SWIDLER BERLIN SHEREFF FRIEDMAN, LLP

THE WASHINGTON HARBOUR
3000 K STREET, NW, SUITE 300
WASHINGTON, DC 20007-5116
TELEPHONE (202) 424-7500
FACSIMILE (202) 424-7647
WWW.SWIDLAW.COM

NEW YORK OFFICE
THE CHRYSLER BUILDING
405 LEXINGTON AVENUE
NEW YORK, NY 10174
TEL.(212) 973-0111
FAX (212) 891-9598

January 13, 2003

The Honorable Magalie Roman Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

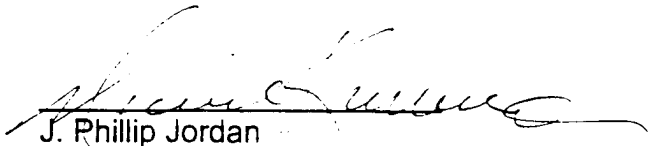
Re: *San Diego Gas & Electric Co., et al.*
Docket Nos. EL00-95-045, *et al.*

Dear Secretary Salas:

Enclosed for filing are one original and fourteen copies of the Comments of the California Independent System Operator Corporation on Proposed Findings on California Refund Liability, submitted in the above-captioned proceeding. Two courtesy copies of this filing are being provided to Presiding Judge Bruce L. Birchman.

Also enclosed are two extra copies of the filing to be time/date stamped and returned to us by the messenger. Thank you for your assistance. Please contact the undersigned if you have any questions regarding this filing.

Sincerely,



J. Phillip Jordan
Michael Kunselman
(202) 295-8465

Counsel for the California
Independent System Operator Corporation

Enclosures

cc: The Honorable Bruce L. Birchman
Restricted Service List

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

San Diego Gas & Electric Company,	)	
	)	
Complainant,	)	
	)	
v.	)	**Docket No. EL00-95-045**
	)	
Sellers of Energy and Ancillary Service Into Markets Operated by the California Independent System Operator Corporation and the California Power Exchange,	)	
	)	
Respondents.	)	
	)	
	)	
Investigation of Practices of the California Independent System Operator and the California Power Exchange	)	**Docket No. EL00-98-042**

COMMENTS OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION ON PROPOSED FINDINGS ON CALIFORNIA REFUND LIABILITY

Charles F. Robinson
General Counsel
Gene Waas
Regulatory Counsel

The California Independent
System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: (916) 608-7049

J. Phillip Jordan
Michael Kunselman

Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W. Suite 300
Washington, DC 20007
Tel: (202) 424-7500

Dated: January 13, 2003

TABLE OF CONTENTS

TABLE OF AUTHORITIES

FEDERAL CASES

FEDERAL REGULATIONS

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

San Diego Gas & Electric Company,	)	
	)	
Complainant,	)	
	)	
v.	)	Docket No. EL00-95-045
	)	
Sellers of Energy and Ancillary Service Into Markets Operated by the California Independent System Operator Corporation and the California Power Exchange,	)	
	)	
Respondents.	)	
	)	
	)	
Investigation of Practices of the California Independent System Operator and the California Power Exchange	)	Docket No. EL00-98-042

COMMENTS OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION ON PROPOSED FINDINGS ON CALIFORNIA REFUND LIABILITY

Pursuant to the Commission's "Order on Clarification and Rehearing," 97 FERC ¶ 61,275, issued on December 19, 2001 ("December 19 Order"), the ISO provides the following comments addressing the Presiding Judge's "Proposed Findings on California Refund Liability," ("Proposed Findings of Fact") issued on December 12, 2002.

I. BACKGROUND AND PROCEDURAL HISTORY

On August 2, 2000, San Diego Gas & Electric Company filed a complaint in Docket No. EL00-95 against all sellers of energy and ancillary services into the ISO and California Power Exchange ("PX") markets. In response, the Commission issued an order on August 23, 2000, in which it instituted formal hearing proceedings under Section 206 of the Federal Power Act to investigate the justness and reasonableness of

the rates of public utility sellers in the California ISO and PX markets, and established a refund effective date for spot sales made into the California marketplace of October 20, 2000. *San Diego Gas & Electric Co.*, et al., 92 FERC ¶ 61,172 (2000) ("August 23 Order"). As a result of this investigation, the Commission issued orders on November 1, 2000 and December 15, 2000, in which it adopted prospective price mitigation for the California marketplace in the form of a soft-cap breakpoint. *See San Diego Gas & Electric Co.*, et al., 93 FERC ¶ 61,121 (2000) ("November 1 Order"); *San Diego Gas & Electric Co.*, et al., 93 FERC ¶ 61,294 (2000) ("December 15 Order"). In addressing the question of refunds, the Commission emphasized that sellers into ISO and PX markets would continue to remain subject to refund liability, noting that, if the Commission found "that the wholesale markets in California are unable to produce competitive, just and reasonable prices, or that market power or other individual seller conduct is exercised to produce an unjust and unreasonable rate, we may require refunds for sales made during the refund effective period." November 1 Order at 61,370.

Shortly after the Commission issued its December 1 Order, the ISO Control Area experienced a period of severe supply shortage, which continued through the early months of 2001. During this period, the ISO was forced to curtail firm load on several occasions. At the same time, the ISO was hampered in obtaining necessary supplies by the failure in creditworthiness of the two largest California investor-owed utilities ("IOUs"), which, in turn, jeopardized the ISO's own financial position. As a result, the ISO petitioned the Secretary of Energy for an emergency order pursuant to Section 202(c) of the Federal Power Act. The Secretary responded, issuing the first of several orders on December 14, 2000. In that order, Secretary Richardson found that an

emergency existed in California, as defined in Section 202(c), due to a shortage of electric energy, and ordered certain entities listed in Attachment A to that order to "make arrangements to generate, deliver, interchange, and transmit electric energy when, as, and in such amounts as may be requested by the [California ISO] . . . consistent with the terms of [the] order." Exh. ISO-11 at 1. In all instances, prior to availing itself of the relief provided, the ISO certified the continuation of crisis conditions. Relief under Section 202(c) was made available between December 14, 2000 and February 6, 2001, in the form of two orders and multiple amendments to those orders.[1]

In the DOE Orders, the Secretary of Energy outlined several limitations to the requirement that the listed suppliers deliver energy when requested by the ISO. First, the entities listed in Attachment A to the order were only required to deliver energy to the ISO that was "available in excess of electricity needed by each entity to render service to its firm customers." Additionally, the Secretary specified that entities in Attachment A were "not required to deliver energy or services under the terms of this order" until some number of hours had passed after the ISO filed with the Department of Energy ("DOE") "a signed certification that it has been unable to acquire in the market adequate supplies of electricity to meet system demand . . . ." Exh. ISO-12 at 2.[2] Also, on a going-forward basis, the Secretary of Energy specified that "in order to continue to

[1] The Secretary of Energy issued Amendments to the December 14 DOE Order on December 20, 2000, Exh. S-4, December 27, 2000, Ex No. S-5, and January 5, 2001, Exh. S-6. The Secretary of Energy issued a new order pursuant to section 202(c) on January 7, 2001 ("January 11 DOE Order"), Exh. ISO-12, and issued amendments to that Order on January 17, 2001, Exh. S-7, and January 23, 2001, Exh. S-8.

[2] In the original December 14 DOE Order, the Secretary of Energy stated that entities were not required to provide energy until *twelve* hours after the ISO filed the required certification with the DOE. In the December 20, 2000 amendment to that Order, the Secretary revised this requirement, stating that entities were not required to deliver energy until *eight* hours after the ISO filed the required certification. Exh. S-4. The Secretary maintained the eight -hour requirement until the expiration of the DOE Orders. See Exhs. S-5, S-6, ISO-12, S-7, S-8.

avail itself of [these Orders] the California ISO is required to submit to DOE a further certification as set forth in the preceding sentence every twenty-four hours until the expiration of the order." *Id.* at 4. With respect to the arrangements made pursuant to these Orders between the ISO and the entities subject to the Orders, the Secretary stated that the terms were to be "as agreed to by the parties," but that if no agreement as to terms could be reached, the Secretary would prescribe the conditions of service and refer the rate issue to the Federal Energy Regulatory Commission for a determination at a later date. *Id.* Finally, in an amendment to the first Order dated December 20, 2000, the Secretary of Energy mandated an important additional procedure: the ISO was required to seek information concerning the amount of energy anticipated to be available from entities subject to the terms of these Orders at the time it filed its certifications with the DOE, and those entities were required to respond to the ISO within six hours. Exh S-4 at 1.

On April 26, 2001, the Commission issued an order adopting a new prospective price mitigation methodology for California wholesale power markets to replace the soft cap breakpoint mechanism. *San Diego Gas & Electric Co.*, et al., 95 FERC ¶ 61,115 (2001) ("April 26 Order"). Under that methodology, price mitigation would apply to all generators in California, including non-public utility generators, with available capacity during periods of reserve deficiency, defined as emergency situations beginning at stage 1 (*i.e.*, when reserves are 7.5 percent or less). *Id.* at 61,358. The ISO would determine the level of mitigation by calculating a marginal cost for each gas-fired

generator in California using heat rate[3] and emissions data provided to the ISO and the Commission by generators, a proxy for gas costs, and a $2.00 adder for operation and maintenance expenses. *Id.* at 61,359. The Commission required the ISO to modify its markets to permit generators to elect the proxy price in lieu of an individual bid above the proxy, and all generators who elected the proxy would be paid a single market clearing price reflecting the highest priced unit dispatched, as determined by calculations using the proxy prices. *Id.*

The Commission expanded this proxy price mitigation methodology to non-reserve deficiency hours and to markets throughout the WSCC in an order issued on June 19, 2001. *San Diego Gas & Electric Co.*, et al., 95 FERC ¶ 61,418 (2001) ("June 19 Order"). In that order, the Commission also required all public utility sellers and buyers in the ISO's markets to participate in a settlement conference "to complete the task of settling past accounts and structuring the new arrangements for California's energy future." *Id.* at 62,570. One of the topics explicitly set for discussion at this conference was the issue of refunds related to past periods. The Commission appointed Chief Judge Wagner as the settlement judge, and required the Chief Judge to provide the Commission with recommendations at the close of the conference if parties did not reach agreement.

After the close of the settlement conference, because no agreement was reached between the parties, Chief Judge Wagner provided recommendations to the Commission on this issue in his July 12, 2001 "Report and Recommendation of Chief Judge and Certification of Record." *San Diego Gas & Electric Co.*, et al., 96 FERC ¶

[3] With respect to the heat rates used in this calculation, the Commission noted that they "must reflect operational heat rates that do not include start-up and minimum load fuel costs." *Id.* at 61,359.

63,007 (2001) ("July 12 Report and Recommendation"). Therein, with respect to refunds for past periods, the Chief Judge opined:

> That very large refunds are due is clear. In fact, the Commission so found in its June 19, 2001, Order. While the amount of such refunds is not $8.9 billion as claimed by the State of California, they do amount to hundreds of millions of dollars, probably more than a billion dollars in an aggregate sum.

Id. at 65,038.

In order to determine the amount of refunds due, the Chief Judge recommended using the price mitigation methodology set forth in the June 19 Order, with several modifications. *Id.* at 65,039-40. Specifically, the Chief Judge recommended (1) using actual unit heat rates, rather than hypothetical heat rates; (2) using daily spot gas prices rather than monthly bid-week prices; (3) separating the state's gas market into northern and southern zones; (4) excluding emission costs from the MMCP and treating them as a separate item deductible from total refund liabilities; and (5) not using the June 19 Order's 85 percent price ceiling for non-emergency hours. *Id.* at 65,040-041.

On July 25, 2001, the Commission issued an order addressing the scope and methodology of refunds for sales in the California marketplace. *San Diego Gas & Electric Co.*, et al., 96 FERC ¶ 61,120 (2001) ("July 25 Order"). The Commission indicated that refunds would be limited to spot market transactions made between October 2, 2000 and June 20, 2001 (the "Refund Period"), and would include sales made by both public and non-public utilities. *Id.* at 61,499. The Commission, however, excluded from refund liability purchases made by the California Department of Water Resources ("CDWR") through bilateral contracts,

as well as transactions made under the DOE Orders issued pursuant to Section 202(c). *Id.* at 61,514-16.

