entire hedging portfolio. California Parties contend that hedging instruments are bought and sold on a continual basis to manage price risk associated with future short-term gas purchases. They repeat that it is thus reasonable to allocate the financial flows associated with all hedging instruments to all gas purchases on a *pro rata* basis.

Commission Determination

36. We will deny rehearing on this point, noting that California Parties have raised no new arguments that the Commission has not previously considered and rejected.

Can the cost of fuels other than gas be recovered through the fuel cost allowance?

37. In the May 12 Order, the Commission found no basis to exclude the cost of any alternative fuel from the fuel cost allowance. The Commission explained that it was irrelevant whether the MMCP is based on gas costs because the MMCP is meant to serve as a proxy for a competitively-set single market clearing price based on the bid of the marginal unit which is most likely to be a gas-fired unit. In contrast, the fuel cost allowance was meant to ensure that generators could recover their actual cost of fuel for all units associated with mitigated sales, not just the marginal unit. As long as fuel was burned to make mitigated sales and the cost of that fuel exceeded the proxy for gas prices used in computing the MMCP, the cost can be included in the fuel cost allowance.

38. On rehearing California Parties state that, as a concept, they do not disagree with the Commission's determination to permit an allowance for fuels other than natural gas. They argue, however, that the Commission did not address any non-gas cost specific issues and point out that energy conversion may complicate claims for non-gas fuel allowances. California Parties conclude that each seller claiming non-gas fuel costs must meet the same burden of proof as sellers claiming gas costs.

Commission Determination

39. We will deny rehearing on this point but grant clarification. As a general matter, California Parties raise no arguments that the Commission has not previously addressed. However, with regard to energy conversion, we will elaborate for the benefit of the independent auditor. Any sellers using non-gas fuels should so specify in their claims and provide evidence for the grade of fuel purchased and burned to make the mitigated sale, together with the associated energy conversion factor.

Should pumped-storage hydro generators be able to claim the fuel cost associated with their ultimate thermal generation source?

40. In the May 12 Order, the Commission permitted the Los Angeles Department of Water and Power (LADWP) to recover fuel costs associated with its pumped-storage sales to the ISO or PX. The input electricity used by a pumped storage facility can come from owned generation or purchased power. In LADWP's case, it comes from LADWP-owned generation which is located elsewhere on LADWP's system. Thus, there is only a single entity, LADWP, both generating the input electricity and making the sale to the ISO or PX, and recovery of the fuel costs is appropriate. The Commission distinguished this from the situation where a pumped-storage facility purchased third-party power as input electricity, in which case there was no relevant difference from a more traditional power marketer.

41. On rehearing California Parties raise three points to argue that the Commission should reject the claimed costs associated with the pumped-storage facilities. First, California Parties raise doubts as to whether the Castaic hydroelectric power plant is actually LADWP's highest-cost generation unit, and hence whether Castaic was capable of being used to make sales outside the LADWP system (given LADWP's obligation to serve native load with cheaper power). Second, California Parties argue that, without a detailed accounting of LADWP's power purchase activities, it is impossible to ascertain whether LADWP actually used its own thermal generation to power the pumped storage device. Third, California Parties cite several complex water management/water accounting issues that they believe are beyond the scope of verification by an independent auditor. These issues are: which hours of generation should be associated with which hours of electricity production from Castaic; how should the costs of generation be allocated if electricity is not produced during a given week; and how does LADWP's traditional accounting of Castaic's operating costs compare to the approach adopted for the fuel cost allowance claim? California Parties close their argument by requesting that if the claims from pumped storage costs are not rejected, the matter cannot be resolved by the independent auditor and should instead be set for hearing to resolve what California Parties consider are material issues of fact.

Commission Determination

42. We will deny rehearing on all three points. With regard to the first point as to whether Castaic was the most expensive of LADWP's units to operate, we note that the sworn Affidavit accompanying LADWP's fuel cost allowance claim clearly states that, "Castaic was the highest cost unit."[20] With regard to the second point concerning

[20] LADWP May 12, 2003 filing, Affidavit of Mark Ward at 8:14.

purchased power, we find that California Parties have presented no arguments that they have not previously raised. We emphasize that the burden is on LADWP to prove, following the Commission's directives, that LADWP actually used its own thermal generation to power the pumped storage device.

