THE 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 Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, Respondents.	)	
Investigation of Practices of the California Independent System Operator and the California Power Exchange	)	**Docket No. EL00-98-042**

PREPARED SURREBUTTAL TESTIMONY OF
SPENCE GERBER, MICHAEL MCQUAY, AND MICHAEL EPSTEIN
ON BEHALF OF
THE CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION

Q. MR. GERBER, ARE YOU THE SAME SPENCE GERBER THAT PREVIOUSLY FILED DIRECT AND REBUTTAL TESTIMONY IN THIS PROCEEDING?

A. [Spence Gerber] Yes.

Q. MR. MCQUAY, ARE YOU THE SAME MICHAEL MCQUAY THAT PREVIOUSLY FILED REBUTTAL TESTIMONY IN THIS PROCEEDING?

A. [Michael McQuay] Yes.

Q. MR. EPSTEIN, ARE YOU THE SAME MICHAEL EPSTEIN THAT PREVIOUSLY FILED REBUTTAL TESTIMONY IN THIS PROCEEDING?

A. [Michael Epstein] Yes.

Q. MR. GERBER, HOW WILL YOUR TESTIMONY BE ORGANIZED?

A. [Spence Gerber] My testimony is organized as follows:

(i) In Section A, I will address arguments made by several witnesses relating to a cut-off date for adjustments to the ISO's "pre-mitigation" data.

(ii) In Section B, I will rebut the contention of Mr. Bradshaw, on behalf of PPL Montana and PPL Energy Plus ("PPL"), that energy imports should be mitigated on an hourly rather than interval basis.

(iii) In Section C, I will rebut arguments made by several parties that transactions that they characterize as "bilateral" should be exempt from mitigation.

(iv) In Section D, I will address arguments made by Dr. Berry on behalf of the California Parties concerning energy exchanges.

(v) In Section E, I will respond to the Presiding Judge's request for further information on the issue of the ISO's Neutrality Adjustment charge, and the separate proceeding before the Commission concerning this charge.

(vi) In Section F, I will address the mitigation of RMR transactions.

(vii) In Section G, I will address the issue of sleeve transactions.

Q. MR. MCQUAY, HOW WILL YOUR TESTIMONY BE ORGANIZED?

A. [Michael McQuay] In Section G, I will describe additional information that I have uncovered since the filing of my Rebuttal Testimony relating to transactions that LADWP claims are sleeve transactions.

Q. MR. EPSTEIN, HOW WILL YOUR TESTIMONY BE ORGANIZED?

A. [Michael Epstein] In Section H, I will address the testimony of Ms. Sztabnik, on behalf of Nevada Power Company ("Nevada Power") and Sierra Pacific Power Company ("Sierra Pacific"), as to amounts owed to Nevada Power and Sierra Pacific Power. In Section I, I will address arguments made by Mr. Tranen, on behalf of the California Generators, and Ms. Miller, on behalf of the PX, concerning the calculation of interest.

A. <u>CUT-OFF DATE FOR ADJUSTMENTS TO ISO PRE-MITIGATION DATA</u>

Q. WHAT CONTENTIONS DO WITNESSES MAKE WITH RESPECT TO A CUT-OFF DATE FOR ADJUSTMENTS TO THE ISO'S PRODUCTION, OR "PRE-MITIGATION" DATA?

A. [Spence Gerber] Mr. Tranen testifies that the Commission should "establish a uniform cutoff date for the ISO and PX to update their pre-

mitigation data bases, prior to the point in time when they make their final refund and offset calculations in this case." Exh. GEN-83 (Tranen) at 4:8-16. Dr. Cicchetti recommends that the Commission "establish deadlines for manual adjustments for transactions occurring in each month of the refund period." Exh. SEL-42 (Cicchetti) at 7:1-10. Ms. Miller states that there is a need for a "final accounting," which requires a cut-off for "all claims for adjustments, offsets, re-calculations, and so forth." In particular, Ms. Miller contends that the Commission must order the ISO to "cease making adjustments to its invoices as of a date certain and rule in this proceeding that there are no more charges or payments due regarding [the PX's] running of the Clearinghouse function and this refund period." Exh. CPX-43 (Miller) at 7:3-11.

Q. HOW DO YOU RESPOND TO THESE WITNESSES?

A. [Spence Gerber] The difficulty with this proposal is that the California ISO Tariff provides for prior period adjustments to transactions without any cut-off date, provided that certain monetary and technical criteria are met. Moreover, such a cut-off date might result in artificially truncating numerous alternative dispute resolution procedures and good faith negotiations between the ISO and Market Participants that would result in adjustments to transactions that occurred during the refund period. Of course, if all parties in the proceeding, and all Scheduling Coordinators, were to stipulate that all outstanding issues relating to trade dates during

the refund period are extinguished as a part of this proceeding and prior to final calculations of refund amounts, the ISO could agree to such a cut-off date.

B. MITIGATION OF ENERGY IMPORTS

Q. MR. BRADSHAW, IN HIS REBUTTAL TESTIMONY, TAKES THE POSITION THAT MITIGATED PRICES SHOULD BE APPLIED TO PPL ON AN HOURLY RATHER THAN INTERVAL BASIS. EXH. PPL-21 (BRADSHAW) AT 5:1-16. DO YOU AGREE WITH THIS APPROACH?