In terms of methodology, the Commission largely adopted the recommendations of the Chief Judge. *Id.* at 61,516-17. The Commission required the ISO to first determine the "marginal unit" in each 10-minute interval by "selecting from the actual units dispatched in real-time the maximum heat rate of any unit dispatched each hour in the real-time imbalance market." *Id.* at 61,517. This heat rate would be multiplied by the simple average daily spot price as reported by Gas Daily, NGI's Daily Gas Price index and Inside FERC's Gas Market Report. *Id.* To this result, the Commission required the ISO to add $6/MWh for O&M expenses, and a 10% creditworthiness adder for transactions made after January 5, 2001 to arrive at the final MMCP for each interval *Id.* at 61,518-19. Finally, the Commission established an evidentiary hearing process before Judge Birchman, and directed the Judge to make findings of fact as to "(1) the mitigated price in each hour of the refund period; (2) the amount of refunds owed by each supplier according to the methodology established herein; and (3) the amount currently owed to each supplier (with separate quantities due from each entity) by the ISO, the investor owned utilities, and the State of California." *Id.* at 61,520. In order to develop the factual record, the Commission ordered the ISO to provide Judge Birchman with a "re-creation of the mitigated prices that result from using the methodology described herein for every hour" during the Refund Period, and directed the ISO and PX to rerun their settlements systems applying the MMCPs and also provide those results to Judge Birchman. *Id.*

As directed by the Commission in the July 25 Order, the ISO calculated mitigated clearing prices for each hour during the Refund Period and submitted those clearing prices to the Presiding Judge and parties in the proceeding. The ISO then used these MMCPs to rerun its settlements and billing system for the Refund Period, and also provided these results to the Presiding Judge and Parites. Because there are relatively discrete sets of issues associated with the calculation of the MMCPs and the determination of what refunds were owed and the resulting current amounts owed to each supplier, it was decided to bifurcate the evidentiary process into two phases in order to address all issues as efficiently as possible. Phase 1 would address the calculation of the MMCPs for each interval and hour during the Refund Period, and Phase 2 would focus on the ISO and PX reruns of their settlement systems, and the issues of what refunds were owed, and, in the end, after taking into account such items as cash positions and interest, "who owed what to whom." The ISO and other parties to the evidentiary proceeding filed testimony and exhibits concerning Phase 1 issues during the fall of 2001.

On December 19, 2001, just prior to the commencement of the hearing on Phase 1 issues, the Commission issued an order addressing requests for rehearing and clarification with respect to a number of issues from the June 19 and July 25 Orders. 97 FERC ¶ 61,275 (2001) ("December 19 Order"). Therein, the Commission modified one aspect of the refund methodology to require the ISO to calculate MMCPs by selecting as the marginal unit that unit with the highest system wide total costs after multiplying

heat rates by gas costs for an interval, rather than selecting the unit with the highest overall heat rate. *Id.* at 62,203.

The Phase 1 hearing on MMCP issues commenced on March 11, 2002 and continued through March 15, 2002. A hearing addressing Section 202(c) transactions was held from March 18 through March 22, 2002. Parties filed initial and reply briefs on both of these issues shortly after the conclusion of these hearings.

On May 15, 2002, the Commission issued an order addressing petitions for rehearing and clarification of the December 19 Order. *San Diego Gas & Electric Co.*, et al., 99 FERC ¶ 61,160 (2002) ("May 15 Order"). Therein, the Commission clarified several issues relating to the refund methodology. First, the Commission indicated that out-of-state generators would be eligible to set the MMCP if they could provide the necessary heat rate information to the ISO. *Id.* at 61,656. The Commission also clarified that Out-of-Market ("OOM") transactions were not eligible to set the MMCP, and ordered the Presiding Judge to address suppliers' allegation of mis-logging of Out-of-Sequence ("OOS") transactions by the ISO. *Id.* Finally, the Commission clarified that the MMCP was to be treated as a cap on historical prices, rather than a substitute clearing price. The Commission explained:

> For accepted bids above the breakpoint, the refund methodology should use the lower of the bid or the MMCP. For accepted bids at or below the breakpoint, the refund methodology should use the lower of the auction price or the MMCP. When the breakpoints were not triggered and there was a single market clearing price, the refund methodology should use the lower of the single market clearing price or the MMCP.

Id. at 61,656.

During the spring and summer of 2002, parties submitted testimony and exhibits addressing Phase 2 issues, and a hearing on those issues was held from August 19 through August 23, 2002. Initial and reply briefs were filed by the parties after the conclusion of the hearing. On December 12, 2002, Presiding Judge Birchman issued his Proposed Findings of Fact addressing all issues in both Phase 1 and Phase 2 of the proceeding.

II. THE PROPOSED FINDINGS OF FACT

A. Phase 1 Issues

With respect to issues in Phase 1 of the proceeding, the Proposed Findings of Fact address two main issues: (1) how to determine MMCPs for each interval and hour during the Refund Period; and (2) what, if any, transactions were made pursuant to Section 202(c) of the Federal Power Act.

1. MMCP Issues

One of the larger issues concerning the appropriate calculation of MMCPs has been whether the ISO should use incremental or average heat rates to determine a unit's heat rate for insertion into the Commission's refund formula (Issue I.B). The Proposed Findings of Fact find that incremental heat rates "are a just and reasonable means to set the MMCP" and are "consistent with the Commission's goal of replicating prices in a competitive market." Proposed Findings of Fact at ¶¶ 40, 70. The Proposed Findings of Fact conclude that incremental heat rate curves should not be adjusted to be monotonically non-decreasing. Proposed Findings of Fact at ¶ 83. Also, with respect to the issue of the operating point on a heat rate curve at which a unit's heat rate should be taken for insertion into the refund formula (Issue I.C), the Proposed Findings of Fact find that the ISO's use of an Acknowledged Operating Target ("AOT")

adhered to the Commission's orders and that it achieves a result that is just and reasonable. *Id.* at ¶ 84.

The Proposed Findings of Fact next address the universe of units eligible to set the MMCP for each interval (Issue I.D). The Proposed Findings of Fact conclude that the eligibility of a unit to set the MMCP during a particular interval is contingent upon that unit having had a bid in the ISO's BEEP stack in that interval. *Id.* at ¶ 94. The Proposed Findings of Fact reason that "the BEEP stack represents the best and closest approximation of what the Commission required of the ISO to re-create, or emulate closely, the outcome of a competitive market with actual dispatch data, rather than a hypothetical dispatch of resources." *Id.* at ¶ 101. With respect to the types of energy eligible to set the MMCP (Issue I.D.2), the Proposed Findings of Fact find that several types of energy are eligible: (1) BEEP Supplemental and BEEP Spin, Non-Spin, and Replacement Reserve Ancillary Services, *id.* at ¶ 115; and (2) Out-of-Sequence ("OOS") Non-Congestion Imbalance Energy Supplemental and OOS Non-Congestion Spin, Non-Spin, and Replacement Reserve Ancillary Services that are eligible to set the historical market clearing price under ISO Operating Procedure M-403, *id.* at ¶ 120.

The Proposed Findings of Fact find that the following types of energy are not eligible to set the MMCP: (1) OOS Congestion, id. at ¶ 135; (2) Out-of-Market ("OOM") sales, *id.* at ¶ 138; (3) Residual Energy, *id.* at ¶ 152; and (4) Regulation Energy; *id.* at ¶ 158.

The Proposed Findings also find that units that did not actually respond to a BEEP dispatch are excluded from eligibility to set the MMCP. *Id.* at ¶ 203.

The final issue relating to unit eligibility addressed by the Proposed Findings of Fact is the issue of whether units outside the ISO control area should be eligible to set

the MMCP (Issue I.D.8). The only out-of-state supplier that provided evidence to support a claim that its units should be included in the ISO's MMCP calculations was Arizona Electric Power Cooperative ("AEPCO"). Because the May 15 Order determined that out-of-state suppliers were eligible to set the MMCP if they provided the appropriate heat rate data to the ISO, the issue became whether AEPCO had provided sufficient data such that its units would be eligible to set the MMCP. *Id.* at ¶ 215. The Proposed Findings answer in the affirmative, concluding that the heat rates provided by AEPCO "are adequate and eligible to be included in the ISO's calculations of MMCPs during the refund period." *Id.* at ¶ 216. Specifically, the Proposed Findings state that AEPCO's heat rate data complies with the Commission's requirements for submission of heat rate information to the ISO as set forth in the June 19 Order, and that the ISO "has sufficient heat rate data from AEPCO to perform the required calculations necessary to include AEPCO's units in the calculation of the MMCPs." *Id.* at ¶ 232. The Proposed Findings of Fact also find that AEPCO's use of Southern California gas prices for determining the marginal cost of its units during the Refund Period was reasonable and proper. *Id.* at ¶ 239.

2. Section 202(c) Issues

A number of suppliers in this proceeding claim that they had made sales to the ISO during the Refund Period under the auspices of the DOE Orders issued pursuant to Section 202(c) of the Federal Power Act. The Proposed Findings of Fact find, in terms of process, that:

> *the DOE Orders* contemplated a process by which suppliers would inform the ISO of their anticipated excess energy for a trade date, and following a certification by the ISO of an emergency, the ISO was authorized to request *energy or services* from suppliers, and suppliers were then

required to provide energy or services, whichever was in excess to that needed to satisfy their own load.

Proposed Findings of Fact at ¶ 254.

With respect to the eligibility of suppliers to prevail on a claim of Section 202(c) sales, the Proposed Findings of Fact find that there must be "concrete and probative evidence" that the supplier was included on Attachment A of the DOE Orders. *Id.* at ¶ 309. Additionally, the Proposed Findings of Fact state that only those transactions that were made with the ISO on a day on which the ISO filed the appropriate certification as required by the DOE Orders are eligible for designation as having been made pursuant to Section 202(c). *Id.* at ¶ 314. As to the issue of whether transactions made through the ISO's markets are eligible, the Proposed Findings of Fact conclude they were not, explaining that "central to each DOE Order is the understanding that only those sales of energy *and* ancillary services made *outside* of the ISO's markets and in response to a request by the ISO are eligible under section 202(c)." *Id.* at ¶ 321.

These three requirements are essentially the first three of the four criteria for eligibility for Section 202(c) sales that were proposed by Commission Trial Staff ("Staff"). *Id.* at ¶ 306. The Proposed Findings of Fact find that those transactions made by suppliers that satisfy these three criteria were made pursuant to Section 202(c). *Id.* at ¶ 308. Additionally, the Proposed Findings of Fact find that those transactions that were noted by ISO operators at the time the sale was made as having been made under the DOE Orders were made pursuant to Section 202(c). *Id.* Specifically, the Proposed Findings of Fact determine that 202(c) sales were made by the following entities: Avista, Bonneville Power Administration ("BPA"), Los Angeles Department of

Water and Power ("LADWP"), Northern California Power Agency ("NCPA"), Pinnacle West, Portland General, PPL Montana, PS Colorado, and Puget Sound. *Id.* at ¶ 270.

B. Phase 2 Issues

Phase 2 of the evidentiary hearing process involved numerous issues relating to the calculation of refund amounts owed by suppliers and the determination of who owes what to whom. The first set of Phase 2 issues addressed by the Proposed Findings of Fact's concerns the ISO's rerun of its settlement database (Issue I.A). With respect to the issue of the proper pre-mitigation database to be used by the ISO in its settlement rerun, the Proposed Findings of Fact conclude that the California Generators had failed to show that mislogging of OOS non-congestion transactions resulted in the ISO establishing incorrect historical market clearing prices, such that the ISO would be required to calculate revised historical market clearing prices pursuant to the Commission's May 15 Order. Proposed Findings of Fact at ¶ 423. The Proposed Findings of Fact also find that the ISO should not be required to create a new pre-mitigation database with records displayed and organized in the manner urged by several parties. *Id.* at ¶ 436.