Regarding the third point on water management and accounting issues, we address below each of California Parties' questions and conclude that these issues are not beyond the scope of the independent auditor. The first question of which hours of generation should be allocated to which hours of electricity production at Castaic is answered in LADWP's fuel cost allowance filing. LADWP states that it uses a weekly average,[21] which the Commission finds to be a reasonable methodology. The second question is how generation costs would be allocated if electricity is not produced at Castaic during a given week. Again turning to the methodology described in LADWP's fuel cost allowance filing, LADWP states, "If Castaic was not generating in the hour…sales were allocated to the highest thermal unit that was operating."[22] This procedure appears to follow the methodology developed by the Commission regarding non-unit specific heat rates. In their third and final question, California Parties fail to adequately explain why it is necessary to compare how LADWP traditionally accounts for Castaic's operating costs with the approach used in its fuel cost allowance filing. We note that the fuel cost allowance covers both a specific time period and addresses a specific matter. The Commission has laid out the methodology to be used in calculating the fuel cost allowance, and we thus find any historical comparisons irrelevant to the proceeding at hand.

Are out-of-state generators eligible to receive a fuel cost allowance?

43. The Commission allowed out-of-state generators to make fuel cost allowance claims provided that they could adequately support their filings in the same way that all other claimants must. In other words, as long as fuel was burned to effectuate a mitigated sale to the ISO or PX, and the fuel was more expensive than the MMCP, the Commission would entertain a fuel cost allowance claim.

44. On rehearing, California Parties argue that certain out-of-state filings should be rejected unless sufficient and verifiable evidence can be adduced to show a clear and convincing linkage between the seller's generation and the ISO and PX sales to which that generation purports to relate. As an example, California Parties state that Tucson Electric Power Company provides no documentation or even a theory to establish generation from its four units as the source of ISO and PX sales.

---

[21] *Id*. at 11-13.

[22] *Id.* at 8:16-18.

Commission Determination

45. We will deny rehearing on this point. We remind California Parties that none of the sellers have had an opportunity to comply with either this order or the May 12 Order. However, we will also emphasize that only those fuel cost allowance claims that can be verified by the independent auditor in accordance with the Commission's directives will be accepted. The burden is on those seeking the claim.

How much information must generators provide on their full range of electricity activities?

46. The May 12 Order clarified that allocation of gas purchases to "spot power sales" refers only to sales in the PX and ISO spot markets, not to spot bilateral sales. Further, the Commission stated that allocation of gas purchases should assign the shortest-term gas supplies first to the ISO/PX sales ahead of bilateral spot sales. For those times when generators made mitigated sales from purchased power, however, they acted as marketers, and thus no fuel cost allowance would be permitted from those periods or transactions.

47. On rehearing, California Parties continue to argue that spot gas purchased for spot bilateral sales cannot be distinguished from spot gas purchased for spot ISO/PX sales. California Parties reason that the issue of what gas was purchased for what sale should be a question of fact to be answered on a case-by-case basis. Further, California Parties claim that some sellers purchased electricity from the market specifically to make ISO and PX sales and thus these purchases should be ineligible for a fuel cost allowance.

Commission Determination

48. We remain unconvinced by California Parties' argument that ISO/PX spot sales and bilateral spot sales are equivalent for the purposes of the fuel cost allowance. Accordingly we deny rehearing on this point. With regard to generators' power purchases, we agree with California Parties and emphasize that only those fuel cost allowance claims that can be verified by the independent auditor in accordance with the Commission's directives will be accepted.

Should average or incremental heat rates be used to calculate the fuel cost allowances?

49. While the Commission has conclusively found in past orders that incremental heat rates should be used in the MMCP calculation,[23] the first order to discuss whether

[23] *See* March 26 Refund Order at 62,066, and October 16 Rehearing Order at 61,367-68.

average or incremental heat rates should be used to calculate the fuel cost allowances was the April 22 Order. The April 22 Order stated simply that the use of incremental heat rates in the determination of the additional fuel cost allowance would be consistent with the calculation of the MMCP. [24] The May 12 Order denied rehearing on this point, holding that to the extent that a generator must, for purposes of this fuel cost allowance calculation, use heat rate data to determine how much fuel was burned by a unit at a particular level of output, incremental heat rates should be used. The Commission explained further that because the predominantly incremental use of generation took place using predominantly the last MWhs produced by the unit, incremental heat rates are most appropriate for use in the fuel cost allowance calculations.

50. On rehearing, AEPCO requests that it be allowed to utilize average heat rates for the fuel cost allowance calculations. AEPCO argues that without the mitigated electricity sales made into the ISO and PX markets, AEPCO's units would not have been operating. AEPCO concludes that in this situation the incremental heat rate is equivalent to the average heat rate. SVP states it did not have a Participating Generator Agreement with the CAISO, was thus not required to maintain incremental heat rate information, and can only identify average heat rates for its generation units. However, SVP indicates that it only made mitigated sales to the PX, which typically required the entire output from the unit involved. Thus, SVP argues, there is no material difference between the units' average and incremental heat rates. Similarly, NCPA states in its answer to California Parties' rehearing that it did not have certain Participating Generator Agreements or incremental heat rate information on file with the CAISO. However, in its May 12, 2003 fuel cost allowance filing, NCPA indicates it employed one of two methods to develop its own incremental heat rate information*:* (1) when available, use the unit's lowest incremental heat rate; or (2) use the incremental heat rates of the most efficient comparable unit for which the CAISO has on file.