A. [Spence Gerber] No. As I explained in my Rebuttal Testimony, the ISO Tariff expressly provides for paying suppliers based on ten-minute pricing. Exh. ISO-37 at 24:7-21. The fact that PPL or other parties could not have changed the amount they were selling during the hour is not relevant, since no parties were bidding or making decisions with knowledge of what the mitigated prices would be. Therefore, there is no inequity in pricing these transactions on an interval rather than an hourly basis.

C. "BILATERAL" TRANSACTIONS

Q. IN HER REBUTTAL TESTIMONY ON BEHALF OF SEMPRA, MS. CANTOR ARGUES THAT SEMPRA ENTERED INTO SEVERAL "SHORT-TERM BILATERAL TRANSACTIONS" THAT ARE EXEMPT FROM REFUND LIABILITY. EXH. SET-6 (CANTOR) AT 4:9-5:13. DO YOU AGREE?

A. [Spence Gerber] No. In my Rebuttal Testimony, I explained in detail why the distinction between OOM transactions and so-called "bilateral" transactions with the ISO that several suppliers have attempted to articulate simply does not exist as it pertains to refund liability in this proceeding. *See* Exh. ISO-37 at 86:15-88:17. Moreover, on a fundamental level, Ms. Cantor is mistaken in her argument that certain Sempra transactions were not OOM. She insists that this is the case because they were not paid pursuant to Section 11.2.4.2 of the ISO Tariff, which sets forth payment options for Participating Generators that do not bid into the ISO's formal markets, but are dispatched by the ISO to prevent System Emergencies or to satisfy locational requirements. There is nothing in Section 11.2.4.2, however, to suggest that it is the sole payment mechanism for OOM transactions. In fact, Section 11.2.4.2 does not even use the terms "OOM" or "Out-of-Market." Therefore, the fact that certain transactions were, or were not, paid pursuant to Section 11.2.4.2 does not establish whether those transactions should be classified as OOM.

Q. MR. BOURNE, IN HIS REBUTTAL TESTIMONY, STATES THAT CERTAIN TRANSACTIONS BETWEEN TRANSALTA AND THE ISO SHOULD BE EXEMPT FROM MITIGATION BECAUSE THEY WERE "BILATERAL TRANSACTIONS." EXH. TRA-6 (BOURNE) AT 5:10-15. DO YOU AGREE?

A. [Spence Gerber] No. Mr. Bourne argues that the Commission only subjected to mitigation "sales of energy and ancillary services into markets operated by the ISO and PX, and not bilateral sales," and without any explanation, concludes that certain transactions between TransAlta and the ISO were bilateral sales. Again, I refer to my discussion of this issue in my Rebuttal Testimony. *See* Exh. ISO-37 at 86:15-88:17. In addition, I would note that Mr. Bourne is, of course, incorrect that the Commission only subjected ISO and PX market transactions to refund liability. In the July 25 Order, the Commission explicitly stated that Out-of-Market transactions were to be mitigated. 96 FERC ¶ 61,120, at 61,515-16 (2001). The Commission confirmed this approach in its December 19 Order. 97 FERC ¶ 61,275, at 62,195 (2001).

Q. MR. BOURNE ALSO ARGUES THAT THE SAME PRINCIPLE UNDER WHICH THE ISO EXEMPTED SLEEVE TRANSACTIONS FROM MITIGATION IN ITS SETTLEMENTS RE-RUN REQUIRES THAT THE ISO EXEMPT FROM MITIGATION TRANSACTIONS IN WHICH SELLERS "(1) OBTAINED INCREMENTAL POWER SUPPLIES ON BEHALF OF THE ISO, AND (2) FOREWENT OPPORTUNITIES IN ORDER TO MAKE SALES TO THE ISO." EXH. TRA-6 (BOURNE) AT 5:19-6:6. HOW DO YOU RESPOND?

A. **[Spence Gerber]** Mr. Bourne is mistaken. In my Rebuttal Testimony, I explained that parties should not be subject to mitigation for transactions in which their role was solely that of a financial intermediary that allowed the ISO to make a purchase that it would not otherwise have been able to make because of the buyers' credit situation. Exh. ISO-37 at 47:5-22. However, the fact that TransAlta chose to "obtain incremental supplies" or forego opportunities to sell elsewhere does not suggest that it was only acting as a financial intermediary; in both cases, TransAlta had the opportunity to make a profit by purchasing and re-selling energy to the ISO.

D. ENERGY EXCHANGES

Q. IN HER REBUTTAL TESTIMONY, DR. BERRY CLAIMS, WITH RESPECT TO ENERGY EXCHANGE TRANSACTIONS, THAT "THE ISO APPEARS TO BE IN THE PROCESS OF RETROACTIVELY CHANGING ITS ACCOUNTING AND SETTLEMENTS PROCESS FOR ENERGY EXCHANGE TRANSACTIONS DURING THE REFUND PERIOD," AND THAT THESE CHANGES WILL "SHIFT SUBSTANTIAL COSTS BETWEEN MARKET PARTICIPANTS." EXH. CAL-54 (BERRY) AT 47:3-8. HOW DO YOU RESPOND?