The Proposed Findings of fact also address numerous issues relating to whether the ISO treated certain transactions and charge types improperly as a part of its mitigation. With respect to "non-spot" transactions (*i.e.* transactions for greater than 24 hours in duration or entered into more than one day prior to delivery), the Proposed Findings of Fact find that a number of suppliers made non-spot sales that should be excluded from mitigation. *See id.* at ¶¶ 475, 486, 491, 493, 512. One of the suppliers that the Proposed Findings of Fact conclude made non-spot sales to the ISO is Dynegy, pursuant to an 11-day contract between Dynegy and the ISO entered into in December,

2000. *Id.* at ¶ 475. The Proposed Findings identify the transactions listed in Exhibit DYN-26 as sales having been made pursuant to this contract, but note that there may be additional sales that were made under the contract, and that this issue is the subject of ongoing negotiations between Dynegy and ISO. *Id.* As to the issue of whether the ISO properly mitigated import transactions, the Proposed Findings find that the ISO improperly used interval mitigated prices to determine refunds associated with imports, and that, "based upon the ISO's and PX's past practices regarding hourly average MMCPs and the inherent characteristics of an MMCP," the ISO should have used average hourly prices instead for this purpose. *Id.* at ¶ 537. The Proposed Findings also find that the ISO erroneously employed the MMCP as the dividing line in its allocation of costs between Charge Types 401 and 481 in its settlements system. *Id.* at ¶ 566.

The Proposed Findings next address issues relating to the rerun of the PX settlements system (Issue I.B). Then, the Proposed Findings of Fact provide findings concerning what emissions amounts are properly offset against refunds. (Issue II). Issue III of the Proposed Findings of Fact includes several items under the heading of "what refund amounts are owed by each supplier, and what amounts are currently owed to each supplier by the ISO, PX, the investor owned utilities, and the State of California." Under this heading, the Proposed Findings of Fact address the bilateralization of obligations, the application of refunds as offsets, the accounting for the cash position of parties, the calculation and application of interest, and the results of applying the Commission's refund methodology. *Id.* at ¶¶ 768-822. With respect to interest, The Proposed Findings of Fact decline to address the merits of the ISO's arguments

concerning the need for the ISO to remain a cash-neutral entity regardless of the mechanism directed by the Commission for collecting interest on amounts owed and owing during the refund period, because, according to the Presiding Judge, concerns relating to cash neutrality do not fall under any of the issues to be addressed in the present proceeding, and instead raise matters with regard to cash shortfalls which the ISO and other parties have expressly agreed to not adjudicate and to have presented to the Commission at a later date. *Id.* at ¶¶ 806, 819.

III. SUMMARY OF ERRONEOUS FINDINGS IN PROPOSED FINDINGS OF FACT

The ISO respectfully suggests that the following findings made in the Proposed Findings of Fact are in error, and should be rejected by the Commission:

1. That the heat rates and gas data supplied by AEPCO are sufficient to permit AEPCO units to be eligible to set the MMCP. Proposed Findings of Fact at ¶ 211.
2. That the parties should not be permitted to conduct discovery and submit additional testimony, subsequent to the issuance of the May 15 Order, concerning the issue of whether AEPCO's data was sufficient to include its units in the calculation of the MMCP. Proposed Findings of Fact at ¶ 215.
3. That the record in this proceeding supports a finding that BPA, LADWP, Pinnacle West and PS Colorado engaged in transactions pursuant to Section 202(c) of the Federal Power Act, and that all of Portland General's transactions listed on PGE-2 Revised, as further revised by TS-1, were

made pursuant to Section 202(c) of the Federal Power Act. Proposed Findings of Fact at ¶¶ 350, 368, 389, 396, 403.

4. That the transactions listed on Exhibit DYN-26 constitute transactions made pursuant to an 11-day contract between the ISO and Dynegy during the refund period, and should therefore be excluded from price mitigation. Proposed Findings of Fact at ¶ 475.

5. That imports should be mitigated using the average hourly MMCPs calculated by the ISO, rather than 10-minute interval MMCPs. Proposed Findings of Fact at ¶ 537.

6. That the dividing line for allocation of costs between Charge Types 401 and 481 for non-mitigated transactions in the ISO's settlement rerun should be the historical market clearing price rather than the MMCP. Proposed Findings of Fact at ¶ 566.

7. That the issues before the Presiding Judge did not encompass the merits of the ISO's arguments concerning the need for the ISO to remain a cash-neutral entity regardless of the mechanism directed by the Commission for collecting interest on amounts owed and owing during the refund period. Proposed Findings of Fact at ¶ 817-818.

IV. POLICY CONSIDERATIONS WARRANTING COMMISSION REVIEW

The Commission, in the December 19 Order, ordered the Presiding Judge to certify to it findings of fact rather than provide an initial decision. December 19 Order at 62,256. The Commission also permitted the parties to file comments addressing the Presiding Judge's findings. Id. at 62,257. Therefore, this pleading is not technically a "brief on exceptions," as contemplated by Rule 711, 18 C.F.R. 385.711 (2002), and the

ISO presumes that the Commission will review all of the Presiding Judge's proposed findings regardless of the policy considerations that parties may or may not articulate in their comments. Nevertheless, it is worth briefly pointing out that the resolution of the issues addressed herein will significantly impact the level of refunds, which are the only redress for the unjust and unreasonable prices that plagued the California wholesale energy markets throughout the Refund Period. Additionally, the issue concerning the payment of interest on refunds and amounts owed to suppliers directly implicates one of the bedrock principles of the ISO's operation: maintaining a cash-neutral position with respect to sellers and purchasers in its markets. Any result that comprises this position would have dire ramifications with respect to the ISO's ability to administer those markets.

V. COMMENTS

A. The Heat Rates and Gas Data Supplied by AEPCO Are Not Sufficient for the ISO to Include AEPCO's California Transactions in its Calculation of MMCPs (Phase 1 - Issue I.D.8)

In his Proposed Findings of Fact, the Presiding Judge found that AEPCO's units that provided imbalance energy to the ISO during the refund period are eligible to set the MMCP during the refund period. Proposed Findings of Fact at ¶ 211. Specifically, Judge Birchman concluded that AEPCO had provided sufficient heat rate and gas data such that the ISO could include AEPCO's units in the ISO's calculations of MMCPs during the refund period. *Id.* The Presiding Judge based these findings on his conclusion that AEPCO had satisfied five underlying criteria: (1) AEPCO's hourly bids adhere to ISO Operating Procedure M-403, which allows such bids to set the Hourly and Interval Ex Post Prices; (2) As required by the May 15 Order, AEPCO provided heat rate information to the ISO for the unit used to supply power to the ISO; (3) AEPCO

submitted the requisite heat rate information to the ISO; (4) AEPCO's use of average heat rates for its GT units was appropriate because these units operated at only one point other than zero output; and (5) AEPCO used the proper gas prices in its heat rate analysis. *Id.* at ¶ 217. These findings are unsupported by the record in this proceeding, and should be set aside by the Commission.

First, the fact that AEPCO's units were eligible to set the historical Hourly and Ex Post Prices in the ISO markets, pursuant to ISO Operating Procedure M-403, does not support a finding that AEPCO has provided sufficient data such that its units should be eligible to set the MMCP. This is the case because the MMCP is calculated in a manner different from the manner in which the historical market clearing price is calculated. In the July 25 Order, the Commission explained that the ISO was to determine MMCPs for each interval and hour during the refund period based on the marginal unit for that interval and hour, and that the marginal unit was to be determined by "selecting from the actual units dispatched in real-time the maximum heat rate of any unit dispatched each hour in the real-time imbalance market . . . ."[4] July 25 Order at 61,517. The Commission also accepted the ISO's method of determining the marginal unit based on an 11-point (incremental) heat rate curve. *See* June 19 Order at 62,563. As explained in the ISO's Direct Testimony, the ISO also needed to know a unit's operating point during each interval, in order to determine which individual point on a unit's heat rate curve should be used in the MMCP calculation. Exh. ISO-1 (Hildebrandt) at 28:15-19.

[4] In the December 19 Order, the Commission modified this formula to require that the ISO select as the marginal unit the highest cost unit after gas costs are multiplied by a unit's heat rate. December 19 Order at 62,203.

During the refund period, the ISO determined market clearing prices based on the prices and quantities associated with the *bids* received through its markets. Therefore, in production, the ISO did not require the heat rate and operating point data on individual units that is necessary in order to effect the Commission's refund methodology. For this reason, the fact that sales from out-of-state suppliers such as AEPCO were eligible to set the historical market clearing prices does not suggest that those suppliers, merely by virtue of providing the ISO with schedules that complied with M-403, had provided sufficient data to allow them to be eligible to set the MMCP.

The Proposed Findings of Fact are also incorrect in concluding that AEPCO has provided "the requisite heat rate information to the ISO." Proposed Findings of Fact at ¶ 217. First, AEPCO failed to sustain its burden to identify the units from which it made specific sales to the ISO during the Refund Period. Without data showing which unit supplied what power, it is impossible to implement the Commission's methodology, which requires that the marginal unit be selected from among "the *actual units* dispatched in real time . . . in the real-time imbalance market." July 25 Order at 61,517. For units within the ISO system, unit attribution is possible because those units are directly metered and dispatched by the ISO. Exh. ISO-19 (Hildebrandt) at 58:14-15. However, as Dr. Hildebrandt explained in his Rebuttal Testimony, the ISO does not have the necessary information to trace imports to specific generating resources. *Id.* at 58:15-17.

Rather than providing meter data to demonstrate which units made specific sales to the ISO during the Refund Period, AEPCO simply assigned the unit with the highest heat rate or highest cost that was operating at the time to the California sale. Exh. AEP-

12 (Bray) at 8:7-9. The Proposed Findings of Fact mistakenly find that this method of unit attribution is sufficient for purposes of including AEPCO's units in the calculation of MMCPs, based in part on the fact that no party challenged this method of attribution in testimony or on cross-examination.

The fact that no party, other than AEPCO, addressed through testimony or cross-examination the specific issue of the attribution of AEPCO's units to California sales does not relieve AEPCO of the burden of presenting sufficient data to meet the Commission's requirement that any units included in the calculation of MMCPs be the "actual units dispatched in real time." July 25 Order at 61,517. That this burden rests squarely on AEPCO is clear from the May 15 Order, in which the Commission stated that out-of-state sellers would be eligible to set the mitigated price only if "*they* can provide the heat rate information to the ISO for the unit used to supply the power." May 15 Order at 61,654 (emphasis added). AEPCO has not provided this information, and its post-hoc mechanism of assigning the highest cost unit operating at the time to all California sales is inadequate. As the ISO pointed out in its Brief as to the Eligibility of Units Operated by AEPCO to Set the Mitigated Market Clearing Price During the Refund Period ("ISO AEPCO Brief"), AEPCO's proposal is particularly dubious given the fact that AEPCO sold power to the ISO in one-hour blocks and agreed to accept the ex-post price for that hour. ISO AEPCO Brief at 5; *see also* Exh. S-26R (Sammon) at 55:6-8. Also, it is possible that AEPCO sought ways to meet its commitments to the ISO by substituting purchased power or some other resource for the highest-price unit that it alleges is associated with the bid. ISO AEPCO Brief at 6.

Moreover, allowing AEPCO's units to set the MMCP, absent data sufficient to establish that those particular units were actually providing energy to the ISO, is inconsistent with the Proposed Findings of Fact's finding with respect to the eligibility of units inside the ISO system to establish the MMCP. Specifically, the Presiding Judge concluded that the ISO should exclude units from eligibility to set the mitigated price if meter data does not demonstrate that those units actually responded to the ISO's dispatch instructions. Proposed Findings of Fact at ¶¶ 203-210. As discussed above, AEPCO has provided no data to establish that any specific units actually provided energy to the ISO, and thus, AEPCO's units would fail this eligibility test. AEPCO should not be granted this unique privilege because of its status as an out-of-state supplier.

