SWIDLER BERLIN SHEREFF FRIEDMAN, LLP

WASHINGTON OFFICE
3000 K STREET, NW, SUITE 300
WASHINGTON, DC 20007-5116
TELEPHONE (202) 424-7500
FACSIMILE (202) 424-7647

NEW YORK OFFICE
919 THIRD AVENUE
NEW YORK, NY 10022-9998
TELEPHONE (212) 758-9500
FACSIMILE (212) 758-9526

October 4, 2002

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

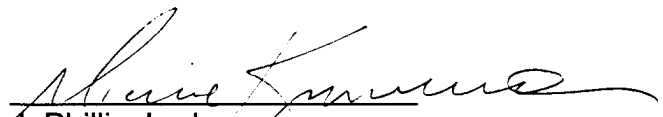
Re: *San Diego Gas & Electric Co., et al.*
Docket Nos. EL00-95-045, *et al.*

Dear Secretary Salas:

Enclosed for filing are one original and fourteen copies of the Initial Brief of the California Independent System Operator Corporation ("ISO") as to Issues Two and Three, 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 is 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

INITIAL BRIEF OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION AS TO ISSUES TWO AND THREE

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: October 4, 2002

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INITIAL BRIEF OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION AS TO ISSUES TWO AND THREE

Pursuant to the procedural schedule adopted in this proceeding, the California Independent System Operator Corporation ("ISO") submits its Initial Brief on the issues set for resolution in this phase of the proceeding, namely the "amount of refunds owed by each supplier according to the methodology established [by the Commission in its July 25 Order]" and "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." *San Diego Gas & Electric Co.*, et al., 96 FERC ¶ 61,120 (2001) ("July 25 Order"). The ISO's positions will be presented as proposed findings of fact under each of the headings and sub-headings in the Joint Narrative Stipulation of Issues ("Joint Narrative") adopted in this proceeding.

In the July 25 Order, the Commission established the current hearing procedures before Presiding Judge Birchman, specifically directing 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. In order to develop the factual record necessary for the Judge to make findings with respect to the first issue, the Commission ordered the ISO to calculate and provide to Judge Birchman mitigated prices for each hour from October 2, 2000, through June 20, 2001, (the "Refund Period") pursuant to the methodology set forth in that order. *Id.* The ISO did so, and matters relating to this first issue were thoroughly litigated and briefed before Judge Birchman in the previous phase of this proceeding.

With respect to the second and third issues, the Commission directed the ISO and the California Power Exchange Corporation ("PX") to "rerun their settlement/billing processes and all penalties. These revised settlements should be submitted to the administrative law judge and parties should use this information to form the basis of any offsets (*i.e.*, the amounts to be refunded against the payments past due)." *Id.* at 61,519.

The ISO followed the Commission's directive and re-ran its settlement and billing system and provided the results of that rerun to the Presiding Judge and the parties. Those results, consisting of re-formulated settlement statements in the format issued to market participants by the ISO in the normal course of business, are in the record of this proceeding as Exhibit Nos. ISO-28 and ISO-29. The ISO also provided several additional exhibits intended to enable the parties and the Presiding

Judge to better understand and use the "raw" data contained in those first two exhibits, in order to address Issues 2 and 3 from the July 25 Order. *See* Exh. ISO-30; ISO-32; ISO-42. Finally, the ISO provided testimony from its then Director of Billing and Settlements, Mr. Spence Gerber, in which Mr. Gerber explained the methodology and results of the ISO's settlement rerun. Exh. ISO-24 (Gerber).

In response to these submissions, parties filed voluminous testimony addressing a number of issues. Some issues raised by parties were ones not addressed by Mr. Gerber in his direct testimony, such as the calculation of interest and emissions offsets. Others focused on alleged errors (of both commission and omission) on the part of the ISO in conducting its settlement rerun. Many of these issues were extensively ventilated through rebuttal and surrebuttal testimony.

At present, all parties recognize that the settlements reruns performed by the ISO and PX that are the subject of this phase of the proceeding will need to be re-done. This is due to a number of factors, most important of which is the need to utilize a different set of mitigated market clearing prices ("MMCPs") than those used in the ISO's settlement rerun, based on at least the changes required by the Commission in its December 19, 2001, Order,[1] and stipulations reached by parties during the previous phase of this proceeding. Moreover, recent actions by the Commission, such as requesting comments on the Commission Staff's report detailing possible natural gas price manipulation in the West,[2] suggest that further modifications to the MMCPs may be warranted. The ISO also recognizes that

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[1] *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, et al., 97 FERC ¶ 61,275 (2001) ("December 19 Order").