Commission Determination

51. We will deny rehearing on this issue. In keeping with the principle of marginal purchase that was outlined in the May 12 Order, we reiterate that, where possible, sellers should use incremental heat rates that are filed with the CAISO to determine their fuel cost allowance. However, in the case where sellers did not have incremental heat rate information on file with the CAISO, we will grant clarification and provide further guidance. If the entire output of a seller's unit during a particular interval consists of only mitigated sales into the ISO and PX markets, we agree that the average and incremental heat rates are equivalent, and thus the average heat rate may be used. If, on the other hand, not all of the electricity output from a unit was sold into the mitigated ISO and PX markets during a particular interval, we direct sellers to determine the

[24] *See* April 22 Order, 103 FERC ¶ 61,078 at 61,259.

incremental heat rates of the most efficient comparable unit for which the CAISO has on file.

How should generators assign heat rates to mitigated power sales that are not unit specific?

52. In the May 12 Order, the Commission found that it is reasonable to assume that a generator would have operated each of its units in order of higher to lower efficiency until all power sales were fulfilled. The Commission reasoned that a mitigated, non-unit specific power sale would have been part of the very last amount of electricity produced, and rejected California Parties' proposal to use a *pro rata* allocation of each generating unit over all sales not tied to a specific generating unit because sellers may have submitted fuel cost allowance claims that assign the heat rate from their least efficient generation to these power sales.

53. On rehearing, California Parties argue that using the heat rate of the marginal unit for non-unit specific sales must be limited by: (1) the actual level of sales from such units; and (2) the actual gas purchases by a generator during the day in which the spot electricity sales are made. Furthermore, California Parties argue that, if the CAISO cannot determine whether sales were from purchased power or generation resources and where the CAISO has no basis for determining the operating characteristics of such resources, the associated claim should be disallowed.

Commission Determination

54. We agree with California Parties that the use of the marginal unit heat rate for non-unit specific sales must be limited by the unit's actual level of sales. Consistent with our finding that fuel cost allowance should be based upon the MWh actually sold into the CAISO and PX markets,[25] we explain that once the actual level of output from a unit is reached, the incremental heat rate from the next least efficient unit in operation should be used.

55. However, we disagree with California Parties' contention that use of the marginal unit heat rate must also be limited by the actual gas purchases by a generator during the day in which the spot electricity sales are made. We find this limitation unnecessary and again remind all parties that the burden is on generators to justify their claims to the independent auditor. Accordingly, we will deny rehearing on this point.

56. We will also deny rehearing on the point that the CAISO must be able to verify whether mitigated sales were from purchased power or generation resources and be able to determine the operating characteristics of such resources. The Commission has

[25] *See* April 22 Order at P 18.

assigned verification responsibilities to the independent auditor, and we thus reject California Parties argument.

Gas Proxy Data Series

57. In the May 12 Order, the Commission clarified that the basin plus transportation price series developed by Dr. Michael J. Harris should be used in the MMCP calculation and in the additional fuel cost allowance calculations. The order noted that the issue was fully discussed at the May 22, 2003 technical conference, that the conference participants agreed that that series should be used to calculate the MMCP, and that representatives of the City of Redding and SVP attending the conference did not participate in that discussion.

58. On rehearing, SVP continues to oppose the use of gas proxy prices in any context on the grounds that they are "fictitious and do not realistically or legitimately represent, and may actually falsely misrepresent, the prices and costs actually paid or incurred by purchasers of natural gas."[26] They argue that, if the Commission is going to use a proxy price, the natural gas cost inputs should be computed based on the highest natural gas prices actually paid by generators in an arm's length transaction for each month of the actual refund period. SVP also argues that the Commission improperly rejected SVP's rehearing request without consideration on the grounds that SVP did not raise objections during the May 22, 2003 Technical Conference.

Commission Determination

59. SVP's request for rehearing that the Commission base a proxy price on the highest natural gas prices actually paid is once again denied. We note that SVP's exact same request for rehearing has already been denied twice by the Commission in the May 12 Order on Rehearing and Clarification[27] and in the October 16 Rehearing Order.[28] We also note that the Commission did not rely on SVP's silence at the March 2003 Technical Conference but decided on the merits.

Market Manipulation

60. Regarding the California Parties' contention that the fuel cost allowance be prohibited for those found guilty of gas market manipulation, the May 12 Order relied on

---

[26] SVP Request for Rehearing at P 26.

[27] *See* San Diego Gas & Electric Company, *et al.,* 107 FERC ¶ 61,519 at P 37 (2004).