AEPCO also failed to provide the ISO with sufficient information on the heat rates of its units to enable the ISO to construct incremental heat rate curves for those units. Instead, AEPCO submitted into the record only single point heat rates for all of its units that it alleges made sales to the ISO during the Refund Period. *See* Exh. AEP-13. AEPCO explains that it submitted incremental heat rates for its combined cycle units that were "generally already in use" before AEPCO made a sale to California, and average heat rates for its simple cycle combustion turbines, which AEPCO asserts would not have been dispatched absent the sales it made into California. Exh. AEP-12 (Bray) at 10:8-21. The Proposed Findings of Fact incorrectly conclude that this bare assertion by AEPCO complies with the Commission's requirements concerning the submission of heat rate information to the ISO. Proposed Findings of Fact at ¶ 231-236. With respect to the incremental heat rates provided for the combined cycle unit,

the Proposed Findings of Fact state that these heat rates appeared to be the difference between the average heat rate of the unit when operating for AEPCO's customers, and the average heat rate of the unit when making sales to the ISO. Proposed Findings of Fact at ¶ 230. The Proposed Findings of Fact conclude, therefore, that AEPCO's incremental heat rates complied with the June 19 Order's requirements regarding the submission of heat rate data, explaining that AEPCO followed the same process as the ISO in developing its single point incremental heat. The Proposed Findings of Fact also find that the average heat rates provided by AEPCO are "an adequate and proper measure of AEPCO's GT units' heat rates." *Id.* at ¶ 236 The Proposed Findings of Fact base this finding on testimony that an "incremental heat rate for a unit not previously running . . . is effectively the same as an average heat rate," AEP-12 (Bray) at 10:17-21, and the conclusion that "Ex. AEP-13 demonstrates that AEPCO's GT units operated at only one point during the intervals their generation was dispatched to the ISO." *Id.* at ¶ 234.

The Proposed Findings of Fact's conclusion regarding AEPCO's calculation of incremental heat rates for its combined cycle unit is speculative, and for that reason, should be rejected. There is no operational data in the record to support a conclusion that AEPCO properly calculated incremental heat rates for its combined cycle units. The Commission's refund methodology required the use of heat rates *calculated by the ISO* for each unit based on data provided to the ISO by suppliers in the format requested by the ISO (and approved by the Commission in the June 19 Order). *See* July 25 Order at 61,516-17; June 19 Order at 62,563. The Commission made no exception to this requirement for out-of-state sellers. The Proposed Findings of Fact'

conclusion regarding AEPCO's average heat rates is also unsupported by the record. The Presiding Judge compares the situation of AEPCO's GTs with those of Pasadena, which he finds should be represented by average heat rates. However, even assuming, *arguendo*, that AEPCO's GTs were only used for sales to the ISO, it is not at all clear from AEPCO's testimony and exhibits that those GTs always went from startup (i.e., zero output) to "whatever operating point they obtained during the interval they operated." Proposed Findings of Fact at ¶ 234. A review of AEP-13, in fact, suggests otherwise. For instance, on November 9, 2000, AEP-13 shows that unit GT#3 operated for four consecutive hours (hours 19-22), presumably in order to make sales to the ISO. Exh. AEP-13 at 1. During those four hours, the heat rate of that unit fluctuated several times, suggesting that it was *not* operating at the same level of output during that four-hour period. Consequently, it would be inappropriate to use average heat rates to calculate the cost of AEPCO's GT units, as using these heat rates would permit AEPCO to recover minimum load costs associated with these units, in violation of the Commission's methodology. *See* April 26 Order at 61,359. The Commission should reject the Proposed Findings of Fact's finding on this issue.

Finally, the Proposed Findings of Fact erroneously find that AEPCO "reasonably and properly used the gas prices identified in Ex. ISO-9 as SP 15 Gas Prices for Refund Calculations." Proposed Findings of Fact at ¶ 239. This finding is largely based on the December 19 Order, in which the Commission concluded that, for purposes of determining prospective price mitigation, out-of-state generators should use the same gas source data as used in California. December 19 Order at 62,204. However, as the ISO pointed out in its AEPCO Brief, the Commission did not, in the May 15 Order,

address the issue of how to calculate gas costs for out-of-state generators. ISO AEPCO Brief at 6. However, in the July 25 Order, the Commission adopted Chief Judge Wagner's recommendation that the MMCP calculation use separate gas costs for Northern and Southern California because "simply averaging gas prices in the north with gas prices in the south will not adequately capture the significant effect of gas prices on the cost of electricity during the refund period." July 12 Report and Recommendation at 65,040. Likewise, simply plugging in gas costs for Southern California is unlikely to accurately reflect the gas price paid by AEPCO. Therefore, the Commission should reject the Presiding Judge's finding that those prices should be used for purposes of determining the cost of AEPCO's units that provided power to the ISO during the Refund Period.

B. The Presiding Judge Improperly Prohibited Parties From Conducting Discovery and Filing Testimony Addressing the Issue of AEPCO's Heat Rate and Gas Data Subsequent to the May 15 Order

At a pre-hearing conference held on June 6, 2002 to address, among other issues, the issue of the eligibility of AEPCO's units to set the MMCP, the California Parties' made a motion, supported by the ISO and Commission Trial Staff, for the opportunity to conduct additional discovery and file additional testimony addressing this issue. The Presiding Judge denied this motion, noting that parties already had the opportunity to conduct discovery and file testimony rebutting AEPCO's testimony. Tr. at 3502:24-3504:11; Proposed Findings of Fact at ¶ 215. This decision was in error, and should be reversed by the Commission. In the December 19 Order, the Commission stated that out-of-state generators would be permitted to set the MMCP on a *prospective* basis, but made no provision for similar treatment for the Refund Period.

December 19 Order at 62,203. Based on this passage from the December 19 Order, the Presiding Judge granted a motion to strike AEPCO's testimony and exhibits from the record. Proposed Findings of Fact at ¶ 213. Then, in the May 15 Order, in response to a Motion for Clarification, the Commission explained that units from out-of-state generators would be eligible to set the MMCP during the Refund Period. May 15 Order at 61,654. Because there was no indication that the Commission intended to allow out-of-state units to set the MMCP during the Refund Period prior to the May 15 Order, and because the Commission made clear in the July 25 Order that the evidentiary hearing before Judge Birchman was not to consider the propriety of the Commission's refund methodology, it is only appropriate that the parties be given an opportunity, prior to Commission determination, to explore the factual issues surrounding the inclusion of out-of-state units in the calculation of the MMCPs.

C. Transactions Entered Into With the ISO by BPA, LADWP, Pinnacle West, and PS Colorado, and Certain Transactions Entered Into With Portland General Should Not Be Found To Have Been Entered Into Under Section 202(C) of the Federal Power Act Because Those Entities Did Not Sustain Their Burden of Proof (Phase 1 - Issue II)

As the Proposed Findings of Fact recognize, the DOE Orders contemplated a process by which suppliers would inform the ISO of their anticipated excess energy (*i.e.* that energy in excess of their native load obligations), and subsequent to certifying an emergency pursuant to the DOE Orders, the ISO was authorized to request energy or services from suppliers, and suppliers were then required to provide the requested energy or services. Proposed Findings of Fact at ¶ 254. The Proposed Findings of Fact also recognize that suppliers bore the burden of proving their assertions that they

entered into transactions with the ISO pursuant to the DOE Orders. As the Proposed Findings of Fact explain:

> The sellers who claim that their transactions were made under the DOE Orders and section 202(c) are seeking an exemption from mitigated market clearing pricing and refund liability required by the Commission's July 25 and December 19 Orders to transactions subject to Section 205 of the Federal Power Act. As such, each seller is the proponent of a claim and, under the Administrative Procedure Act of 1946 . . . as well as the [Federal Power] Act, has the burden of establishing a prima facie case in support of its claim, and the ultimate burden of persuasion.

Id. at ¶ 273.

In assessing the claimed 202(c) transactions of BPA, LADWP, Portland General, Pinnacle West, and PS Colorado, however, the Proposed Findings of Fact fail to properly apply this standard. With respect to transactions entered into by these five suppliers, the Proposed Findings of Fact offer no explanation as to how those entities have met their burden of demonstrating that those transactions were made pursuant to the DOE Orders. Instead, the Proposed Findings of Fact simply adopt Staff's first three criteria for determining which transactions were made pursuant to Section 202(c), stating that those criteria "achieve an end result that is just and reasonable." Proposed Findings of Fact at ¶ 308. Those criteria are:

(1) the entity providing the energy was listed on Attachment A to the DOE Orders;

(2) the transaction was provided on an ISO certification day;

(3) the transaction was not made through a bid into one of the ISO's structured markets for energy or ancillary services.

Proposed Findings of Fact at ¶ 306. Because a number of transactions claimed by these five entities meet these three criteria, the Proposed Findings of Fact accept Staff's

conclusion that they were made under the DOE Orders, and are exempt from mitigation. Proposed Findings of Fact at ¶¶ 350, 368, 389, 396, 403.[5]

The ISO agrees that transactions that do not satisfy Staff's first three criteria could not have been made pursuant to 202(c). However, sales should not be found to have been made pursuant to 202(c) solely because they meet these three criteria. Initial Brief of the California Independent System Operator as to 202(c) Issues. *See* Exh. ISO-21 (O'Neill) at 5:1-21:9.

The DOE Orders specify that entities listed in Attachment A were required to provide energy to the ISO only when requested by the ISO, and in the amounts requested by the ISO. Exh. ISO-11 at 1. The most logical reading of this language is that an actual, specific request by the ISO was necessary in order to trigger a supplier's obligation to provide energy during this period, either in the form of a direct request to the supplier, or the ISO's acceptance of energy from a supplier with the clear understanding that the energy was being offered because of the authority contained in the DOE Orders. *See* Exh. ISO-10 at 10:9-18, 11:10-17; ISO-21 at 7:4-10. To argue that no request by the ISO for energy was necessary in order to trigger suppliers' obligation to provide under the DOE Orders would inevitably lead to the illogical conclusion that *all* energy supplied to the ISO during this period was being made available pursuant to the DOE Orders, because the ISO was always encouraging suppliers, generally, to provide energy through various mechanisms. Tr. at 2328:8-15.

---

[5] The Proposed Findings of fact identify the following sales entered into by these suppliers as having been made pursuant to the Section 202(c): (1) BPA - the OOM sales listed in the next to last column on Exhibit BPA-2, Proposed Findings of Fact at ¶ 350; (2) LADWP - the OOM sales shown on Exhibit DWP-4R, *id.* at ¶ 375; (3) Pinnacle West – the sales shown in Exhibit PNW-2 except for the sales on December 22, 2000, HE 21 and January 16, 2001, HE 7, *id* at ¶ 389; (4) Portland General – the sales shown in

If all transactions during this period were considered made pursuant to Section 202(c), the Commission's mandate to separate 202(c) from non-202(c) transactions would be rendered meaningless, as no practical mechanism would exist to distinguish between them. This interpretation would also mean that the ISO had no option to transact under any mechanism but 202(c) during this period, a bizarre result, and one that is plainly inconsistent with the ISO's expressed desire to limit the use of the DOE authority to the most dire of emergencies. Tr. at 2289:7-17.

Moreover, the DOE Orders also contemplated that the ISO and supplier would reach some agreement as to the "terms of any arrangement subject to" these Orders. *See* Exh. ISO-21 (O'Neill) at 7:1-4 (quoting December 14 DOE Order). As Ms. O'Neill explained in her Rebuttal Testimony, the ISO could hardly even attempt to come to terms with suppliers if it didn't even understand that the energy that it was procuring was being made available because of the DOE Orders. *Id.* at 7:7-10.

Therefore, based on the language of the DOE Orders and the procedures contemplated therein, only transactions with respect to which it was clear that suppliers were providing power pursuant to Section 202(c), either because the ISO contacted a supplier requesting energy identified as excess, or because a supplier explicitly stated that the energy was being offered because of the DOE Order and the ISO then requested it , should be classified as transactions made pursuant to 202(c). Staff's criteria do not capture this critical concept; instead, they sweep up any and all OOM transactions that the ISO entered into on days that it certified an emergency pursuant to the DOE Orders. This result is patently overbroad. As the ISO pointed out in testimony,

---

Exhibit PGE-2 Revised, as further revised by trial stipulation TS-1, *id.* at ¶ 396; (5) PSC Colorado – the

there were numerous reasons why sellers might have been selling OOM energy to the ISO besides the invocation of the DOE Orders. For instance, suppliers were able to command particularly high prices during this period, especially in the case of OOM transactions. Exh. ISO-10 (O'Neill) at 13:1-10. The Commission recognized this in the July 25 Order, noting that the mere fact that the ISO was entering into OOM transactions served to indicate to suppliers that the ISO was in a "must-buy" situation, which, in turn, provided an even greater opportunity for suppliers to exercise market power and charge unjust and unreasonably high prices. *See* July 25 Order at 61,515. Because the Proposed Findings of Fact adopt Staff's first three criteria, without requiring a further showing by suppliers that they were providing power pursuant to Section 202(c), either because the ISO contacted them requesting energy identified as excess, or because they explicitly stated that the energy was being offered because of the DOE Order and the ISO then requested it, the Commission should reject the Proposed Findings of Fact's finding that DOE transactions were entered into by BPA, LADWP, PS Colorado, and Pinnacle West, and that certain transactions of Portland General were entered into pursuant to the DOE Orders.