[2] Fact finding investigation of Potential Manipulation of Electric and Natural Gas Prices, Initial Report on Company Specific-Separate Proceedings and General Pre-evaluations; Published Natural Gas Price Data; and Enron Trading Strategies; Docket No. PA-02-2-000, August 2000. Cite to Staff Report

certain mechanical errors were made in its settlement rerun that will need to be corrected in any future rerun. Nevertheless, most of the issues addressed herein can be taken up without further delay; the ISO presumes that the Presiding Judge and the Commission will do so and that the ISO will be directed to conduct any future settlement rerun consistently with the resolution of those issues.

I. DID THE ISO AND PX CORRECTLY RERUN THEIR SETTLEMENT AND BILLING PROCESSES?

A. Did the ISO Correctly Rerun its Settlement and Billing Process?

1. What is the appropriate pre-mitigation data to use as a baseline for applying the Mitigated Market Clearing Prices (MMCPs) litigated as Issue 1 in this proceeding in order to calculate refunds?

a. Cut Off Date for Adjustments – What cutoff date, if any, should be set for adjustments to the settlement records for this proceeding?

- **Proposed Finding – The Commission should not establish a strict cutoff date that does not permit the future adjustment, outside of this proceeding, of transactions occurring during the Refund Period, unless Scheduling Coordinators agree to such a cutoff date.**

During the normal course of business, the ISO continually updates its settlements data to reflect new information, as well as the resolution of disputes lodged by market participants concerning specific transactions. Thus, a transaction that is settled on a particular date may be subsequently revised, as to either quantity or price, and that change is then reflected on a subsequent settlement statement. Because some transactions that took place during the Refund Period are still subject to adjustment, there exists a potential for a continuing impact from future adjustments on the "bottom line" in this proceeding, *i.e.,* what amounts are owed and owing to participants after application of the MMCP. *See* Exh. ISO-45 (Gerber) at 4:15-17.

In light of this uncertainty, several parties suggest that the Commission should establish a "cut-off date" for the ISO to make adjustments to the historical settlements data for transactions during the Refund Period (the "pre-mitigation database"). *See* Exh. GEN-83 (Tranen) at 4:8-16; Exh. SEL-42 (Cicchetti) at 7:1-10; Exh. CPX-43 (Miller) at 7:3-11. As Mr. Gerber explained in his surrebuttal testimony,

one potential problem with establishing such a cutoff date is that, with respect to transactions that meet certain monetary and technical criteria, the ISO Tariff provides for no limitation on the time frame for adjustments. Exh. ISO-45 (Gerber) at 4:15-17. Additionally, instituting such a cut-off date may result in the artificial termination of ongoing negotiations and arbitration proceedings associated with disputes related to transactions that took place during the Refund Period. *Id.* at 4:18-21.

The ISO agrees that a cutoff date would be appropriate in the sense that a new and final "snapshot" of its pre-mitigation settlements data will have to be taken as of a date certain so that there exists a baseline set of records to which the ISO can apply the MMCPs that the Commission determines are appropriate, and so parties are not faced with a "moving target" in this proceeding. *See* Exh. ISO-24 (Gerber) at 23:6-21. However, for the reasons set forth above, the ISO is opposed to setting a strict cutoff date that does not permit further adjustments to Refund Period transactions, as long as such adjustments are handled outside of this proceeding. As Dr. Stern, testifying for the California Parties, recognizes, adjustments can be made after refunds and amounts owed and owing are determined, so long as such changes are made "with reference to the new market-clearing prices that result from this proceeding." Exh. CAL-82 (Stern) at 14:11-15. Indeed, Mr. Tranen, the witness for the California Generators, appears to recognize the inequity that would likely result from establishing a strict cutoff date, when he states that "we need to ensure that [pre-existing settlements] disputes remain open for possible resolution in some other forum at some future date, instead of being summarily decided in the ISO's favor through its settlement reruns." Exh. GEN-36 (Tranen) at 6:10-13.