A. **[Spence Gerber]** The ISO has not yet fully accounted for energy exchanges in its production settlement system in a manner consistent with the allocation methodology that it has proposed for these transactions, and would endeavor to correct this prior to any subsequent re-run of its settlement system as directed by the Commission in the refund case. As I stated in my Rebuttal Testimony, the ISO had only partially run the energy exchange settlement in production and for the refund re-calculation. Exh. ISO-37 at 31:5-14. While issues may arise concerning cost shifting among Market Participants, both the production re-run and the final refund re-calculation must treat energy exchanges identically to ensure symmetrical treatment.

E. NEUTRALITY

Q. MR. GERBER, PLEASE DESCRIBE FURTHER THE COMPLAINT PROCEEDINGS BEFORE THE COMMISSION CONCERNING THE APPROPRIATE TREATMENT OF NEUTRALITY CHARGES, WHICH YOU BRIEFLY DESCRIBED IN THE PREPARED REBUTTAL TESTIMONY YOU PROVIDED IN THE PRESENT PROCEEDING ON JULY 26, 2002.

A. [Spence Gerber] The proceeding before the Commission concerning the appropriate treatment of neutrality charges is an ongoing proceeding in Docket Nos. EL00-111 and EL01-84. As I will explain below, the latest development in the neutrality proceeding is that a number of parties, including the ISO, jointly filed an "Offer of Settlement and Settlement Agreement" ("Settlement Agreement") on July 31, 2002 to resolve all issues in the neutrality proceeding.

I wish to emphasize at the outset of my testimony that, in order to get a full understanding of the history and issues raised in the neutrality proceeding, the best resource to review (other than the entire record of the proceeding) is the "Explanatory Statement in Support of Offer of Settlement" ("Explanatory Statement") and the Settlement Agreement as filed with the Commission on July 31, 2002, and to which the ISO is a signatory. The Explanatory Statement and Settlement Agreement are included in the present filing in Exhibit No. ISO-46. The description of the

neutrality proceeding that I provide below, while useful for purposes of gaining a broad understanding of the history and issues, cannot reasonably serve as a substitute for the full Explanatory Statement and Settlement Agreement.

The neutrality proceeding is the result of two complaints filed with the Commission, one submitted by the Southern Cities on September 15, 2000 in Docket No. EL00-111, and the other submitted by Salt River Project ("SRP") on June 1, 2001 in Docket No. EL01-84. The neutrality proceeding concerns the ISO's implementation of two different calculations of Neutrality Adjustment charges, as were variously authorized by the Commission, during the period of June 1, 2000 to February 27, 2001.

Inasmuch as the neutrality proceeding focuses on the timing for which different calculation methodologies should have been used, that proceeding addresses the ISO's adherence to the several different maximum levels of Neutrality Adjustment charges. The maximum Neutrality Adjustment charge and the time period over which it is to be calculated is the "cap" to which Dr. Cicchetti and Mr. Nichols refer in the testimony they submitted on July 3, 2002 in the present proceeding. I presented a detailed discussion of the Neutrality Adjustment charge that the ISO uses in my Rebuttal Testimony filed on July 26, 2002.

Q. PLEASE CONTINUE WITH YOUR DESCRIPTION OF THE ISSUES AND HISTORY CONCERNING THE NEUTRALITY PROCEEDING.

A. [Spence Gerber] On March 14, 2001, the Commission issued an order concerning the Southern Cities complaint ("March 14 Order"), in which it found that the ISO had violated the alleged "cap" in the ISO Tariff on the ISO's Neutrality Adjustment charges, and ordered the ISO to pay to one of the complainants refunds of amounts charged above the alleged "cap". 94 FERC ¶ 61,268, at 61,934 (2001). However, the Commission found that there was no basis for requiring the ISO to absorb the costs of such refunds, and so permitted the ISO to allocate those costs to the remaining Scheduling Coordinators in proportion to their relevant metered Demands. Additionally, the Commission found moot the aspect of the Southern Cities' complaint concerning the manner in which the ISO allocated Energy costs. The ISO and other parties filed requests for rehearing of the March 14 Order.

On May 14, 2001, the Commission issued an order on rehearing of the March 14 Order ("May 14 Order"), in which it reaffirmed its determination that the ISO had violated the alleged "cap" on Neutrality Adjustment charges. 95 FERC ¶ 61,197, at 61,687 (2001). The Commission required the ISO to apply the alleged "cap" equally to all customers that were assessed Neutrality Adjustment charges, and to calculate the Neutrality

Adjustment charges assessed to all Scheduling Coordinators in accordance with the alleged "cap". Additionally, the Commission denied the Southern Cities' request for rehearing of their complaint concerning the ISO's allocation of Energy costs. The ISO and other parties filed requests for rehearing of the May 14 Order.

Subsequently, the ISO, the Southern Cities, and SRP jointly filed a motion with the Commission to begin settlement proceedings to resolve the issues raised in the Docket Nos. EL00-111 and EL01-84 complaint proceedings. (SRP's complaint had not been addressed by the Commission by the time the motion to initiate settlement proceedings was filed.) The Commission granted the motion, and stayed further consideration of the issues in the neutrality proceeding pending the outcome of settlement discussions, and Judge Jacob Leventhal was appointed as settlement judge. Further, parties that had filed petitions for review of the March 14 and May 14 Orders with the United States Court of Appeals for the District of Columbia Circuit had their cases voluntarily dismissed without prejudice pending the outcome of settlement discussions.