Portland General presents a somewhat unique situation. The Proposed Findings of Fact conclude that the ISO, along with Staff and Portland General, had agreed through stipulation that all of the sales listed on Exh. PGE-2 Revised, as further revised by sections 5(m), (n), and (o) of Exh. TS-1 trial stipulation, were made pursuant to the DOE Orders. This is incorrect. The ISO only stipulated that Portland General was an attachment A entity, that all of the sales listed on PGE-2 Revised, as further revised by TS-1, were made on DOE certification days, and that no transactions on PGE-2

---

sales shown in Exhibit PSC-2 that were made on January 17, 2001, *id.* at ¶ 403.

Revised, as further revised by TS-1, were market transactions or were made in excess of $64/MWh on January 9, 2001. Exh. TS-1 at ¶ 3. In fact, the ISO explicitly avoided characterizing any specific sales as made pursuant to the DOE Orders. *Id.* At ¶ 4. In a nutshell, the ISO agreed in TS-1 that the sales shown on PGE-2 Revised, as further revised in TS-1, satisfied Staff's four criteria, but, consistent with its position as articulated above, did not agree that those sales were therefore necessarily made pursuant to the DOE Orders.

Portland General was also unique among these five suppliers in that it did produce contemporaneous evidence, in the form of operator phone logs, demonstrating that it engaged in a number of transactions with the ISO pursuant to the DOE Orders. *See* Exhs. PGE-6, 8, 9, 13, 16. Based on this evidence, the ISO conceded in testimony and on brief that those transactions should be excluded from mitigation in this proceeding because they were made under 202(c). Exh. ISO-21(O'Neill) at 16:15-21. However, because Portland provided no contemporaneous evidence with respect to the remainder of the sales listed on Exh. PGE-2 Revised, the Commission should decline to find that they were made pursuant to the DOE Orders.[6]

D. The Commission Should Defer Ruling on Which Specific Transactions Were Made Pursuant to the 11-day Contract Between the ISO and Dynegy (Phase II – Issue I.A.2.b)

On December 5, 2000, the ISO and Dynegy entered into an 11-day contract under which Dynegy agreed that the ISO could dispatch Dynegy units pursuant to certain contract terms. *See* Exh. DYN-15. In testimony, witnesses for both the ISO and

[6] The ISO has provided as Attachment A to these comments a list of exactly which sales made by Portland General the ISO believes were made pursuant to Section 202(c).

Dynegy agreed that any sales made pursuant to this contract would constitute non-spot sales, and therefore not subject to price mitigation under the July 25 Order. Exh. ISO-37 (Gerber) at 71:20-22; Exh. DYN-16 (Williams) at 23:1-7.[7] In his Phase 2 Direct Testimony on behalf of Dynegy, Mr. Williams explained, however, that issues relating to the 11-day contract were currently the subject of good-faith negotiations between the ISO and Dynegy, including the question of exactly which transactions were made pursuant to the contract. DYN-16 (Williams) at 24:4-5. Mr. Williams included with his testimony a list of transactions, Exhibit DYN-26, that he claimed were made pursuant to the contract, but noted that this was not the entire universe of sales that Dynegy believes was made under the contract. Mr. Williams concluded his testimony on this issue by stating:

> It is not necessary for the Presiding Judge to make a determination whether or not the transactions listed in DYN-26 were undertaken pursuant to the 11-day bilateral contract, nor any determination regarding the additional disputed matters. Rather, the ISO simply should be directed to update its settlement records to reflect the outcome of those and other pending disputes prior to rerunning its refund settlements in a compliance filing.

Exh. DYN-16 (Williams) at 25:15-21.

In his Rebuttal Testimony, Mr. Gerber agreed with Mr. Williams that any transactions made pursuant to the contract would constitute "non-spot" transactions, but declined to take a position on whether any particular transactions (including those listed in DYN-26) were, in fact, made under the contract because of the ongoing negotiations between Dynegy and the ISO. Exh. ISO-37 (Gerber) at 71:18-72:3. Mr. Gerber concurred with Mr. Williams that the most appropriate treatment for this issue would be

to wait until a resolution is reached between the ISO and Dynegy as to which sales were made under the contract, at which time the ISO would make the necessary adjustments to its settlement records to reflect the non-mitigation of those transactions. *Id.* at 72:16-20.

Despite this testimony, the Proposed Findings of Fact conclude that "it is appropriate to determine whether the transactions listed in Ex. DYN-26 are non-spot transactions." Proposed Findings of Fact at ¶ 483. The Proposed Findings of Fact answer this question in the affirmative, finding that the sales of energy in DYN-26 are non-spot transactions that should not be mitigated, but noting that this finding does not address "whether other Dynegy transactions that were made under the 11-day contract and are the subject of ongoing settlement negotiations between Dynegy and the ISO are non-spot transactions." *Id.* The ISO respectfully requests that the Commission reject this finding for several reasons.

First, the Proposed Findings of Fact rely on a mischaracterization of the ISO's position on this issue. The Proposed Findings of Fact state that the ISO has agreed that the transactions set forth in Exhibit DYN-26 are multi-day transactions, and therefore not subject to mitigation. Proposed Findings of Fact at ¶¶ 479, 484. This assertion in incorrect. Neither the ISO's testimony nor the ISO's discovery responses contain such an admission. As explained above, in his Rebuttal Testimony, Mr. Gerber took no position as to whether any specific transactions were made under the contract, but instead recommended that the Presiding Judge decline to rule on the issue of which transactions were made pursuant to the contract. This position appeared to be

[7] Mr. Williams also filed testimony in Phase 1 of this proceeding in which he raised the issue of the Dynegy contract as it concerned the calculation of the mitigated price. Exh. DYN-14 (Williams) at 6:6-14.

consistent with Dynegy's, based on Mr. Williams' statement in his testimony that it was not necessary for the Presiding Judge to rule on whether the transactions listed in DYN-26 were made pursuant to the contract. Likewise, in his deposition, Mr. Gerber explained that while he viewed the universe of transactions made under the contract as "non-spot," the issue of exactly which transactions were made under the contract was subject to good-faith negotiations. Exh. DYN-27 at 2-4. Mr. Gerber did not indicate or suggest that he agreed that a certain set of transactions (such as those listed in DYN-26) had been made pursuant to the contract.

This confusion may be based in part on Dynegy's own inconsistency in addressing this issue. Despite Mr. Williams' statement in testimony that there was no need for the Presiding Judge to address whether the transactions in Exhibit DYN-26 were made pursuant to the contract, Dynegy, in its Initial Post Trial Brief on Issues II and III (hereinafter "Dynegy Phase 2 I.B."), argues that "removing the transactions listed in Exhibit DYN-26 from mitigation is not inconsistent with that approach, given that the ISO did not dispute in the first phase of the hearing that these transactions, in fact, were undertaken pursuant to the 11-day contract." Dynegy Phase 2 I.B. at 6. Although Mr. Williams did raise the issue of the Dynegy contract in Phase 1, he did so in the context of whether or not certain transactions were eligible to set the MMCP, rather than whether they should be excluded from price mitigation. In fact, Mr. Williams explicitly recognized that this latter issue would be addressed in testimony in Phase 2 of this proceeding. *See* Exh. DYN-14 (Williams) at 6:9-14. Even more telling, Exhibit DYN-26, the list of transactions that the ISO supposedly did not contest as having been made pursuant to the 11-day contract, was not introduced in Phase 1 – it was filed with Mr.

Williams' Phase 2 direct testimony. Obviously, the ISO could not have opined on a list that was not, at the time of the Phase 1 hearing, even in the record.

A second reason that the Proposed Findings of Fact's finding on this issue should be rejected is that it may adversely affect the good-faith negotiations between the ISO and Dynegy concerning the 11-day contract. These negotiations are still ongoing. The ISO believes that the parties should have the freedom to explore the widest variety of solutions to the issues being addressed in these negotiations, including the question of exactly which transactions were made pursuant to the contract. Moreover, there is no need to resolve now any issue as to which transactions were made under the contract. All parties, as well as the Presiding Judge, understand that the final figures as to who owes what to whom cannot be determined with any precision at this moment. And, as the Proposed Findings of Fact recognize, it may be determined that other transactions besides those listed in DYN-26 were made under the 11-day contract. As Mr. Williams and Mr. Gerber both stated in their Phase 2 testimony, there was no reason whatsoever for the Presiding Judge to try to determine whether any particular transactions were made pursuant to the contract, and there is no reason for the Commission to rule on this issue at this time. We repeat: such a ruling might limit the ability of the ISO and Dynegy to conclude the good-faith negotiations on this issue in a mutually satisfactory manner. Given the Commission's oft-stated preference for resolution of disputes through settlement and alternative dispute resolution mechanisms, it would be a perverse result for the Commission's own actions to interfere with the parties' ability to do so. Therefore, the Commission should reject the Proposed Findings of Fact's finding on this issue, and defer ruling on the question of whether any

specific transactions were made pursuant to the 11-day contract, leaving that issue for resolution through the ongoing good faith negotiations between Dynegy and the ISO.

E. The ISO Properly Mitigated Import Transactions Using Interval MMCPs, Rather Than Average Hourly MMCPs (Phase 2 – Issue I.A.2.i)

This issue concerns whether the ISO should mitigate the prices paid to suppliers of imports on the basis of ten-minute intervals – as is the ISO's normal practice in accordance with the ISO Tariff – or on an hourly basis using an average MMCP. The Proposed Findings of Fact conclude:

> 544. Far from exclusively using the 10-minute interval MMCP, the ISO itself uses the hourly MMCPs in the ancillary service markets and the PX markets. Ex. ISO-37 at 24. As stated by Gerber, he was certain that the ISO's records of hourly transactions prior to April 25, 2002 were "absolutely" correct. The PX hourly market transactions are also mitigated using the hourly MMCPs. Tr. at 4272-73. In particular, hourly MMCPs must be used to mitigate energy imports in order to justly and reasonably compensate those importers who were only allowed to sell, according to the WSCC rules, their energy based on hourly schedules. To do otherwise would subject energy importers to market conditions that did not exist at the time of their sales. Thus, I find and conclude that there is nothing in this record that precludes the use of hourly MMCPs to mitigate imported energy and that such use is warranted on the record as made.

Proposed Findings of Fact at ¶ 544.

For imports bid into the ISO's supplemental energy market, where the supplier was paid based on the clearing price in that market, there is no credible argument for mitigating these transactions on an hourly basis. The ISO Tariff expressly provides for paying all suppliers, including imports, that bid into its markets on a ten-minute basis, and to treat suppliers differently than they are treated in production would introduce inaccuracies into the calculation of refund amounts. Exh. ISO-37 (Gerber) at 24:12-16.

The methodology proposed by the Proposed Findings of Fact would create significant anomalies. For example, assume that a supplier of an import bid 100 megawatt-hours into the market during an hour which the MCP was $50 for all six intervals, and the MMCP was $40 in three intervals and $80 in three intervals. Under the methodology in the Proposed Findings of Fact, the average MMCP would be $60, the supplier would be paid the average MCP ($50) for all 100 megawatt-hours, and the supplier would receive $5000. Under ten-minute settlements, the supplier would be paid the MMCP ($40) for three intervals, the MCP ($50) for three intervals, and the supplier would receive $4500 for the hour. Thus, under the methodology in the Proposed Findings, the supplier would be allowed to profit from bids that were higher than the MMCP. Moreover, the supplier of imports would be provided an advantage over other suppliers who, under the ISO Tariff, submit one energy bid for the entire hour. There is no justification or rationale for such distinctions.