There are, however, two caveats to the ISO's argument against a strict cutoff date. First, if all Scheduling Coordinators, including but not limited to the parties to this proceeding, could agree to a final strict cutoff date, and the Commission specifically overrode the ISO Tariff provisions discussed above, the ISO would not be opposed to such a cutoff date. Exh. ISO-45 (Gerber) at 4:21-5:3. Moreover, the reasons not to institute a cutoff date may be less forceful depending on the time frame in which the Commission issues its decision in this proceeding, as the passage of time will reduce (although not necessarily eliminate) the number and likelihood of additional changes to Refund Period settlements data.

b. Mislogged Transactions – Which, if any, transactions were mislogged by the ISO, and how should such transactions be accounted for?

- **Proposed Finding –The Commission and the Presiding Judge have limited the consequences of any mis-logging, if found, to the recalculation of historical MCPs, rather than MMCPs. In any case, no party has made a clear and convincing case that mis-logging, as defined by the Commission, actually occurred. Therefore, the Presiding Judge should decline to find that mis-logging occurred. Alternatively, if the Presiding Judge does find that mis-logging occurred, it should be the ISO that undertakes a thorough review to determine the exact transactions mis-logged and recalculate the historical MCPs using this data.**

In its order issued on May 15, 2002,[3] the Commission addressed the filing made by the California Generators four business days before the Commission's order, in which they alleged that the ISO had mis-logged numerous Out-of-Sequence ("OOS") non-congestion transactions as Out-of-Market ("OOM") transactions during the Refund Period. The Commission stated:

[3] *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, et al., 99 FERC ¶ 61,160 (2002) ("May 15 Order").

> With regard to out-of-sequence non-congestion related dispatches, we direct the presiding judge in the refund hearing to address this "mis-logging" issue. If the presiding judge finds information, through either an internal ISO audit or other disclosures, that out-of-sequence non-congestion transactions were not logged according to the ISO's Tariff provisions, the ISO must recalculate each clearing price during the Refund Period where an out-of-sequence non-congestion transaction was "mis-logged" and use these corrected clearing prices in the refund hearing.

May 15 Order at 61,654.

The first important point to note is that the Commission explicitly limited the consequence of any mis-logging that might be found to the correction of the historical market clearing price ("MCP"). That is, the Commission directed that the ISO recalculate, as necessary, "each clearing price during the Refund Period," not that it recalculate the "mitigated market clearing price" ("MMCP"). Therefore, the Commission did not direct the recalculation of the MMCPs to allow the addition of units to the list of units eligible to set the MMCP in this proceeding.

Even if the Commission had intended to permit the recalculation of the MMCP based on mis-logging that might be found, there would be no basis in fact for including in the recommendations that such recalculation of the MMCP occur. The issue of which units were to be included in the universe of units allowed to set the MMCP was litigated in the first hearing, and the record on that issue was closed even before the Commission issued its May 15 Order. Based on that record, the Presiding Judge articulated preliminary findings at a discovery conference held on May 20, 2001. Specifically, the Presiding Judge, in discussing the ramifications of the May 15 Order as to mis-logging, stated that:

> There may be something . . . that's relevant to [Phase II] with regard to mischaracterization. And if we can determine exactly what that is and

> how that fits in, I think it's appropriate to pursue, because I think there's a relationship, there's a potential relationship between mischaracterization and a basket of dollars. But you guys [the Generators] went after that in the [Phase I] hearing, and you missed.

Tr. at 3284:3-10.

Additionally, while noting that there was some evidence suggesting mischaracterization of transactions, the Presiding Judge made clear that "One can't take that a step further based on what the generators have provided to determine, assuming it was relevant to determine in the MMCP phase, what the significance of that mischaracterization was in relationship to the MMCP." Tr. at 3243:6-13. Therefore, no matter what findings the Presiding Judge makes based on the evidence presented in the second hearing, those findings will *only* affect the issue of whether the ISO should be required to recalculate the historical market clearing price (and therefore affect the issue of "who owes what to whom").