[28] *See* October 16 Rehearing Order at P 166.

the discussion in the October 16 Rehearing Order concerning how entities found guilty of this type of activity will be dealt with. The October 16 Rehearing Order explained that culpability for market manipulation has been investigated in enforcement proceedings as a separate matter from fixing a just and reasonable rate for the Refund Period in the refund proceeding; the latter "involves a determination of whether a rate or charge is in excess of the just and reasonable rate . . . and does not necessarily implicate any wrongdoing by the entity directed to pay the refund."[29] On rehearing, California Parties continue to request that the fuel cost allowance be prohibited for those found guilty of gas market manipulation

Commission Determination

61. As explained in our prior orders, findings of energy market manipulation will not affect the determination of the just and reasonable clearing prices (or the resetting of the clearing prices) developed for the Refund Period, which is the issue in the refund proceeding. Rather, such evidence goes to whether there were potential violations of tariffs or orders, and those issues are properly being addressed in other proceedings. Accordingly, we deny rehearing.

Soft Cap and Eligibility for Fuel Cost Allowance

62. In separate reply comments to the July 26, 2004 Refund Conference, the CAISO and California Parties raise concerns that generators understood the May 12 Order to mean that if any seller/unit was mitigated during a particular interval, then all sellers/units should be eligible for a fuel cost allowance during that interval. The CAISO argues that if a *unit* is not mitigated during a particular interval, then it should not be permitted a fuel cost allowance during that interval. California Parties makes a similar argument, but specify that if a *seller* is not mitigated during a particular interval, then it should not be permitted a fuel cost allowance during that interval. California Parties conclude that for purposes of determining the relevant mitigation intervals for a fuel cost allowance, a seller only needs its own data, together with the market clearing price, the MMCP, and exempted transactions data already provided by the CAISO.

63. In reply comments to the Refund Conference, AEPCO requests that the Commission facilitate the treatment of the soft cap and the MMCPs by "requiring the CAISO to publish the relevant information to enable parties to determine their fuel cost allowances."[30] In another reply comment to the Refund Conference, LADWP argues that the CAISO's proposed clarification regarding unit specific sales is inappropriate for generators who made portfolio and not unit specific sales.

---

[29] *Id.* at P 205.

[30] AEPCO, Reply Comments to the Refund Conference at 5.

Commission Determination

64. We agree with California Parties and the CAISO and provide the following clarification, based on the fact that ISO sales are unit specific while PX sales are made on a portfolio basis. For power sales into the ISO market, only the particular unit that is mitigated will be permitted a fuel cost allowance and only to the extent the seller's unit(s) was or were needed to make the mitigated sales. For power sales into the PX market, only the particular seller that is mitigated will be permitted a fuel cost allowance. Accordingly, we find that this clarification renders AEPCO's request unnecessary and hereby reject it.

Motions to Lodge

65. On September 24, 2003, as supplemented on December 4, 2003, the California Parties filed a motion to lodge eight orders by the Commodity Futures Trading Commission (CFTC). Those orders addressed offers of settlement reached between the CFTC and eight different entities, which neither admitted nor denied the findings in the CFTC's orders. The California Parties stated that the CFTC orders would provide additional support for the California Parties' position that the submitted fuel cost allowance calculations were based on inappropriate methodologies, were inadequately supported, and significantly overstated actual gas costs and thus should be rejected. The California Parties asserted that the CFTC orders would aid the Commission's understanding of the issues in the instant proceeding by explicating both the scope and severity of the misreporting by major gas marketers. In the California Parties' opinion, the CFTC orders demonstrated how flawed the gas index pricing was during the Refund Period and how inappropriate it was to use these very same indices to calculate gas cost allowances.

66. Several parties opposed the California Parties' motion to lodge, arguing that the CFTC's orders the California Parties seek to lodge in the instant proceeding are irrelevant to both the determination of the proxy gas price and the generators' fuel cost allowance filings. The opposing parties argued that the California Parties' challenges of the March 26 Refund Order's findings pertaining to gas indices were overbroad and that the movants failed to establish a link between alleged misreporting of gas prices and the indices to be used in calculating fuel cost allowances.