These problems arise from the Proposed Findings of Fact's erroneous assumption that because suppliers of imports,[8] according to the WSCC customary business practices, were only allowed to sell their energy based on hourly schedules, it would be unjust to settle imports according to ten-minute intervals because this practice would subject energy importers to market conditions that did not exist at the time of their sales. Proposed Findings of Fact at ¶ 544. To the contrary, the market existing at the time, as directed by the ISO Tariff, provided for interval settlement. Importers into the ISO's markets whose bids were accepted were historically paid on a ten-minute basis using the interval market clearing price, pursuant to the ISO Tariff. *See* Exh. ISO-37

[8] The reference to suppliers of imports as importers in actually a misnomers. The ISO is the importer. The suppliers of imports into the ISO are in actuality exporters from their own control area.

(Gerber) at 24:12-13. The hourly volume was divided into six even parts, one for each interval, and the MCP (or as-bid price as appropriate) for each interval was applied to the corresponding interval. The application of the MCP to the ten-minute intervals was the manner in which *all* suppliers that successfully bid into the ISO's markets, each of whom (like suppliers of imports) submitted bids for entire hours, were compensated.

The analogy to the PX and Ancillary Service markets included in the Proposed Findings of Fact is inapt. The PX and Ancillary Services markets are *hourly* markets. Bids are submitted and selected on an hourly basis. The Real Time Market is, from a settlement perspective, a ten-minute market.[9] Although energy bids are submitted for the entire hour, energy from these bids are dispatched throughout the hour and prices are established on a 10-minute basis. Thus, an import bid may clear the market in some intervals within the hour and fail to clear in others. In the former case, the supplier would be paid for Instructed Energy and in the latter for Uninstructed Energy.

The only settlement difference between imports and other transactions is that real-time imports are typically dispatched for the entire hour, so that the hourly volume scheduled is divided evenly among the six intervals. For other transactions, the ISO is able to measure the actual energy delivered in each interval. Exh. ISO-19 (Hildebrandt) at 58:14-17. There is no reason to carve out separate treatment in this proceeding for imports. Indeed, such special treatment would be contrary to the Commission's orders. In the July 25 Order, the Commission directed the ISO to *rerun* its settlements system as it existed during the refund period, not to create new rules. July 25 Order at 61,520.

---

[9] The ISO has settled real-time energy transactions at 10 minute intervals since September 1, 2000.

Accordingly, all settlements of real-time imports bid into the markets are appropriately done on the basis of ten-minute intervals.

Imports that were handled as OOM sales were historically priced on an hourly basis. These prices were established through negotiations, however, and not determined by the MCP calculated in the ISO's formal real-time market. Mitigation of such prices can thus not be achieved by simply applying the same technical rerunning of the market, because there is no market to rerun. With regard to the OOM sales in the ISO Control Area, which are also settled hourly, [10] the Commission decided to treat OOM sales the same as sales through the Real Time Market. July 25 Order at 61,516. The same reasoning should apply to OOM sales that are imports. Moreover, if the Commission agrees with the ISO and mitigates imports based on interval MMCPs, importers will not be deprived of any reliance on hourly bids because, as Mr. Gerber explained in his surrebuttal testimony, importers – like other Market Participants – were not making bidding decisions based on knowledge of what the mitigated prices would be. Exh. ISO-45 (Gerber) at 5:10-16.

For the reasons above, the Commission should reject the Proposed Findings of Fact's finding regarding the settlement of imports.

F. With Respect to Non-Mitigated Transactions, the ISO Properly Re-Allocated Amounts Above the MMCP From Charge Type 401 to Charge Type 481 in the Settlements Rerun (Phase 2 – Issue I.A.2.m)

Paragraphs 571-592 of the Proposed Findings of Fact concern the ISO's allocation to customers, in connection with transactions exempt from refund liability, of costs in excess of the "soft cap" in effect from December 8, 2000, through April 26,

2001. The ISO believes that the conclusion reached in these findings is erroneous, and the Commission should reject it.

The soft cap operated as a limit on the MCP, but the ISO could pay suppliers as-bid above the soft-cap MCP if the ISO required energy beyond that available at the MCP. Under the methodology approved by the Commission and which went into effect in December of 2000, any amounts that suppliers were paid above the soft-cap breakpoint were charged to Scheduling Coordinators ("SCs") with net negative deviations under Charge Type ("CT") 481, while amounts paid up to the breakpoint were collected under CT 401 and charged to all SCs purchasing imbalance energy. Exh. ISO-37 (Gerber) at 21:20-22:4. When the ISO reran its settlements system, it substituted the MMCP for the MCP in those instances in which the MMCP was less than the MCP. With respect to transactions exempt from refund liability where suppliers were historically paid as-bid, the difference between the MCP and the MMPC was transferred from CT 401 to CT 481.

Mr. Tranen, on behalf of the Generators, argued that this treatment was inappropriate, contending:

> [T]he Commission never ordered the ISO to reallocate charges to buyers for non-mitigated transactions, just because mitigated transactions became subject to a new MMCP. The Commission's May 15 Order ruled that the MMCPs do not constitute revised MCPs. Therefore, amounts that were paid for non-mitigated transactions above the MMCP, but below the prior MCP, should not be reallocated from CT401 to CT481.

Exh. GEN-36 (Tranen) at 29:13-18.

---

[10] OOM sales inside the ISO Control Area, where Generators were obligated to respond to emergency dispatch orders were paid, at the suppliers annual option, either the Hourly Ex Post Price or a cost-based price. ISO FERC Electric Tariff at 11.2.4.2.1.

As Mr. Gerber explained in his rebuttal testimony, this allocation scheme does not constitute an "error." Rather, this treatment was consistent with the ISO's treatment of the as-bid portion of transactions in production. Exh. ISO-37 (Gerber) at 21:14-22:7. Moreover, contrary to Mr. Tranen's view, nothing in the May 15 Order suggests a different result. Mr. Tranen is correct that the MMCP does not constitute a new market clearing price in the strict sense of that term, because the market is permitted to clear below the level of the MMCP. Instead, the MMCP is more akin to a hard cap (hence the characterization of the debate resolved in the May 15 Order as "cap" versus "clearing price") that replaces the prior soft cap mitigation methodology. The dividing line between CT 401 and CT 481 is, in actuality, based on the breakpoint price, as established by either the historical MCP or the MMCP during the rerun, rather than the "market clearing price." This is because, as the Commission recognized in the May 15 Order, during intervals in which bids were accepted above the level of the soft cap, there was no single "market clearing price, in the sense that suppliers would be paid at either the historical MCP or the MMCP, depending on which was lower." May 15 Order at 61,656. Thus, the crucial issue for determining allocation of charges between Charge Types 401 and 481 is whether the ISO accepted and paid bids over the *breakpoint or ceiling price*, which again, pursuant to the May 15 Order, is defined as the lower of the historical MCP or the MMCP. Because non-mitigated transactions are, pursuant to the Commission's orders, eligible to be paid above the breakpoint, which is now the MMCP, it is appropriate to set the amount charged through CT 481 using the MMCP rather than the previous soft cap breakpoint.

Nonetheless, the Proposed Findings of Fact conclude that the ISO should not have transferred the difference between the MCP and the MMCP to CT 481. It focused not so much on the relationship between the MCP and MMCP, but on the exempt status of the transactions. The Proposed Findings of Fact include the following:

> 592. The July 25 and December 19 Rehearing Orders made clear which transactions are subject to *price mitigation and refund*. The May 15 Rehearing Order clarified how to apply the MMCP as a ceiling price approach to *refund calculations*. By its very definition, a transaction exempt from mitigation *is not* subject to either refunds or any refund calculations or to be used in any refund calculation. But as Gerber testified, the ISO "certainly" made a unilateral decision to run its settlement process by reclassifying the amounts paid to an "unmitigated seller." Tr. at 4237.
>
> 593. When the ISO reclassifies amounts paid to a seller of transactions exempt from mitigation, the amount paid for a transaction exempt from mitigation remains the same. *But, when the ISO reclassified that amount by shifting the difference between CT 401 and CT 481 based on the MMCP rather than the MCP, it changed that transaction exempt from mitigation into a mitigated transaction as far as the ISO's settlement system is concerned.* This occurs because, rather than being independent CTs accounting for a transaction exempt from mitigation, CT 401 and CT 481 are interrelated within the ISO's settlement system, which results in an unjustified amount of $3 million.
>
> 594. Consequently, I find that the ISO's unilateral decision to shift the amount charged through CT 481 based on the MMCP, rather than the MCP, fundamentally violates the Commission's Orders in regards to transactions exempt from mitigation. As explained above, the interrelation of the ISO's CTs in its settlement process will eventually mitigate the very transactions that are exempt from mitigation. For transactions exempt from mitigation, the ISO may not change this dividing line by lowering it from the MCP to the MMCP.

Proposed Findings of Fact at ¶¶ 592-94.

The underlying error of the Proposed Findings of Fact is the assumption that all parties to an entire exempt transaction – both suppliers and purchasers – are immune to all effects of the refund proceeding. This is not what the Commission ordered.

Rather, the *suppliers* in exempt transactions are exempt only from *refund liability*. In establishing this proceeding, the Commission stated:

> We will direct Judge Birchman to make findings of fact with respect to: (1) the mitigated price in each hour of the refund period; (2) the amount of refunds owed by each supplier according to the methodology established herein; and (3) the amount currently owed to each supplier (with separate quantities due from each entity) by the ISO, the investor owned utilities, and the State of California.

July 25 Order at 61,520. Only the amounts due to and from the suppliers are to be decided in this proceeding; allocations of the subsequent costs involved is governed by the ISO Tariff, pursuant to which amounts above the ceiling price are allocated to SCs with net negative deviations through CT 487.

Thus, with regard to bilateral transactions entered into by the Department of Water Resources, the Commission stated that it "believe[d] that imposing after-the-fact *refund liability* on California transactions outside the centralized ISO and PX markets is unjustified," July 25 Order at 61,515 (emphasis added), and on rehearing that it disagreed with "arguments for extending *refund liability* to include DWR transactions," December 19 Order at (emphasis added). Regarding short-term bilateral contracts, the Commission stated that it was "not convinced that any other short-term contracts may be made *subject to refund* under the July 25 Order." December 19 Order at 62,195 (emphasis added). Although the Commission merely stated that DOE section 202(c) transactions were outside the scope of the proceeding, the proceeding, as noted above, concerns only suppliers' refund liability. There is simply nothing in the Commission's orders that precludes the ISO's application of its Tariff requirements, which result in the re-allocation of some costs to *purchasers*.

Finally, the ISO notes that these findings are not actually findings of fact, but interpretations of the Commission's orders, and thus conclusions of law. This is therefore a matter to be decided *de novo* by the Commission, without regard to the Proposed Findings of Fact. The ISO submits that, upon review of the ISO's allocation, the Commission should find it appropriate.