Q. WHAT OCCURRED AFTER SETTLEMENT PROCEEDINGS IN THE NEUTRALITY PROCEEDING WERE INITIATED?

A. [Spence Gerber] Following a number of months of settlement discussions among a number of parties, the ISO, Southern Cities, SRP, Vernon, and CDWR agreed to the Settlement Agreement, which was filed with the Commission on July 31, 2002. My understanding is that the Settlement Agreement will now be subject to comment pursuant to Rule 602 of the Commission's Rules of Practice and Procedure.

Q. PLEASE DESCRIBE THE NATURE OF THE NEGOTIATED SETTLEMENT EMBODIED IN THE SETTLEMENT AGREEMENT.

A. [Spence Gerber] As with the description of the history and issues in the neutrality proceeding, the best description of the Settlement Agreement is contained in the Explanatory Statement and, of course, in the Settlement Agreement itself, provided in Exhibit No. ISO-46. However, I can summarize the nature of the negotiated settlement embodied in the Settlement Agreement.

The Settlement Agreement would, as a matter of compromise, assign responsibility for the costs of Energy procured by the ISO to the Scheduling Coordinators for which the ISO purchased Energy to serve their loads during the period December 8-11, 2000. (If not for the Settlement Agreement, assignment of cost responsibility in this manner

would have begun on December 12, 2000, pursuant to a Tariff change contained in Amendment No. 33 to the ISO Tariff). The Settlement Agreement provides that the parties to the Settlement Agreement would agree, as a matter of compromise, to request that the Commission exercise its discretion to decline to order the ISO to pay refunds of amounts collected in excess of a Neutrality Adjustment cap, if any, during the period June 1, 2000 through February 26, 2001.

The Settlement Agreement also provides that the terms of the Settlement Agreement are non-severable. Thus, should the results of the refund proceeding alter the terms and conditions of the Settlement Agreement, that agreement would be null and void. Simply stated, the refund and neutrality proceedings have different purposes: *i.e.*, the refund proceeding concerns the application of the MMCP to the sales and purchases of Imbalance Energy and Ancillary Services while the neutrality proceeding concerns allocation of certain portions of ISO charges for Energy and Ancillary Services, among other products and services, that are invoiced and settled through the Neutrality Adjustment charge. That is, the Settlement Agreement narrowly resolves the actual Neutrality Adjustment charges and the Settlement Agreement, if approved by the Commission, would in no way interfere with the outcome of the refund proceeding. As explained on page 16 of the Explanatory Statement, amounts shown on Scheduling Coordinators' settlement statements that changed as the

result of applying the terms of the Settlement Agreement would remain subject to further changes as a result of other proceedings pending before the Commission and/or the court(s). The Explanatory Statement specifically mentions the refund proceeding as an example of a proceeding that may require such further changes to Scheduling Coordinators' settlement statements. The Explanatory Statement goes on to state that the Settlement Agreement would not in any way interfere with the outcome of the refund proceeding, because the settlement statements would reflect further changes resulting from the refund proceeding.

Q. PLEASE DESCRIBE THE LEVEL OF SUPPORT FOR THE SETTLEMENT AGREEMENT THAT CURRENTLY EXISTS AMONG PARTIES IN THE NEUTRALITY PROCEEDING.

A. **[Spence Gerber]** As noted in the Explanatory Statement, in addition to the parties that filed the Settlement Agreement, the Commission Staff, Southern California Edison Company, the Modesto Irrigation District, Silicon Valley Power, the City of Redding, California, the City of Palo Alto, California, and the M-S-R Public Power Agency support or do not oppose the Settlement Agreement. In fact, the only party that opposes the Settlement Agreement is Pacific Gas and Electric Company.

Q. DO YOU BELIEVE THAT THE ISSUES RAISED IN THE NEUTRALITY PROCEEDING SHOULD BE ADDRESSED IN THE REFUND PROCEEDING?

A. [Spence Gerber] No, I do not. As I have described, the neutrality proceeding concerns issues that are separate from those under consideration in the refund proceeding, and the Commission has before it now a Settlement Agreement that would resolve all Neutrality Adjustment issues.

Thus, the issues raised in the neutrality proceeding should be resolved in that proceeding, and should not needlessly be imported into the present proceeding. Dr. Cicchetti would have the ISO's production data base, which is not at issue in this refund proceeding, altered to apply the alleged cap on Neutrality Adjustment charges that is at issue in the neutrality proceeding. Yet, the outcome of the neutrality proceeding itself, if the Settlement Agreement is approved, will be that the production data base will not be altered. In other words, importing consideration of a maximum level on the Neutrality Adjustment charge into the refund proceeding could result in two Commission proceedings with different resolutions of a single issue. Moreover, the issue of the "cap" for Neutrality Adjustment charges is no different from any other type of specific dispute that might be pending between the ISO and a Market Participant (for example, in arbitration under the ISO Tariff), or a dispute in another complaint

proceeding at the Commission. Any of these charge type disputes, once resolved, could cause a re-invoicing for some particular period of time. Therefore, inasmuch as the Neutrality Adjustment issue does not concern Market Clearing Prices and is already pending in a narrowly tailored Commission proceeding to resolve the specific charge limits, the issue should not be "imported" into this proceeding; neither should the dispute embodied in the neutrality proceeding be dealt with here as Dr. Cicchetti suggests by altering the production data base in a manner inconsistent with the Settlement Agreement.