There should be no dispute on this point, *i.e.*, that any mis-logging that might be found could affect only the historical market clearing price. Mr. Tranen, the witness for the Generators who performed the most in-depth analysis of this issue on the suppliers side, did not propose any modifications other than a recalculation of the historical MCP and a correction to pre-mitigation settlements data. *See* Exh. GEN-36 (Tranen) at 17:16-18:2.[4] Nevertheless, the Presiding Judge should make clear in his findings of fact that, based on the plain language of the Commission's May 15 Order and the reasons articulated in his preliminary finding discussed above, the only consequence of a finding of mis-logging would be that the ISO would be

[4] The only suggestion that potential mis-logging might also involve a recalculation of MMCP's comes from Dr. Cardell, a witness for Powerex, who presented illustrative calculations suggesting that refund amounts would be significantly reduced if the ISO included in its *MMCP calculations* transactions that she alleges were mis-logged. *See* Exh. PWX-56 (Cardell) at 17:23-18:1, 18:14-17.

required to re-compute the historical MCP for intervals during the Refund Period in which it is determined that mis-logged transactions occurred.

Of course, there need be no recalculation even of historical clearing prices unless the Presiding Judge, in fact, finds "information, through either an internal ISO audit or other disclosures, that out-of-sequence non-congestion transactions were not logged according to the ISO's Tariff provisions." May 15 Order at 61,654. The ISO respectfully suggests that no such showing has been made. The only party that attempted to make such a showing was the California Generators, through the testimony of Mr. Tranen. While other parties have offered testimony on this issue, none besides the Generators have presented any factual evidence that even suggests the occurrence of mis-logging during the Refund Period. Therefore, the decision by the Presiding Judge as to whether mis-logging did, in fact, occur, hinges on the evidence presented by Mr. Tranen. For the reasons set forth below, Mr. Tranen's analysis does not make a convincing case for mis-logging.

Before addressing that analysis, it is useful to put this issue into perspective in terms of potential impact. As explained above, a finding that mis-logging did occur will require only that the ISO recalculate historical MCPs. Mr. Tranen, in his rebuttal testimony, suggests that such a recalculation would result in an approximately $22 million increase in payments to suppliers on a pre-mitigation basis for sales made during the Refund Period. Exh. GEN-36 (Tranen) at 24:6-7. However, as pointed out by Dr. Stern, and recognized by Mr. Tranen, this figure does not accurately reflect the impact on amounts owed and owing (*i.e.*, the "bottom line" in this proceeding) because many of the higher historical MCPs that result from Mr. Tranen's calculation would be overriden by application of the MMCPs. *See* Exh. CAL-53 (Stern) at 18:15-17; Exh. GEN-36 (Tranen) at 24:6-9. Dr. Stern estimates

the final net increase in amounts owed to suppliers at $12 million, while Mr. Tranen actually estimates an even smaller increase, of $10 million, additionally owed to suppliers.[5] Exh. CAL-53 (Stern) at 18:15-17; Exh. GEN-36 (Tranen) at 36:20-22. The ISO is not suggesting that these amounts are somehow *de minimis*. Nevertheless, the ISO respectfully suggests that the Presiding Judge should weight the ultimate amounts at issue against the substantial commitment of time and resources that will be necessary, as explained below, to arrive at an accurate determination as to what, if any, transactions were actually mis-logged.

There are several flaws in Mr. Tranen's analysis that cast considerable doubt on his conclusions. First is the issue of whether Mr. Tranen has actually demonstrated mis-logging in violation of the *ISO Tariff*, which the Commission has required that the Presiding Judge find prior to requiring recalculation of historical MCPs. As Mr. Gerber pointed out in his rebuttal testimony, no witness for any party has identified any specific provision or provisions of the ISO Tariff that have been violated by any alleged mis-logging, or by the failure to set the historical MCP by the bid associated with any mis-logged transaction. Exh. ISO-35 (Gerber) at 36:16-37:6.

Mr. Tranen attempts to rebut this argument by asserting that the Commission has "expressly considered Operating Procedures such as M-403 to be part and parcel of the ISO's Tariff." Exh. GEN-89 (Tranen) at 31:5-6. However, the precedent relied on by Mr. Tranen simply does not support so grandiose a characterization. In *Dynegy Power Marketing Inc.*, 98 FERC ¶ 61,074 (2002), the Commission rejected the ISO's attempt to expand Operating Procedure M-403 to prohibit external resources from setting the market clearing price. The Commission

[5] Even these amounts may be overstated, given the flaws in the analysis performed by Mr. Tranen, as discussed below.