67. On July 22, 2003, Duke filed a motion to lodge the Settlement Agreement concluded between El Paso Merchant Energy-Gas, L.P. and El Paso Merchant Energy Company on one side, and the CPUC, PG&E, SoCal Edison, and the City of Los Angeles, California on the other side (El Paso Agreement)[31] in the instant proceeding. In Duke's opinion, this would require vacating the portion of the March 26 Refund Order

[31] The El Paso Settlement Agreement was accepted by the Commission on

modifying the natural gas price indices in calculating the MMCP. Duke explained that because the El Paso Settlement Agreement established the settlement fund, of which approximately 72.9 percent goes directly to compensate California retail electricity consumers, the use of the producer basin price indices to calculate the MMCP would result in duplicate recovery for the same injury, *i.e.,* artificially high electricity prices resulting from non-competitive basis differentials in the natural gas markets. El Paso responded to Duke's motion to lodge stating that it mischaracterized the conclusions reached in the Final Staff Report regarding the causes of higher natural gas prices at the California border. California Parties and Duke in their separate motions to lodge requested that the Commission reopen the evidentiary record and reconsider the methodology and process for calculating refunds and fuel cost allowances.

68. In the May 12 Order, the Commission found that the California Parties and Duke failed to show good cause to reopen the record pursuant to Rule 716 of the Commission's Rules of Practice and Procedure, 18 C.F.R § 385.716. The Commission stated that the documents that they sought to lodge were irrelevant to the instant proceeding, and that the need for finality in the proceeding dictated the denial of California Parties' and Duke's motions to lodge.

69. California Parties seek rehearing, stating that the purpose of the filings was to supplement the record regarding the finding that California border prices were not reliable. If the Commission grants rehearing concerning entities who manipulated gas markets (discussed above) California Parties point out that the CFTC orders would provide evidence of gas index manipulation for several claimants.

70. California Parties' August 2004 Motion to Lodge seeks to introduce into the record of this proceeding several additional CFTC consent settlements and a district court order disposing of a CFTC investigation against Enron Corp. Indicated Parties[32] oppose the motion, asserting that the CFTC settlements are not relevant to the issues in the instant proceeding because they dispose of allegations related to activities outside of California energy markets and they contain no findings related to sales in California during the Refund Period. Further, they state that the California Parties offer no reason why the findings in the May 12 Order should not apply to this motion.

71. Duke contends on rehearing that the Commission erroneously found that the El Paso Master Settlement Agreement is irrelevant to this proceeding, that Duke failed to

---

November 14, 2003. *See* Public Util. Com'n of the State of California v. El Paso Natural Gas Co., *et al.*, 105 FERC ¶ 61,201 (2003).

[32] The Indicated Parties are: Constellation Power Source, Inc., Coral Power, L.L.C., IDACORP Energy, LP, Portland General Electric Company, Powerex Corp., and Puget Sound Energy, Inc.

show good cause to reopen the record pursuant to Rule 716, and erred in concluding that concerns regarding finality militated against granting the motion. According to Duke, its motions to lodge made clear that because both the El Paso Settlement and the March 26 Refund Order "redress the same injury to California electricity consumers during the same period, the Refund Proceeding would result in the collection of refunds that would duplicate restoration of just and reasonable prices that has already been achieved under the El Paso Settlement."[33] Further, Duke contends that the Federal Power Act does not authorize duplicate restoration of just and reasonable rates or double recovery for the same injury, and cites numerous court cases holding that double recovery is against public policy. Because of this potential impact on the Refund Proceeding, Duke argues that the settlement is very relevant and should be lodged in the record.

72. Regarding the Commission's decision not to reopen the record, Duke asserts that the proceeding is not final, and thus the record cannot be closed; thus, Duke reasons, the Commission can grant its motion to lodge without reopening the record. Similarly, because the proceeding is not final, Duke urges that concerns for preserving the finality of the proceeding cannot be implicated here.

Commission Determination

73. As explained in the section above, concerns about market manipulation are not a factor in determining which entities should receive a fuel cost allowance or in what amount. It is simply not necessary to supplement the record regarding the Commission's finding that California border prices were not reliable; the record is sufficient as it stands. Thus, for purposes of this aspect of the refund proceeding, the content of the CFTC orders and District Court Order are not relevant, and we will deny California Parties' August 2004 Motion to Lodge. We will also deny rehearing of the May 12 Order on this point.

74. Regarding Duke's arguments, we note that the El Paso Settlement is a private settlement primarily between the Attorneys General of several Western states and El Paso that resolves a separate complaint about wholly different market activities. El Paso had been charged with withholding capacity on natural gas pipelines, and thus artificially raising the price for gas at the California border. At issue in the instant proceeding are activities of electricity sellers and the impact of dysfunctional electric markets that raised the price of electric generation. Although the relief is intended for electricity customers, it remedies the portion of the excessive electricity prices accounted for by artificially high gas prices. It does not address the other factors that led to high electricity prices, which are the focus of this proceeding. Thus, we do not agree that refunds in this proceeding will provide double recovery of customer overcharges. Accordingly, the El Paso

[33] Duke Rehearing Request at 11.

Settlement is not relevant to this proceeding, and we will deny rehearing of our decision to deny Duke's motion to lodge.