Additionally, as I explained above, the Settlement Agreement, if approved, would allow further changes to Scheduling Coordinators' settlement statements resulting from Commission and/or court proceedings, including changes resulting from the refund proceeding. Therefore, there is no possibility that the approval of the Settlement Agreement would cause interference with the outcome of the refund proceeding. That is, even if the Settlement Agreement is approved, there will be no bar to changes to the Neutrality Adjustment charge resulting from application of the MMCP to other charge types in this proceeding.

On the other hand, if the Settlement Agreement is abandoned because, for example, the issue is imported into the present refund proceeding and the Commission orders the ISO to apply the "cap" to the entire refund

period (or any other) period, the ISO will be required to charge Market Participants accordingly to obtain funds needed to pay other Market Participants for prior charges above the "cap". The Commission has already approved the ISO charging Market Participants to obtain funds needed for "refunds" for all such prior charges and so, if the Settlement Agreement is abandoned, some Market Participants will incur charges that they would not otherwise have incurred if the Settlement Agreement had been approved. Stated differently, a majority of parties in the refund proceeding will either be indifferent or benefited should the Settlement Agreement be adopted but these parties will incur charges from the ISO should the ISO be required to obtain funds from its Market Participants in order to make refunds for any past Neutrality Adjustment charges that are above specified maximum levels during the refund period.

Q. IS MCP APPLIED TO THE NEUTRALITY ADJUSTMENT CHARGE?

A. [Spence Gerber] No. The Neutrality Adjustment charge type is not a charge to which any Market Clearing Price, mitigated or not, is applied. Instead, the Neutrality Adjustment charge type is a balancing charge type that the ISO uses to ensure allocation and collection of costs remaining after certain charges are first settled through other charge types that do have Market Clearing Prices applied to their specific calculation formulas. That is, differences between the amounts paid and charged as a result of a Market Clearing Price applied in several other ISO charge types are

"bundled" into the Neutrality Adjustment charge type in order to assure their collection, and thus, revenue neutrality for the ISO.

F. MITIGATION OF RMR TRANSACTIONS

Q. WHAT POSITION DOES DR. BERRY TAKE IN HER REBUTTAL TESTIMONY WITH RESPECT TO RMR TRANSACTIONS?

A. [Spence Gerber] In response to testimony filed on behalf of NCPA, Dr. Berry states that "cost-based" sales made under RMR contracts would not be subject to mitigation in this proceeding, but that "market-based RMR sales would be subject to mitigation as they are spot sales into the ISO's or PX's markets." Dr. Berry therefore concludes that any RMR transactions for which NCPA relied on the market for payment should be mitigated. Exh. CAL-54 (Berry) at 32:18-20.

Q. HOW DO YOU RESPOND TO THIS STATEMENT?

A. [Spence Gerber] First, I would like to offer a brief bit of background on how RMR transactions are paid and settled, which will facilitate explaining my position on this issue. It is important to understand that RMR contracts provide for two different options that RMR Owners can elect when they receive an RMR dispatch from the ISO: (1) a "contract path," under which an RMR Owner receives payment for the energy provided based on a cost-of-service formula contained in the RMR contract itself; or (2) a "market path," in which the RMR owner bids the energy into the ISO's

real-time market and is paid based on the clearing price established for the relevant ten-minute interval. When generation is dispatched by the ISO in real-time, however, the ISO initially settles all RMR energy under Charge Type 401 (instructed imbalance energy), regardless of whether the contract or market path option is elected, and pays the RMR Owner accordingly through the standard production settlements process. The wrinkle occurs with respect to those situations in which the RMR Owner elects the contract path. In those situations, the RMR Owner invoices the ISO for the contract payment associated with that unit. However, because the RMR Owner has already been separately paid for that energy under Charge Type 401 in the market settlement process, and in order to avoid a double payment for the same service, the owner must then credit the amount received under Charge Type 401 back to the Responsible Utility (PG&E for NCPA), which actually received the benefit of that RMR dispatch, and which is billed by the ISO for the contract payment to the RMR Owner. Of course, with respect to market path RMR transactions, the situation is much simpler – the RMR Owner is simply paid under Charge Type 401in the same manner as any other Scheduling Coordinator is paid for a sale of Instructed Imbalance Energy into the ISO's real-time market.

Q. HOW DID THE ISO DEAL WITH RMR TRANSACTIONS IN ITS SETTLEMENTS RERUN PROCESS?

A. **[Spence Gerber]** In the re-run, the ISO did not distinguish between RMR and non-RMR transactions for purposes of applying the mitigated price to Charge Type 401. What this means is that all RMR transactions that were settled under Charge Type 401 (*i.e.*, all RMR transactions made in real-time) were, in effect, "mitigated" in the settlement rerun.