rejected that addition to the Operating Procedure, explaining that if the ISO wished to implement this proposal, it would need to do so through a formal filing under Section 205 of the Federal Power Act. *Id.* at 61,211. Mr. Tranen, however, misunderstands the Commission's rationale for this conclusion. The Commission did not suggest, in this decision, that all of the ISO's operating procedures (or Operating Procedure M-403 itself), and the terms of those procedures, were equivalent to tariff provisions, but instead, found that a specific proposal, made in the form of a modification to an ISO operating procedure, had the effect of a tariff modification, because it went "well beyond 'simply add[ing] details or procedures necessary to implement tariff provisions,' which the Commission has recognized do not need to be filed with the Commission," and instead "affect the rates under the CA-ISO tariff." *Id.* at 61,211. For the same reasons, the Commission reached the opposite result in *California Independent System Operator Corp.*, 88 FERC ¶ 61,146 (1999). There, the Commission rejected an argument that the ISO had improperly failed to file certain amendments to its operating procedures, agreeing with the ISO that none of these revisions needed to be filed because they were consistent with existing provisions in the ISO Tariff. *Id.* at 61,487. For these reasons, there is no reason to find that Operating Procedure M-403 is a part of the ISO's Tariff, as that term is used in the Commission's May 15 Order.

Mr. Tranen argues that "a review of the relevant filings leading up to the May 15 Order shows that the Commission was addressing violations of M-403 when it discussed mis-logging," and that the May 15 Order "responded to the California Generators' May 8, 2002 update to their request for clarification of the December 19 Order." Mr. Tranen's facts are correct, but his conclusion is wrong. In this case, the Generators are the victims of their own rhetoric. In their May 8, 2002, request for

clarification, the Generators consistently characterized the mis-logging issue as a violation of the ISO's *Tariff*, with only one conclusory and self-serving sentence and a few brief references hinting that this mis-logging issue is, in fact, premised on the alleged violation of ISO Operating Procedure M-403. *See* Exh. GEN-91. In light of this fact, and with less than a work week between the filing of this pleading and the Commission's May 15 decision, it would be understandable if the Commission had viewed this issue as one that implicated a violation of the provisions of the ISO Tariff, rather than just Operating Procedure M-403. Nevertheless, the language of the Commission's May 15 Order is unambiguous. Nowhere in that Order did the Commission either mention Operating Procedure M-403 or indicate that it agreed with the Generators' position that M-403 was part and parcel of the ISO Tariff.

In his rebuttal testimony, Mr. Gerber pointed out another possible flaw in Mr. Tranen's analysis – that even in cases where there existed both an OOM call and a valid bid in the BEEP stack for the same unit, mis-logging would only have occurred if the Scheduling Coordinator for the unit had submitted the bid prior to the OOM dispatch instruction by the ISO. Exh. ISO-37 (Gerber) at 34:20-35:1. As Mr. Gerber explained, there were some instances in which the ISO dispatched a unit as OOM for multiple hours, and the Scheduling Coordinator for that unit subsequently submitted bids for some or all of those hours, and characterizing the ISO's dispatches as OOM was appropriate. *Id.* at 35:1-8.

Mr. Tranen takes issue with Mr. Gerber's conclusions, arguing that the Commission "already has rejected the notion that the ISO could be allowed to categorize a dispatch as OOM when a bid in the BEEP Stack is submitted after the ISO gave an OOM dispatch order." Exh. GEN-89 (Tranen) at 39:12-23 (citing *California Independent System Operator Corp.*, 90 FERC ¶ 61,006 (2000)). Mr.

Tranen's interpretation of this order is flawed. In this decision, the Commission addressed and rejected a specific ISO proposal to "direct the redispatch of generating units to manage intrazonal congestion, not only when there are insufficient bids, but also when it determines that the bids that are submitted will not be the result of a competitive market." *Id.* at 61,011. The Commission rejected the ISO's contention that its already-existing Tariff provisions concerning generation dispatch gave it the authority to proceed in this manner, explaining that the ISO's dispatch authority was:

> clearly limited to situations when the supply that has bid into the market is less than the amount needed to *physically* satisfy the ISO's need, *e.g.*, the supply that has bid cannot be dispatched due to transmission constraints. There is nothing in the ISO Tariff that suggests that the ISO can disregard market bids that have the physical ability to meet the ISO's need and to either direct those same bidding generators to perform at a different price (the OOM price) or dispatch a generating unit that has not bid into the market.

Id. (emphasis original).