75. Whether the record remains open or closed at this point in time is thus irrelevant. Nevertheless, we note that, although the proceeding is not final, the record is closed with respect to new evidence that impacts issues now pending before the Ninth Circuit.[34]

AEPCO-Specific Issues

76. AEPCO argues that the $6/MWh "adder" for O&M costs that is part of the MMCP calculation should also be part of the fuel cost allowance calculation. AEPCO notes that the O&M adder reflected the costs for combined cycle units, and that since AEPCO used simple cycle turbines with higher O&M costs, the Commission should provide a procedure for generators to include a showing that their O&M costs for particular units exceeded $6/MWh.

77. AEPCO also requests guidance on how it treats imbalance gas and the confines of the gas "day" for the purposes of calculating a fuel cost allowance. AEPCO states that it excluded imbalance gas from its earlier allowance filing because the gas was not received or burned on the day it was ostensibly purchased, and when the gas was received and burned, gas may have been received from multiple days, thereby substantially complicating any price determination and allocating. Regarding the gas "day," AEPCO states it purchases gas on a "day" that runs from 0800 to 08000 Mountain Standard Time. Its standard business practice to resolve the discrepancy between gas "day" and power "day" is to utilize a gas price that reflects 1/3 of the gas price for the prior day and 2/3 of the gas price for the instant day.

Commission Determination

78. AEPCO's request for an O&M adder in the fuel cost calculation is denied. The Commission has previously determined that it will not allow any additional costs to be included in the refund formula.[35] Regarding the treatment of gas imbalance and the gas "day," we note that the Commission has directed the independent auditor to review and verify whether each generator's allocation of fuel purchases to mitigated power sales conforms to the Commission's directions.

Time Granularity of the Fuel Cost Allowance Submissions

---

[34] *See* Public Utilities Commission of the State of California, *et al.* v. FERC, No. 01-71051, *et al*. (9th Cir. Aug. 21, 2002).

[35] *See* San Diego Gas & Electric Company, *et al.*, 97 FERC ¶ 61,275 at 62,213-15 (2001).

79. The May 12 Order reversed a previous Commission determination that the fuel cost allowance should be allocated to customers as an offset to refunds in proportion to customers' Gross Control Area Load in the same manner as emissions costs offsets.[36] Instead the Commission directed that "the recovery of the fuel cost allowance should be assigned to those that relied on the energy sales spot market to serve load" and ordered the CAISO to develop a method that follows this principle.[37]

80. On August 17, 2004, the CAISO submitted a compliance filing detailing its proposed methodology for allocating the recovery of the fuel cost allowance. Although the CAISO states that the allocation could be calculated based on an hourly, daily or monthly basis, it recommends that the Commission direct generators to file their fuel cost data on an hourly basis. The CAISO also notes that it cannot allocate fuel cost amounts based on a time interval shorter than the time interval by which the data is provided, and believes that an hourly allocation is most consistent with the May 12 Order.

81. AEPCO concurs with the CAISO's proposal to allocate on an hourly basis. It states that "use of a longer interval to calculate and/or allocate fuel cost allowances would introduce distortions in terms of heat rates and netting of periods when a seller covered and did not cover its fuel costs."[38]

82. In response to the CAISO's compliance filing, California Parties state that a daily time interval which matches the daily calculation of gas prices is a more appropriate measure. However, California Parties believe that since calculating fuel amounts burned will be determined based on mitigated transactions which occur on an hourly interval, the CAISO will still need hourly data.

83. The Competitive Supplier Group, Sempra and Constellation protest that the CAISO's time interval proposal is inconsistent with the May 12 Order, which requires generators to provide average *daily* fuel costs and to aggregate those costs on a monthly basis to calculate their fuel cost allowance. They contend that an hourly time interval is

inconsistent with how gas markets operate, being neither bought nor sold on an hourly basis.

Commission Determination

[36] *See* October 16 Rehearing Order at P 197.

[37] May 12 Order at P 60.

[38] AEPCO at 3.

84. As an initial matter, we note that we will address in this order only the time granularity of the fuel cost allowance submissions, because the generators and the independent auditor need this information in order to file their claims with the CAISO. The Commission will address all remaining aspects of CAISO's proposal to allocate recovery of the fuel cost allowance in a later order.

85. We find the CAISO's proposal to allocate recovery of the fuel cost allowance on an hourly basis achieves the best results. We note that mitigated PX sales were made on an hourly basis, and mitigated ISO sales were made on a ten-minute basis. Consistent with our finding that the fuel cost allowance is an offset to transactions for which a seller has refund liability,[39] generators are required to calculate and demonstrate their fuel cost allowance claims using these same time intervals. At a minimum, all data is thus available on an hourly basis (if ISO sales are aggregated), and we believe that allocating fuel cost allowances associated with each hour to spot market sales for that same hour provides for the highest level of accuracy. Regarding several comments that an hourly interval is inconsistent with a daily gas cost, we note that the calculated daily cost of gas can be used for each hour interval within the day. Accordingly, we direct generators to submit their fuel cost allowance data to the CAISO on an hourly basis.