Q. **DO YOU BELIEVE THAT THIS IS THE CORRECT RESULT GOING FORWARD?**

A. **[Spence Gerber]** I am not certain. In saying this, let me clarify that I am taking a somewhat different position than the one that I set forth in my Rebuttal Testimony. Therein, in response to NCPA, I stated that to the extent that RMR Owners are paid under the market path, those transactions should be mitigated. Exh. ISO-37 at 29:4-10. Since filing that testimony, I have devoted further research and consideration to this issue, and am not entirely convinced that mitigating these transactions, or any RMR transactions for that matter, is the appropriate result. However, the Commission did not address this issue in any of its orders, and, likewise, this point has received almost no attention in the testimony filed by other parties in this proceeding. Therefore, lacking guidance or the benefit of additional viewpoints, I am not advocating one particular method or another. Instead, I believe that I can best assist the Presiding Judge and the Commission in their deliberations on this matter by providing

some information about the unique concerns that mitigating these transactions raise.

Q. WHAT DO YOU MEAN BY UNIQUE CONCERNS?

A. [Spence Gerber] First, with respect to the issue of whether or not to mitigate market path RMR transactions, I agree with Dr. Berry that RMR Owners who elected a market path payment assumed a certain risk of spot market outcomes. However, it also seems to me that if an RMR Owner chose to receive payment through the market, it did so based on a comparison of its RMR contract rate and the prevailing market prices *as they existed at that time*. Moreover, these units were obligated to respond and run pursuant to their long-term, non spot-market RMR contracts when dispatched by the ISO. I believe that any decision on whether market path RMR transactions should be mitigated in future re-runs needs to take these considerations into account.

With respect to contract path RMR transactions, there exists a different concern. That is, if the Charge Type 401 payments associated with these transactions are mitigated in the ISO's settlements system, the results of this mitigation would also need to be passed through the RMR invoicing process in order to avoid RMR Owners' being deprived of a portion of their contract payment. This is the case because of the process that I described above, in which the RMR Owner credits on its invoice the

amount of its Charge Type 401 payment when it elects to receive a contract payment. This credit is then passed on to the Responsible Utility in the form of a reduction to the cost-of-service payment. In order to make the RMR Owner "whole" under the scenario in which contract-path transactions are mitigated, an amount equal to the refund associated with the 401 payment to the RMR Owner would need to be returned to the RMR Owner by the Responsible Utility – in essence, re-running the RMR invoicing process to true-up the revised Charge Type 401 to the contract amount. This would involve a Prior Period adjustment, which are permitted under the RMR Contract.

Q. SO HOW DOES THIS AFFECT NCPA SPECIFICALLY?

A. [Spence Gerber] The fact that all RMR transactions that were originally settled under Charge Type 401 were mitigated in the ISO's re-run explains the source of NCPA's concern as to the treatment of its RMR transactions, both market path and contract path. As for how those transactions should be treated in future settlement re-runs, I refer to my response to the previous question. However, there exists another wrinkle with respect to NCPA. Mr. Park testifies that the ISO has re-classified certain NCPA transactions as OOM that had originally been settled and paid as RMR transactions. Exh. NCP-10 (Park) at 6:20-25. In point of fact, these transactions were re-classified by the ISO on the adjusted RMR invoices provided to NCPA by the ISO. Nevertheless, because those transactions

currently exist in the ISO's settlement database as OOM transactions, they were mitigated in a manner identical to any other transaction labeled as OOM.

Q. HOW DO YOU PROPOSE TO DEAL WITH THESE RE-CLASSIFIED TRANSACTIONS?

A. [Spence Gerber] The issue of whether these transactions are properly classified as OOM or RMR is the subject of an ongoing dispute between the ISO and NCPA. The other ISO witnesses and I have consistently taken the position in this proceeding that issues concerning pre-existing disputes between the ISO and Market Participants should not be litigated or re-litigated in this proceeding. Thus, the issue as to whether these transactions are properly classified as OOM or RMR is simply beyond the scope of this proceeding, which is focused on the calculation of a mitigated price consistent with the Commission's methodology and the correct application of that mitigated price through the ISO's settlement and billing process. Given the expedited procedural schedule and the abundance of other issues that are legitimately in this proceeding, it would do injustice to the merits of pre-existing disputes such as this one to attempt to resolve them through the current proceeding. I believe that this issue can be handled in a manner similar to that which I suggested for the Dynegy contract, which presents a similar procedural scenario. *See* ISO-37 at 71:18-72:20. That is, the Presiding Judge and Commission should

not attempt to determine which transactions properly should be classified as OOM or RMR, but should simply recognize that any transactions that might be re-classified by the ISO back to RMR from OOM would need to be treated in a manner consistent with the Commission's decision on how mitigation should apply to RMR transactions.