On cross-examination, Mr. Tranen made clear that it was this last sentence that he took to mean that the ISO could not characterize a transaction as OOM if a generator had a valid bid in the BEEP Stack, even if the ISO had dispatched the unit as OOM prior to the Scheduling Coordinator for that unit submitting the bid or bids into the BEEP stack. Tr. at 5013:20-5014:2. However, as demonstrated by Mr. Tranen's colloquy with the Presiding Judge, the Commission was not making a broad pronouncement of the sort that Mr. Tranen suggests, but instead, was drawing a distinction between the ISO's authority to require a generator to operate for physical reasons, such as transmission constraints, and its lack of authority to dispatch a generator for purely economic reasons. *See* Tr. at 5014:15-5017:9. The Commission explained that the ISO's determination that a bid already submitted was

non-competitive did not allow the ISO to ignore that bid by calling that unit, or another unit, as OOM, because the ISO's OOM authority only extended to situations in which it was unable to obtain amounts to *physically* satisfy its needs. 90 FERC at 61,011.

Without the benefit of any precedent or other support, Mr. Tranen's argument that any transactions for which the ISO dispatched a generator as OOM, and the unit later submitted a bid into the BEEP stack, cannot be characterized as OOM, must fail. Because Mr. Tranen's analysis did not take into account the possibility of this "first OOM, then a bid" scenario, Tr. at 5023:18-5024:3, the accuracy of his analysis is highly suspect, as is his resulting conclusion that substantial mis-logging of OOS non-congestion transactions occurred. While there exists no definitive list of transactions in which a generator was called Out-of-Market by the ISO, and then submitted a bid in the ISO's market for real-time energy, on cross-examination, Mr. Tranen was presented with and admitted that over 500 entries on his list of mis-logged transactions (set forth in Exhibit No. GEN-61) were the result of a series of transactions in which several units owned by one entity were called Out-of-Market by the ISO, and subsequently, that entity chose to bid portions of the output of those units into the BEEP stack. Tr. at 5034:8-5037:5.

Another potential oversight in Mr. Tranen's analysis, pointed out by Dr. Stern, is that there could exist situations in which there was an agreement between an in-Control Area supplier and the ISO to provide OOM energy (*i.e.*, an OOM transaction that was not the result of the ISO exercising its Tariff dispatch authority) and, separately, the supplier bid in additional energy from the same unit into the BEEP Stack during the same hour. Again, in this case, the designation of the first portion of that delivery as OOM would not constitute mis-logging, although it would satisfy

the terms of Mr. Tranen's mis-logging criteria. *See* Exh. CAL-53 (Stern) at 17:13-19. Mr. Tranen, in his surrebuttal testimony, responded that this could only occur in cases where a unit inside the ISO's Control Area had a non-spot contract with the ISO, or in connection with transactions between the ISO and units outside the ISO control area that are not subject to dispatch and therefore not contained in the file analyzed by Mr. Tranen. Exh. GEN-89 (Tranen) at 33:15-17, 34:16-35:2. With respect to the first situation, Mr. Tranen testified that he had confirmed that no non-spot transactions with units inside the ISO's control area appeared in his list of mis-logged transactions. *Id.* at 34:1-11.

On cross-examination, however, Mr. Tranen was asked whether he had considered and analyzed the possibility that there existed negotiated *spot* OOM transactions with suppliers in the ISO Control Area. Tr. at 5039:5-7. Mr. Tranen asserted that he had, in fact, analyzed the ISO's SLIC logs (consisting of eight banker's boxes worth of documents) over the course of less than a week, and was satisfied that there was nothing in those logs that changed the results of his mis-logging screen, but admitted that he had prepared no written documentation reflecting the results of this analysis. Tr. at 5039:5-5041:13. However, when confronted by counsel for the California Parties with a transaction that appeared to have been a negotiated OOM transaction that did, in fact, appear on Mr. Tranen's list of allegedly mis-logged transactions, he admitted that "it's possible that a few things slipped through" his analysis. Tr. at 5052:7-11. Such an admission is hardly surprising, given that his analysis, as he described it, involved sifting through eight banker's boxes worth of log data in less than a week's time. Plainly, Mr. Tranen's hasty, unwritten, and unproduced, analysis does not answer the very real possibility raised by counsel for the California Parties on cross-examination that there existed

spot OOM transactions negotiated by a supplier and the ISO for a certain amount of output from a unit, with respect to which that supplier then bid additional energy from the same unit into the BEEP stack, thus giving the false impression, under Mr. Tranen's criteria, that the OOM transaction was mis-logged. This very real possibility casts even further doubt on the accuracy and usefulness of the results of Mr. Tranen's mis-logging analysis, and consequently, his conclusion that a showing of mis-logging has been made.