Audit-Related and Process Issues

86. Many parties raise concerns about the Commission's decision to direct an independent auditor to review the fuel cost allowance claims and not use some other process for their verification. Initially, California Parties assert that the Commission has improperly delegated its authority to ensure just and reasonable rates to a private entity.[40] California Parties are concerned that this review by an independent auditor and direct submission to CAISO will not permit parties to challenge or evaluate the claims and prevents Commission review and approval of charges subject to Commission jurisdiction, and they argue that such delegation is arbitrary and capricious and an abuse of discretion.

87. California Parties further state that it is legal error for the Commission to fail to provide a process for parties to examine and challenge the fuel cost allowance claims, and they renew their call for a full evidentiary hearing, particularly because the Commission has never itself reviewed the filings in detail or conducted discovery. They assert that the process adopted by the Commission violates the Administrative Procedure Act and is inconsistent with due process. California Parties contend that the May 22, 2003 technical conference and clarifications provided in the May 12 Order did not

[39] *See* May 12 Order at 18.

[40] California Parties cite United States Telecom Ass'n v. FCC, 359 F.3d 554, 566 (D.C. Cir. 2004) (*US Telecom*) for the proposition that federal agencies may not delegate to outside entities absent affirmative evidence of authority to do so.

eliminate the need for the data requests requested by them because for the most part the clarifications related to the mechanism for determining the allowance but not to specific claims. The data request, they assert, was intended to gather information necessary to evaluate the claims themselves.

88. If the Commission does not grant rehearing on this issue, California Parties propose an alternative approach whereby the auditor would submit an interim report to the Commission, to be followed by proceedings at the Commission during which the claims may be evaluated and challenged, with the Commission ruling on the interim report shortly thereafter. The figures would then be submitted to CAISO and would be final on all issues except the determination of which hours are mitigated.

89. Mirant objects to the auditing requirements because they impose burdens and expenses on generators despite the fact that generators already incurred substantial expense in preparing the claims filed in May 2003. Mirant believes that by following the guidance in the Commission's earlier orders and using qualified experts to prepare its claim, it took reasonable steps to secure the fuel cost recovery that the Commission authorized. Moreover, Mirant contends that the audit process violates the Paperwork Reduction Act (PRA) because it imposes unreasonable information collection requirements on persons interacting with the federal government. Mirant notes that the PRA was intended to minimize paperwork obligations by "eliminating regulatory burdens 'which are found to be unnecessary and thus wasteful.'"[41] According to Mirant, the audit requirement unnecessarily requires all generators that pursue fuel cost allowance claims to compile, review, and provide data to the Commission at significant cost.

90. AEPCO notes that its audit and any expense involved will be for naught if it is determined that governmental entities are not subject to refunds in the first place (which issue is pending judicial review), in which event their allowance claims will be rendered moot. AEPCO requests that the Commission provide a mechanism for entities found outside the Commission's jurisdiction to be reimbursed for their audit costs in the event it is determined they are not subject to refunds.

91. Finally, in its petition for relief, Hafslund requested an exemption from the MMCP based on its analysis concluding that the revenue it is owed under the original, unmitigated market clearing price is consistent with the revenue it would have gotten under a just and reasonable rate. The May 12 Order rejected Hafslund's Petition and directed them to file a cost and revenue study. On rehearing, Hafslund argues that the Commission provided no justification for rejecting its Petition, contravened its own prior

[41] Mirant at 13, *quoting* Black Citizens for a Fair Media v. Federal Communications Commission, *et al.*, 719 F.2d 407, 416 (D.C. Cir. 1983).

orders, and directed Hafslund to re-submit the same analysis which the Commission was rejecting.

Commission Determination

92. We do not agree that directing the use of an independent auditor in this proceeding is an improper delegation of the Commission's authority. The Commission has established the methodology for calculating the fuel cost allowance, and has provided (or is providing below) all of the guidance necessary for the independent auditor to perform the ministerial functions described in the May 12 Order. In addition, we describe below a mechanism for parties to raise objections or concerns with the auditor and, subsequently, to bring any unresolved disputes to the Commission. California Parties are correct in noting the limits on an agency's power to delegate its authority to an outside entity, but the duties directed to the independent auditor in this instance do not exceed those limits. Ernst & Young will not be exercising any decision making authority in its review of sellers' fuel cost allowance claims, but will merely be verifying the accuracy and completeness of data and confirming that all calculations are in conformance with our directions.[42] This type of analysis is not proscribed by *US Telecom*,[43] which faulted the FCC for delegating to other entities the authority to make substantive determinations.