Q. IS THERE ANY OTHER INFORMATION YOU WISH TO PROVIDE WITH RESPECT TO THESE NCPA TRANSACTIONS?

A. [Spence Gerber] Yes. Mr. Park, in his testimony, argues that NCPA has verified that these sales were RMR sales and states that NCPA "invited the ISO" to use the alternative dispute resolution procedures that exist in the RMR contract to resolve this matter, but that to his knowledge, the ISO had not yet done so. Exh. NCP-10 (Park) at 6:26-7:6. In point of fact, under the good faith negotiation procedures included in the RMR agreement, it is NCPA's responsibility, not the ISO's, to initiate such procedures. It is properly within the ISO's purview to make adjustments, such as the re-classification of transactions from RMR to OOM. If a Market Participant disagrees with such an action, it is squarely the responsibility and obligation of that participant to dispute that matter to the ISO using the appropriate procedures, not vice versa. It appears that NCPA tacitly recognizes this: in a cover letter to a Statement of Claim provided to the ISO by NCPA on June 6, 2001, concerning a separate RMR dispute, NCPA noted that it reserved the right to amend that

Statement of Claim to include the RMR/OOM reclassification issue within that dispute. In a reply letter on July 6, 2001, the ISO informed NCPA that it did not have the right in accordance with the RMR Contract to amend the Statement of Claim at a later date, and stated that "NCPA [should] formally request good faith negotiation and arbitration of the reclassifications", which it has never done. Both of these letters are included as Exhibit No. ISO-47.

G. SLEEVE TRANSACTIONS

Q. A NUMBER OF PARTIES ADDRESS THE ISSUE OF SLEEVE TRANSACTIONS IN THEIR REBUTTAL TESTIMONY. MR. GERBER, DO YOU HAVE ANYTHING TO ADD WITH RESPECT TO THIS ISSUE?

A. **[Spence Gerber]** Yes. I wish to address the testimony of Mr. Dennis M. Elliot, on behalf of Williams, concerning this issue. Mr. Elliot claims that Williams engaged in almost 300 credit sleeving transactions with the ISO during the period December, 2000 through January, 2001. Exh. DME-37 (Elliot) at 3:16-21; Exh. DME-23. According to Mr. Elliot, Williams "purchased power . . . at the behest of the ISO and on Williams' own credit, for sale to the ISO and for use in California from December 14, 2000 through January 10, 2001," and that these transactions "make up the vast majority of the marketing activities in which Williams has engaged that are subject to refund." Exh. DME-37 (Elliot) at 3:16-4:4.

Q. WHAT POSITION DOES MR. ELLIOT TAKE WITH RESPECT TO THESE TRANSACTIONS?

A. **[Spence Gerber]** The point that Mr. Elliot appears to be making in his Rebuttal Testimony is that if the California Parties are correct that certain parties, which acted as sleeving intermediaries, should not be subject to mitigation, then Williams' transactions should qualify as well. Mr. Elliot argues that the fact that an intermediary may have had a larger role in the transaction beyond simply "putting up the cash" is not relevant to whether those transactions are considered sleeves and excluded from mitigation. However, Mr. Elliot does not indicate whether or not he actually believes that sleeves, however they are defined, should be subject to mitigation.

Q. DO YOU AGREE THAT WILLIAMS' TRANSACTIONS THAT MR. ELLIOT REFERS TO SHOULD BE CONSIDERED SLEEVE TRANSACTIONS, FOR PURPOSES OF EXEMPTING THOSE TRANSACTIONS FROM MITIGATION?

A. [Spence Gerber] No. In the ISO's Rebuttal Testimony, Mr. McQuay addressed one transaction with Williams that the ISO had preliminarily identified as a sleeve when it undertook its settlements re-run, and, based on his review of telephone conversations between operators for the ISO and Williams, explained why that transaction in fact did not qualify as a sleeve under the ISO's definition thereof. Exh. ISO-37 at 63:18-64:5. Additionally, Mr. Elliot essentially admits that with respect to many of these

transactions, Williams sold to the ISO at a price higher than that at which it obtained the power. I do not agree with Mr. Elliot that all transactions "for which an entity used its credit to purchase power at the ISO's request" should be considered sleeves. It is quite possible, if not likely, that Williams and other sellers who purchased and re-sold power to the ISO realized substantial profits on those transactions, and should, therefore, be subject to mitigation like any other OOM seller. Moreover, there is no indication that these transactions were made specifically at the ISO's behest based on negotiations between the ultimate supplier and the ISO as to price and quantity terms. This is the heart of the issue. As near as I can tell from Mr. Elliot's testimony, Williams was merely performing a normal marketing function. Williams was simply purchasing and re-selling power to the ISO that it could obtain from a variety of sources.

Q. MR. MCQUAY, DO YOU HAVE ANY FURTHER TESTIMONY TO PROVIDE WITH RESPECT TO SLEEVE TRANSACTIONS?

A. [Michael McQuay] Yes. In my Rebuttal Testimony, I discussed a number of facts that I had discovered with respect to sleeve transactions. Subsequent to the filing of that testimony, I have had an opportunity to discover further information relating to 19 transactions that took place during the period December 7 through December 12, 2000, with respect to which LADWP claimed it acted as a sleeving intermediary between the ISO and Powerex.

Q. WHAT ADDITIONAL INFORMATION HAVE YOU BEEN ABLE TO DISCOVER WITH RESPECT TO THESE LADWP TRANSACTIONS?

A. [Michael McQuay] I have discovered several telephone recordings of conversations between employees of the ISO and LADWP and employees of ISO and Powerex in addition to those that LADWP produced in Exhibit No. DWP-27. The additional recordings are attached as Exhibit No. ISO-48.