However, if, even in light of the serious questions with respect to the reliability of Mr. Tranen's analysis and conclusions discussed above, the Presiding Judge determines that there has been some threshold showing of mis-logging made by Mr. Tranen sufficient to satisfy the Commission's May 15 Order criterion, and that, consequently, there should be a recalculation of the historical MCPs, Mr. Tranen's analysis should not be taken as determining, finally which transactions were mis-logged. The foregoing discussion of errors in his analysis makes clear that there must be a rigorous and thorough examination of all of the transactions at issue to determine precisely which were, in fact, actually mis-logged, whether they were eligible to set the MCP, and, if so, whether the MCP must be modified as a result of their inclusion. As Mr. Gerber points out, because the Commission has directed that the ISO calculate the MCP in the event that the Presiding Judge finds that mis-logging has occurred, the ISO would have to perform its own analysis "to determine, at a minimum, if each of the situations identified by Mr. Tranen in fact requires recalculation of the historical MCP for the relevant interval." Exh. ISO-37 (Gerber) at 35:21-36:5. Mr. Gerber's point is bolstered by the evidence adduced on cross-examination showing that Mr. Tranen's quantitative analysis may be seriously flawed. Moreover, as Mr. Gerber also points out, this would be a signficant

undertaking, which would involve considerable time and expense on the part of the ISO. *See id.* at 36:5-6. The ISO believes, given the relatively small potential impact of this issue in proportion to the overall amounts at stake in this proceeding, that the better course is for the Presiding Judge to conclude that there has been no showing sufficient to make a finding of mis-logging.

c. Combined Settlements Database – Should a pre-mitigation database that combines all transaction records be created? If so, when should it be created, who should create it, and how should costs be covered?

- **Proposed Finding – The ISO has provided the parties in this proceeding with its initial settlements production data. The ISO is under no obligation to and it is not feasible for the ISO to create a new database of settlements data different from the one that it uses in production.**

The parties agree that the starting point for any rerun of the ISO's settlements system for purposes of calculating refunds is the selection of a baseline set of settlements data, often referred to as a "pre-mitigation" database, to which the mitigated price will be applied to determine refunds and amounts owed and owing. In his Direct Testimony, Mr. Gerber explained that the ISO, in performing its settlements rerun, initially selected a "snapshot" on a date certain of its "production database", which consists of existing transaction and price data as provided to Scheduling Coordinators in their regularly published settlement statements and settlement detail files, including adjustments to original data to reflect the results of settled disputes and other changes through the date of the "snapshot." *See* Exh. ISO-24 (Gerber) at 23:8-14.

As required by the Commission, the ISO produced to the Presiding Judge and parties the revised settlement records created as a result of applying the

mitigated price to this "snapshot" of pre-mitigation settlements data. *See* July 25 Order at 61,520; *see also* Exh. ISO-28; ISO-29. After the ISO provided the revised statements, several parties, apparently interested in verifying the calculations in the ISO's rerun on a transaction by transaction basis for *every* market participant during the Refund Period, requested through discovery the ISO's pre-mitigation database, which the ISO then provided. Exh. ISO-37 (Gerber) at 14:18-19; Exh. PWX-56 (Cardell) at 5:19-6:1.

In testimony, two parties (the California Generators and Powerex) expressed dissatisfaction with the pre-mitigation database provided by the ISO. Powerex argues that the ISO must provide "a complete and accurate database of all transactions during the Refund Period, a database not only useful to the ISO itself, but also provided in a format that is useful to all [Scheduling Coordinators]." Exh. PWX-80 (Cardell) at 11:21-23. The Generators and Powerex contend that the ISO must provide a database that links all subsequent adjustments to the original transaction that those adjustments modify. Exh. GEN-89 (Tranen) at 76:11-13 Exh.; PWX-56 (Cardell) at 10:23-12:11. In the ISO's current database, adjustments to transactions are recorded as separate line entries coded with the letter "A" (meaning "adjustment"), while original records are entered with the code "D." This is the case because both price and quantity adjustments are made to historical transactions as a result of updated data received by the ISO, as well as the resolution of disputes raised with the ISO by market participants. *See* Exh. ISO-24 (Gerber) at 15:17-22; Exh. PWX-56 (Cardell) at 3:15-24. The Generators and Powerex maintain that the ISO must now create a new database that links each original "D" record with all of its associated "A" records (if any), resulting in a single record for each transaction. Powerex claims that without this new database, "parties cannot readily calculate the