93. Nevertheless, we will provide an opportunity for parties to raise concerns that they may have regarding the verified claims with the auditor following submission of the claims to the CAISO on October 29, 2004. We will direct the auditor to resubmit to the CAISO fuel cost allowance claims reflecting any resolved disputes on or before November 27, 2004. Any disputes with respect to specific claims remaining unresolved may be brought to the Commission's attention as part of parties' protests of the CAISO's refund compliance filing, which is expected to be filed by January 2005.

94. We again find no merit to the California Parties' argument that a full evidentiary hearing is necessary to adjudge the fuel cost allowance claims. The bulk of the analysis will entail data verification and review of calculation methodologies that are well suited for independent review under the procedures we have provided, and it may be conducted in a quicker time frame and thus is an appropriate means to promote administrative efficiency and economy. Moreover, the May 12 Order prescribed specific sets of data that each seller must identify in its claims[44] that will lend consistency to the data the auditor will review and will obviate the need for claim-by-claim discovery or data requests. Accordingly, we will deny rehearing on this issue.

---

[42] *See* May 12 Order at P 74.

[43] *See supra* n.42.

[44] May 12 Order at P 76.

95. Regarding the contention that the Commission must analyze the claims filed in May of 2003, we note that the requirements for calculating the claims have been modified and the format standardized as a result of our intervening orders, and we conclude that our review of those earlier claims now would be wasteful. California Parties mention what they believe to be specific deficiencies in their rehearing request[45] that they assert must be decided by the Commission, and they state that a more thorough review of the May 2003 claims will likely raise additional issues. Some of the California Parties' concerns have already been addressed in this and earlier orders, and others are aspects of data verification that will appropriately be handled by the independent auditor process. We will clarify, however, that for any claimant using another entity as a Scheduling Coordinator (not just the City of Burbank as we explained in the May 12 Order[46]) a fuel cost allowance may not be recovered. Because refund liability in this proceeding generally attaches to the Scheduling Coordinator of each transaction, such sellers may not receive a fuel cost allowance offset for purchases for which they will not be held refund liable. We will also specify 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. We direct the CAISO not to process any fuel cost allowance claims until the auditor has determined that they are fully verified and in compliance with our directives.

96. Because Mirant was on notice after the March 26 Refund Order that rehearing had been sought of numerous aspects of the fuel cost allowance methodology, it was aware of the risk that the determinations in that order could be altered. Because the Commission modified the methodology in some respects and standardized the format, all claimants will have to resubmit their claims. The fact that Mirant took it upon itself to hire industry experts to review its initial claims does not lessen the need for the claims to be verified at this time. Thus, we are not persuaded that the auditing requirements impose unnecessary burdens on claimants, and we deny rehearing. Similarly, the PRA is concerned with unnecessary and wasteful reporting requirements, and as we have explained here, sellers seeking fuel cost allowances must resubmit these claims to assure that the claims are adequately supported and in conformance with our prior rulings.

97. Responding to AEPCO's concern, absent a stay, Commission orders are in full force and effect pending judicial review. In the event the Commission is overturned with respect to refund liability of governmental entities, the question of reimbursement for audit costs would be addressed at that time.

---

[45] *See* California Parties' request for rehearing dated June 14, 2004 at 26-29.

[46] *See* May 12 Order at P 18.

98. Regarding Hafslund's rehearing request, the Commission previously noted that sellers had not had an opportunity to present evidence of their marginal costs and stated:

> …the Commission will provide an opportunity after the conclusion of the refund hearing for marketers and those reselling purchased power or selling hydroelectric power to submit evidence as to whether the refund methodology results in an overall revenue shortfall for their transactions in the ISO and PX spot markets during the refund period.[47]

We reiterate that all marketers, including Hafslund, will have an opportunity to file a cost and revenue study to demonstrate whether rates were inadequate. The procedures necessary to file this cost and revenue study will be described in a future Commission order. If Hafslund's Petition meets the requirements set forth in the future Commission order, Hafslund may then resubmit its filing as is. Otherwise, Hafslund will be required to make adjustments to its filing to comport with the Commission's directives.

The Commission orders:

(A) The requests for rehearing of the May 12, 2004 Order are hereby denied, as discussed in the body of this order.

(B) The fuel cost allowance requirements are hereby clarified, as discussed in the body of this order.

(C) California Parties' August 16, 2004 Motion to Lodge is hereby denied.

(D) The CAISO's compliance filing of August 17, 2004 is hereby accepted in part, as discussed in the body of this order.

By the Commission. Commissioner Kelly not participating.

(S E A L)

Magalie R. Salas,
Secretary.

[47] December 19 Order at 62,254.