Q. WHAT CONCLUSIONS HAVE YOU BEEN ABLE TO DRAW FROM THAT ADDITIONAL INFORMATION?

A. [Michael McQuay] I believe that these recordings support the conclusions that Mr. Gerber and I reached in our Rebuttal Testimony. Specifically, after the first transaction, arrangements for the additional 18 transactions were handled directly between LADWP and Powerex. While there were several telephone conversations between ISO and Powerex personnel, no negotiations took place during those conversations. In most instances, Powerex simply related that it would have energy available, but that the ISO would have to deal with LADWP if it wished to obtain that energy.

H. AMOUNTS OWED AND OWING

Q. MR. EPSTEIN, WHAT IS YOUR RESPONSE TO MS. SZTABNIK'S CLAIMS AS TO AMOUNTS OWED BY THE ISO TO NEVADA POWER AND SIERRA PACIFIC?

A. **[Michael Epstein]** With respect to Nevada Power, I take no issue with Ms. Sztabnik's conclusions, as she agrees with the figure reported in Exhibit No. ISO-32. I would only note that these amounts were updated in Exhibit No. ISO-42, which I provided with my Rebuttal Testimony. With respect to Sierra Pacific, however, Ms. Sztabnik claims an amount different than that indicated in either Exhibit No. ISO-32 or Exhibit No. ISO-42. However, Ms. Sztabnik provides no explanation as to how she arrived at her total. Therefore, I can offer no specific criticism of her testimony on this issue, and simply refer to the discussion in my Rebuttal Testimony of the process by which the ISO arrived at amounts owed and owing for Market Participants. Exh. ISO-37 at 102:4-106:4.

I. CALCULATION OF INTEREST

Q. PLEASE DESCRIBE THE PROPOSAL IN MR. TRANEN'S TESTIMONY REGARDING COMBINING THE ISO AND PX MARKETS FOR THE PURPOSES OF ASSESSING INTEREST.

A. **[Michael Epstein]** Mr. Tranen asserts that the simplest method to handle interest is to combine the ISO and PX markets for the purposes of assessing interest over the entire refund period. As a rationale for

combining the ISO and PX markets in this way, Mr. Tranen asserts that the PX cannot separate its ISO Scheduling Coordinator activities from its other activities. Exh. GEN-83 (Tranen) at 34:3-12.

Q. DO YOU AGREE WITH MR. TRANEN'S PROPOSAL?

A. [Michael Epstein] No, because Mr. Tranen's proposal may not be workable. The PX and ISO are two separate legal entities and the PX has filed for bankruptcy. The ISO and its Market Participants all have specific legal claims in the PX bankruptcy. Those legal claims could be compromised if the markets are commingled as Mr. Tranen proposes. The ISO would not be able to identify the amounts legally owed from and to its Market Participants.

Q. PLEASE COMMENT ON MR. TRANEN'S AND MS. MILLER'S TESTIMONY REGARDING THE METHODOLOGIES THEY ESPOUSE FOR THE CALCULATION OF INTEREST.

A. [Michael Epstein] Both Mr. Tranen and Ms. Miller propose a specific methodology for the calculation of interest. *See* Exh. CPX-43 (Miller) at 2:4-6:6; Exh. GEN-83 (Tranen) at 34:12-35:16. However, neither of them sufficiently addresses the issues that may arise due to bankruptcies. It is my understanding, based on discussions with bankruptcy counsel, that a claim for interest cannot be made after the bankruptcy filing date. If this is the case, then, as to the PX, interest cannot be assessed after March 9,

2001, the date it filed for bankruptcy protection, and as to PG&E, interest cannot be assessed after April 6, 2001, the date it filed for bankruptcy protection. The trade month of November 2000 was the last month to settle before March 9, 2001. That means that ISO creditors for all trade months after November 2000 may only be able to make a claim for interest from either February 14 (for the preliminary invoice) or February 21 (for the final invoice) through March 9, 2001. Creditors for all trade months after November 2000 may have no claims for interest from the PX, as those months were all settled after March 9, 2001. The ISO assessed default interest to the PX using this method, which I understand to be prescribed by bankruptcy law.

Both Mr. Tranen's and Ms. Miller's testimony provide for calculating interest by applying the FERC rate to the unpaid creditor and debtor balances. These methods will accrue interest on an excess of $2.5 billion. Yet it would seem to make no sense to accrue interest payable on several billion dollars if bankruptcy bars the billing for the receivable thus accrued. I believe the effect of the PX and PG&E bankruptcies needs to be further analyzed.

Q. ARE THERE ANY OTHER AREAS YOU WANT TO EMPHASIZE?

A. [Michael Epstein] I want to emphasize one other matter. As shown in Exhibit No. ISO-32 and the update to that exhibit, Exhibit No. ISO-42, the

receivables and payables on a monthly basis vary by significant amounts. Thus any methodology that may be ultimately adopted must be cash neutral for any month.

Q. THANK YOU, GENTLEMEN. I HAVE NOTHING FURTHER.