G. The Commission Should Ensure That Any Mechanism It Approves for the Collection of Interest on Amounts Owed and Owing Does Not Violate the ISO's Status as a Cash-Neutral Entity (Phase 2 - Issue III.D)

The Proposed Findings of Fact assert that the Presiding Judge should not address the merits of the ISO's arguments concerning the need for the ISO to remain a cash-neutral entity regardless of the mechanism directed by the Commission for collecting interest on amounts owed and owing during the refund period, because the ISO's (and PX's) concerns for cash neutrality do not fall under any of the issues to be addressed in the present proceeding, and instead raise matters with regard to cash shortfalls which the ISO and other parties have expressly agreed to not adjudicate but instead to present to the Commission at a later date. Proposed Findings of Fact at ¶¶ 806, 819. Moreover, the Proposed Findings of Fact assert that no interest rate other than the rate described in Section 35.19a of the Commission's regulations, 18 C.F.R. 35.19a (the "Commission interest rate"), should be applied to amounts that are currently subject to an interest rate below the Commission interest rate, because the July 2001 and December 2001 Orders directed that the Commission interest rate be applied to refunds and amounts (receivables) past due, the Orders did not provide for any exceptions to this directive, and arguments concerning the interest rate to be applied

raise matters with regard to cash shortfalls which the Commission is to address in the future. *Id.* at ¶¶ 800-01, 803-08. Additionally, the Proposed Findings of Fact assert that ISO witness Michael Epstein did not have the expertise to address in his testimony the possible effects of the bankruptcy of PG&E and the PX on the ISO's cash-neutral status, and therefore that the portions of Mr. Epstein's testimony concerning these effects is entitled to little or no probative value. *Id.* at ¶ 817. Moreover, the Proposed Findings of Fact assert that Mr. Epstein's statements that the December 2001 Order does not permit the ISO to remain cash-neutral and fails to provide for any adjustment where there are imbalances between receivables and payables in the ISO marketplace are not entitled to any probative value, for two reasons. The first reason given is that the ISO, on brief, mistakenly suggested that the Commission could resolve the difficulties posed by the December 2001 Order by applying in the present proceeding the same treatment of interest as was applied in a June 3, 2002 Commission order addressing the payment of interest by the ISO (*California Independent System Operator Corp.*, 99 FERC ¶ 61,253 (2002) ("June 2002 Order" or "June 3 Order"). The second reason given is that the ISO's suggestion is an impermissible collateral attack on the July 2001 and December 2001 Orders. Proposed Findings of Fact at ¶ 818.

As explained below, all of these assertions in the Proposed Findings of Fact are erroneous. The need to preserve the ISO's cash-neutral status, regardless of the mechanism for applying interest that is ultimately employed, is a subject that should have been addressed in the Proposed Findings of Fact, and should be addressed by the Commission now. Moreover, all of the testimony presented by Mr. Epstein should have been considered in the Proposed Findings of Fact and should now be considered

by the Commission. The Commission should find that any specific method of assessing interest on amounts unpaid and on refunds should preserve the ISO's position as a cash-neutral entity.

As the ISO has repeatedly stressed in its prepared testimony and on brief, it is imperative that any mechanism directed by the Commission for collecting interest on amounts owed and owing during the refund period not violate the ISO's position as a cash-neutral entity. Exh. ISO-37 (Epstein) at 129:3-19, 132:21-23; Exh. ISO-45 (Epstein) at 33:22-34:3; ISO Phase 2 I.B. at 55; ISO Phase 2 R.B. at 31-32. In his Prepared Rebuttal Testimony, Mr. Epstein explained:

> I have no preference as to which methodology to use to determine which amounts have interest applied to them, so long as the following condition is met: the application of the methodology must not result in a violation of the ISO's position as a cash-neutral entity, *i.e.*, the amount of interest that will be paid or accrued to SC creditors (payables or "AP") must be equal to the amount of interest that is due from and will be collected from SC debtors (receivables or "AR"). Differences between AR and AP lead to different amounts of interest receivable and payable, which results in a net cash payment to or collection from SCs and thus violates the ISO's position as a cash neutral entity. Thus, in order for the ISO to maintain its cash neutrality, the balances of AR and AP must be equal for each trade month, or if they are not equal every month (which they are in fact not at present, as discussed below), any imbalance between the AR and AP must be allocated to a party or parties other than the ISO. I approve of any methodology that is used to determine which amounts have interest applied to them so long as the methodology allocates any interest imbalance among a party or parties other than the ISO.

Exh. ISO-37 (Epstein) at 129:3-19. Similarly, Mr. Epstein explained that "I have no preference as to which interest rate is applied, so long as the interest rate used does not violate the ISO's position as a cash-neutral entity as I have described above." *Id.* at 132:21-23.

The ISO has also described a number of complicating factors that can cause the balances of payables and receivables to not be equal and/or that do not allocate any interest imbalance among a party or parties other than the ISO, thus keeping the ISO from maintaining its cash-neutral status. Exh. ISO-37 (Epstein) at 130:1-131:30; Exh. ISO-45 (Epstein) at 32:17-33:19; ISO I.B. at 55-56; ISO R.B. at 31-32. Mr. Epstein explained that these complicating factors include the following:

- The application of interest based on the methodology described in the order issued in the refund proceeding on December 19, 2001 ("December 2001 Order"). In the December 2001 Order, the Commission directed that interest be assessed at the Commission interest rate on both refunds and receivables past due, i.e., on both creditors and debtors. However, the December 2001 Order did not provide for any adjustment where there is an imbalance between AR and AP, which imbalances are occurring at present. Thus, the December 2001 Order does not permit the ISO to remain cash-neutral.

  The Commission has, however, issued another order that does not violate the ISO's cash neutrality: the June 2002 Order. In the June 2002 Order, The Commission directed that creditors are only entitled to receive default interest collected by the ISO from defaulting parties. The ISO has made a compliance filing to implement the June 2002 Order and is awaiting Commission approval of the compliance filing. However, even if the compliance filing is approved, the December 2001 Order still prevents the ISO from being cash-neutral.

- The uncertainty as to whether the ISO can assess interest on the bankrupt parties PG&E and the PX after their bankruptcy dates. The Commission has not explicitly addressed the issue of whether the ISO can assess interest on a party in bankruptcy after the bankruptcy filing date. The June 2002 Order in effect (although it did not explicitly say so) provided for the discontinuance of interest from bankrupt SCs. In the June 2002 Order, the Commission directed that creditors are only entitled to receive default interest collected by the ISO from defaulting parties. Moreover, the June 2002 Order did not direct that creditors are entitled to receive interest from an SC debtor as to which the ISO cannot assess interest (such as a bankrupt party). Thus, the June 2002 Order cannot reasonably be read as permitting interest that is accrued to SC creditors relating to defaults on amounts in bankruptcy to be collected. In the compliance filing submitted in response to the June 2002 Order, the ISO proposes to continue not

assessing interest on defaulted amounts due from SC debtors after the date of the bankruptcy filing. However, calculating interest for the refund period, pursuant to the December 2001 Order, means that interest will be assessed on bankruptcy amounts for all periods. The parties in this proceeding that have applied a flat interest rate to their calculated amounts owed and owing are not factoring in the effects of the different treatments of interest from bankrupt parties as described above.

- The additional effects of market reruns. ISO market reruns are booked in the month in which the rerun is conducted. The original month is not reinvoiced, but the effects of reruns are included in the current month's invoices. There were large market rerun amounts relating to pre-bankruptcy activity of PG&E and the PX that occurred in May 2001 through March 2002, which were months subsequent to those entities' bankruptcies. There is a queue of reruns of earlier periods waiting to be processed as well, which include pre-bankruptcy activity that has yet to be invoiced. The treatment of interest assessment on defaulted bankrupt amounts will lead to different balances of AR and AP upon which interest is assessed.

- The effects of payment offsets, as when a payable in one month is offset against an amount receivable in a different month, which leads to AR and AP imbalances.

- The effects of charges carried over and incompleted invoices. In various trade months, AR did not equal AP due to charges or credits carried over to a subsequent month or invoices incompleted.

Exh. ISO-37 (Epstein) at 130:5-131:25.

With regard to the potential difficulty that the December 2001 Order, and also the July 2001 Order, did not provide for any adjustment where there are imbalances between receivables and payables in the ISO marketplace (described in the first bullet point of Mr. Epstein's testimony, above), thus endangering the ISO's cash neutrality, the ISO requested on brief that the Presiding Judge bring this issue to the Commission's attention and recommend that interest not be collected on amounts owed and owing and refunds in a manner that violates the ISO's status as a cash-neutral entity. The ISO also suggested that the potential difficulty could be resolved by a ruling that SC

creditors are entitled to receive interest only to the extent that the ISO collects interest from defaulting participants, which is the approach the Commission adopted in the June 2002 Order. ISO Phase 2 I.B. at 55-56. To address the potential problem that the ISO may not be able to levy interest on amounts owed by bankrupt parties after their bankruptcy dates (described in the second bullet point of Mr. Epstein's testimony, above), the ISO respectfully suggested that the Commission address this issue. ISO Phase 2 I.B. at 56.

The Proposed Findings of Fact erroneously state that the ISO's (and PX's) concerns for cash neutrality do not fall under any of the issues to be addressed in the present proceeding, and instead "raise matters with regard to cash shortfalls" which the ISO and other parties have expressly agreed, as part of a Joint Narrative Stipulation of Issues, to not adjudicate and to have presented to the Commission at a later date. Proposed Findings of Fact at ¶¶ 806, 819. To the contrary, the subject of the ISO's status as a cash-neutral entity falls squarely under the issue of how interest should be calculated and applied, which is Issue III.D in the present proceeding and is an issue the Proposed Findings of Fact were required to address. The question of how interest should be applied cannot be sufficiently answered without an answer also being provided to the question of how the ISO's cash-neutral status is to be maintained; interest cannot be applied in a way that violates the ISO's cash-neutral status. It is for this reason that Mr. Epstein explained the various complicating factors that could prevent the ISO from being able to maintain its cash neutrality.

Moreover, it is not the case that the ISO and other parties have agreed to address the subject of the ISO's cash neutrality exclusively at a later date. To be sure,

as the Proposed Findings of Fact state, the parties did stipulate to address in the future the issues of how any shortfalls in cash available for distribution should be treated, if at all, and when and how cash should flow between buyers and sellers. Proposed Findings of Fact at ¶ 806. It may well be the case that issues of the ISO's cash neutrality can be addressed then, as well as now. However, the subject of the ISO's cash neutrality, as explained above, also falls within the issue of how interest should be applied. Therefore, the Commission should address the ISO's need for cash neutrality now, in its considerations on Issue III.D. The simple fact is that the ISO has no source of cash other than what it receives from the market or earns in interest, and that must be taken into account.

Moreover, the Proposed Findings of Fact incorrectly assert that no interest rate other than the Commission interest rate should be applied to amounts that are currently subject to an interest rate below the Commission interest rate, because the July 2001 and December 2001 Orders directed that the Commission interest rate be applied to refunds and amounts (receivables) past due, and the Orders did not provide for any exceptions to this directive. The Proposed Findings of Fact make this assertion in response to arguments by the California Parties and the PX that exceptions from application of the Commission interest rate should be allowed for interest on amounts in the PX settlement trust account and in the PX chargeback account, because these amounts are currently subject to interest rates lower than the Commission interest rate, and application of the Commission interest rate to these amounts will result in a cash shortfall for the PX, due to the difference between the lower interest rates and the Commission interest rate. The Proposed Findings of Fact also state that the California

Parties and the PX raise concerns regarding cash shortfalls, which the December 2001 Order stated were reserved for future Commission consideration and which the parties agreed to address in the future. Proposed Findings of Fact at ¶¶ 800-01, 803-08. Where the Proposed Findings of Fact err is in characterizing the concerns raised by the California Parties and the PX as relating solely to cash shortfalls, while ignoring the possible effects that applying the Commission interest rate to all amounts, without exception, will have on cash neutrality. The ISO has concerns similar to those of the PX, with regard to the effect that applying the Commission interest rate will have on the ISO's accounts. The ISO currently keeps in an escrow account amounts that generators have been fined and the escrow account earns interest on the amounts of the fines at a rate lower than the Commission interest rate; if the Commission interest rate were to be applied to these fines, the ISO's cash-neutral status would be violated, to the degree of at least several million dollars, if the ISO were required to pay out interest at the Commission rate, due to the difference between the escrow-account interest rate and the Commission interest rate.[11] As described above, the subject of the ISO's cash-neutral status is at issue in the present proceeding, and it is necessary that the ISO maintain this status. Therefore, the Commission should not require that the Commission interest rate be applied where doing so will result in a violation of cash neutrality.

[11] In order to pay out these amounts, the ISO, being a cash-neutral entity, would have to assess the amounts to parties other than the ISO. (See Mr. Epstein's testimony quoted above concerning the need for the ISO to apply any imbalance between AR and AP to a party or parties other than the ISO.) One conceivable way the amounts could be assessed is through the ISO's Grid Management Charge ("GMC"). In that case, the investor-owned utilities ("IOUs") in California would be responsible for paying the majority of the amounts, because the IOUs are responsible for paying the majority of the GMC.

The Proposed Findings of Fact also mistakenly assert that the Presiding Judge should not consider specific arguments made by Mr. Epstein concerning the ISO's cash neutrality. The Proposed Findings of Fact assign "little or no probative value" to the portions of Mr. Epstein's testimony concerning the possible effects of the bankruptcy of PG&E and the PX on the ISO's cash-neutral status (described in the second and third bullet points of Mr. Epstein's testimony, above), because Mr. Epstein "has no apparent expertise with regard to the application of the bankruptcy laws and the parties have not proffered evidence or otherwise addressed this subject clearly and comprehensively." Proposed Findings of Fact at ¶ 817. However, Mr. Epstein did not need to be a bankruptcy expert to provide his testimony, which explained the *effects* that the bankruptcy of PG&E and the PX could have on the ISO. As the ISO's Controller, Mr. Epstein is responsible for the ISO's corporate accounting, fixed assets, procurables, payables, receivables, financial, tax, and Commission reporting functions, market cash settlements, and audit coordination for all the ISO's activities. Exh. ISO-37 (Epstein) at 2:1-5. Therefore, Mr. Epstein is eminently qualified to describe how different circumstances could affect the ISO's cash neutrality. Accordingly, in his testimony, Mr. Epstein explained the possible effects on the ISO's cash neutrality that could follow *if* the ISO is not permitted to assess interest on the bankrupt parties PG&E and the PX after their bankruptcy dates, as well as the additional effects of market reruns. Further, Mr. Epstein explained these possible effects in detail sufficient to show clearly what the effects could be. Thus, there was no need for the ISO to proffer the additional evidence described in the Proposed Findings of Fact.

Additionally, the Proposed Findings of Fact assert that Mr. Epstein's statements that the December 2001 Order does not permit the ISO to remain cash-neutral and fails to provide for any adjustment where there are imbalances between receivables and payables in the ISO marketplace (described in the first bullet point of Mr. Epstein's testimony, above) are not entitled to any probative value. Proposed Findings of Fact at ¶ 818. The Proposed Findings of Fact provide two reasons for this assertion. *Id.* Neither reason has any merit.

The first reason given is that the ISO, on brief, mistakenly suggested that the Commission could resolve the difficulties posed by the December 2001 Order by ruling in the present proceeding, as it did in its June 2002 Order, that SC creditors are entitled to receive interest only to the extent that the ISO collects interest from defaulting participants. *Id.* The Proposed Findings of Fact assert that "footnote 2 of the June 3 Order expressly indicated that the resolution in that Order addressing the payment of interest by the ISO did *not* apply to the issues set for hearing in these proceedings." Proposed Findings of Fact at ¶ 818. In fact, however, footnote 2 of the June 2002 Order explained that the treatment of interest described in the order "*is without prejudice to* the outcome of [the refund] proceeding." 99 FERC at 62,103 n.2 (emphasis added). Thus, the Commission found only that the treatment of interest described in the June 2002 Order did not necessarily have to be the same as the treatment of interest in the refund proceeding, rather than that the treatment of interest described in the June 2002 Order *was barred from being employed* in the refund proceeding, as the Proposed Findings of Fact would have it. The ISO, while recognizing that the treatment of interest described in the June 2002 Order "is without prejudice" to the treatment of interest in the

present proceeding, respectfully submits that the same treatment of interest as in the June 2002 Order should apply in this proceeding.

The second reason given in the Proposed Findings for not according Mr. Epstein's testimony probative value is that the ISO's suggestion that the Commission apply here the treatment of interest described in the June 2002 Order "is nothing short of an impermissible collateral attack" on the July 2001 and December 2001 Orders. Proposed Findings of Fact at ¶ 818. However, as explained above, the question of how interest should be applied is at issue in the present proceeding, and the ISO's status as a cash-neutral entity falls squarely under that issue. Therefore, far from being any kind of collateral attack on the July 2001 and December 2001 Orders, the ISO's proposal is entirely appropriate to be made in the present proceeding.

VI. CONCLUSION

For the reasons set forth above, the ISO respectfully requests that the Commission rule on the Proposed Findings of Fact consistent with the ISO's positions as set forth herein.

Respectfully submitted,

Charles F. Robinson
General Counsel
Gene Waas
Regulatory Counsel

The California Independent
System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: (916) 608-7049

J. Phillip Jordan
Michael Kunselman
Bradley Miliauskas

Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W., Suite 300
Washington, DC 20007
Tel: (202) 424-7500

Dated: January 13, 2003

ATTACHMENT A

ATTACHMENT A - TRANSACTIONS BETWEEN PORTLAND GENERAL AND THE CALIFORNIA ISO

This table displays the transactions claimed by Portland General as being made pursuant to Section 202(c), as set forth in Ex. No. PGE-2. The column entitled "DOE" represents those transactions as to which the ISO agrees were made pursuant to section 202(c), based on the notations on its OOM Sheets (Ex. No. ISO-15) or transcripts of telephone conversations provided by Portland (Ex Nos. PGE-6, 8, 9, 13 and 16). See Ex. Nos. ISO-21 at 16:15-21; PGE-17 at 6.

Date	Hour Ending	DOE
12/20/00	6	x
12/20/00	7	x
12/20/00	8	x
12/20/00	9	x
12/20/00	10	x
12/20/00	11	x
12/20/00	12	x
12/20/00	13	x
12/20/00	14	x
12/20/00	15	x
12/20/00	16	x
12/20/00	22	x
12/21/00	1	x
12/21/00	2	x
12/21/00	3	x
12/21/00	3	x
12/21/00	7	x
12/21/00	9	
12/21/00	10	
12/21/00	11	
12/22/00	9	
12/22/00	10	
12/22/00	11	
12/22/00	12	
12/22/00	13	
12/22/00	15	
12/22/00	17	
12/22/00	20	
12/22/00	21	
12/22/00	22	
12/22/00	22	
12/22/00	23	
12/23/00	2	
12/23/00	3	
12/23/00	4	
12/23/00	4	
12/23/00	5	
12/23/00	5	
12/23/00	6	
12/23/00	7	
12/23/00	7	
12/23/00	8	
12/23/00	8	
12/23/00	9	
12/23/00	10	
12/23/00	11	
12/23/00	12	
12/23/00	13	
12/23/00	21	

Date	Hour Ending	DOE
12/23/00	22	
12/23/00	23	
12/23/00	24	x
12/24/00	1	
12/24/00	2	
12/24/00	3	
12/24/00	4	
12/24/00	5	
12/24/00	6	
12/24/00	7	
12/24/00	8	
12/24/00	9	
12/24/00	10	
12/24/00	11	
12/24/00	12	
12/24/00	13	
12/24/00	14	
12/24/00	15	
12/24/00	16	
12/24/00	17	
12/24/00	18	
12/25/00	2	
12/25/00	3	
12/25/00	4	x
12/26/00	3	
12/26/00	3	
12/26/00	4	
12/26/00	4	
12/26/00	5	
12/26/00	6	x
12/26/00	7	
12/26/00	9	
12/26/00	10	
12/26/00	11	
12/26/00	12	
12/26/00	13	
12/26/00	14	
12/26/00	19	
12/26/00	20	
12/26/00	21	
12/26/00	22	
12/27/00	1	
12/27/00	2	
12/27/00	2	
12/27/00	3	
12/27/00	3	
12/27/00	4	
12/27/00	5	
12/27/00	6	
12/27/00	9	
12/27/00	10	
12/27/00	11	
12/27/00	12	
12/27/00	13	
12/27/00	14	
12/27/00	15	

Date	Hour Ending	DOE
12/27/00	16	
12/27/00	17	
12/27/00	18	
12/27/00	19	
12/27/00	20	
12/27/00	20	
12/27/00	21	
12/27/00	22	
12/28/00	4	
12/28/00	6	x
12/28/00	11	
12/28/00	12	
12/28/00	13	
12/28/00	14	
12/28/00	15	
12/28/00	16	
12/28/00	17	
12/28/00	18	
12/28/00	19	
12/28/00	20	
12/28/00	21	
12/28/00	22	
1/2/01	10	
1/2/01	16	
1/2/01	17	x
1/9/01	15	x
1/12/01	3	
1/12/01	4	
1/12/01	13	
1/12/01	14	
1/12/01	15	
1/12/01	16	
1/12/01	18	
1/12/01	18	
1/12/01	19	
1/12/01	19	
1/12/01	20	
1/12/01	20	
1/12/01	21	
1/12/01	21	
1/12/01	22	
1/12/01	22	
1/12/01	22	
1/12/01	23	
1/12/01	23	
1/12/01	24	
1/12/01	24	
1/12/01	24	
1/17/01	7	
1/17/01	8	
1/17/01	9	x
1/17/01	10	x
1/17/01	13	x
1/17/01	17	
1/17/01	18	x

Date	Hour Ending	DOE
1/17/01	19	x
1/18/01	1	
1/18/01	2	
1/18/01	3	
1/18/01	7	
1/18/01	8	
1/18/01	9	
1/18/01	10	x
1/18/01	16	x
1/18/01	17	
1/18/01	22	
1/19/01	2	
1/19/01	3	
1/19/01	4	
1/22/01	23	
1/23/01	4	
1/23/01	14	
1/23/01	14	
1/23/01	14	
1/24/01	1	x
1/24/01	2	x
1/24/01	3	
1/24/01	4	
1/24/01	9	
1/24/01	24	
1/25/01	1	
1/25/01	21	
1/25/01	22	
1/30/01	9	
1/30/01	10	
1/30/01	11	
1/30/01	12	
1/30/01	13	
1/30/01	18	
1/30/01	19	
1/31/01	16	
1/31/01	17	
1/31/01	18	
1/31/01	19	
1/31/01	20	
1/31/01	21	x
1/31/01	22	
2/1/01	1	
2/1/01	2	x
2/1/01	3	x
2/1/01	4	x
2/1/01	5	
2/1/01	6	x
2/1/01	7	x
2/1/01	8	x
2/1/01	9	
2/1/01	10	
2/1/01	11	

Date	Hour Ending	DOE
2/1/01	12	
2/1/01	13	
2/1/01	14	
2/1/01	15	
2/1/01	16	
2/1/01	17	
2/1/01	18	
2/1/01	19	
2/1/01	20	
2/1/01	21	x
2/1/01	22	x
2/1/01	23	
2/1/01	24	
2/2/01	1	
2/2/01	2	
2/2/01	3	x
2/2/01	4	x
2/2/01	5	x
2/2/01	6	x
2/2/01	7	x
2/2/01	10	
2/2/01	12	
2/2/01	13	
2/2/01	16	
2/2/01	18	
2/2/01	22	
2/2/01	22	
2/3/01	1	
2/3/01	2	
2/3/01	3	
2/3/01	4	
2/3/01	5	
2/3/01	6	
2/3/01	7	
2/3/01	7	
2/3/01	7	
2/3/01	8	
2/3/01	22	
2/3/01	23	
2/3/01	24	
2/4/01	1	x
2/4/01	2	x
2/4/01	3	x
2/4/01	4	x
2/4/01	5	x
2/4/01	6	x
2/4/01	7	x
2/4/01	8	x
2/4/01	9	x
2/4/01	10	x
2/4/01	11	x
2/4/01	12	x
2/4/01	13	x
2/4/01	14	x
2/4/01	15	x
2/4/01	16	x
2/4/01	17	x

Date	Hour Ending	DOE
2/4/01	23	
2/4/01	24	
2/5/01	1	
2/5/01	2	
2/5/01	3	
2/5/01	4	
2/5/01	5	
2/5/01	6	
2/5/01	7	
2/5/01	8	
2/5/01	13	x
2/5/01	14	x
2/5/01	15	x
2/5/01	16	x
2/5/01	17	
2/5/01	18	x
2/5/01	19	
2/5/01	20	x
2/5/01	21	
2/5/01	22	
2/5/01	24	
2/6/01	1	
2/6/01	2	
2/6/01	3	
2/6/01	4	
2/6/01	5	
2/6/01	6	
2/6/01	7	
2/6/01	10	
2/6/01	11	
2/6/01	12	
2/6/01	13	x
2/6/01	14	x
2/6/01	15	x
2/6/01	16	x
2/6/01	17	x
2/6/01	18	

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the service list compiled by the Secretary in this proceeding.

Dated at Washington, DC, this 13th day of January, 2003.

Michael Kunselman
(202) 295-8465