'refunds,' which prevent [sic] determination of the Issue 2 amounts with precision," and that parties will not be able to verify the ISO's calculations without this information. Exh. PWX-56 (Cardell) at 11:3-12:11.

What the Generators and Powerex are now asking is that the ISO be required to create a *new* database of historical, pre-refund transactions so that they, and presumably other interested parties, can attempt to "re-create," at the individual transaction level, the ISO's settlements rerun. Such a database is, as Mr. Gerber testified, "completely different from the one the ISO uses to run its settlements and billing system." Exh. ISO-37 (Gerber) at 16:16-17. Dr. Cardell, testifying on behalf of Powerex, takes issue with this explanation, characterizing Mr. Gerber's representation as "rather excessive." Exh. PWX-80 (Cardell) at 12:13-18. However, it is Mr. Gerber, not Dr. Cardell, who possesses intimate working knowledge of the ISO's settlements and billing process, and an understanding of the level of effort involved in such a task. In any event, neither Dr. Cardell nor Mr. Tranen, testifying on behalf of the California Generators, disputes the fact that such a database would represent a *new* database, *different* than the one that the ISO uses in its production system, and different than the one used in its refund calculations.

The ISO respectfully suggests that the Generators' and Powerex's concerns with respect to the ability of parties to "verify" the ISO's settlements calculations suggests a misunderstanding on their part of the purpose of this proceeding, and the scope of activities that the ISO has been directed to undertake. In the July 25 Order, the Commission was explicit as to the task that it set for the ISO:

> Once the ISO has calculated the hourly market clearing prices for the Refund Period, this data should be used by both the ISO and PX to rerun their settlement/billing processes and all penalties. These

> revised settlements should be submitted to the Administrative Law Judge and parties should use this information to form the basis of any offsets (*i.e.* the amounts to be refunded against the payments past due).

July 25 Order at 61,519.

Nowhere in this passage, or in any of the other language of the July 25 Order or other orders in this proceeding, did the Commission mandate that the ISO create a new database of its settlements data for the purpose of this proceeding. Moreover, there is no indication that the Commission even intended that parties have the ability to re-create, transaction by transaction, the ISO's settlement rerun calculations. The Commission assigned the ISO, and the ISO alone, the responsibility of conducting the settlement rerun of its markets. The Commission did not indicate that any sort of collaborative effort was called for, and certainly did not require the ISO to engage in the sort of time-consuming, resource intensive, and expensive exercises that would be necessary to allow other parties to, in effect, duplicate the products of the ISO's settlements staff and software.

The Commission refrained from requiring that sort of effort for good reason. The proposition advanced by Powerex, that parties will be unable to verify the ISO's data without a new pre-mitigation database, is simply incorrect. The pre-mitigation database that the Generators and Powerex deride as inadequate consists of the identical data that the ISO provided to market participants during production. Using this information, these market participants have, and exercise, the right to dispute transaction records to the ISO in the normal course of business. *See* Tr. at 3252:13-3253:4; 3255:17-3256:12. Indeed, several parties in this proceeding, without the benefit of analysis of the full "pre-mitigation database," were able to identify and

articulate errors made by the ISO during the course of the settlements rerun. *See, e.g.,* Exh. VER-3 (Lanzalotta) at 9:6-11:10.

Nevertheless, in an effort to assist parties in performing the sort of detailed analysis that Powerex and the Generators have undertaken, the ISO put these parties' consultants in contact with a software development company that is familiar with the presentation of ISO data and could -- at these parties' expense -- prepare the type of database that Powerex and the Generators contend is necessary to fully verify the ISO's rerun calculations. Exh. ISO-37 (Gerber) at 16:10-17. The ISO is unaware that the parties to date have taken advantage of that resource; instead, they have continued to urge that the ISO be required to create such a database for them. *Id.* at 16:14-15. Moreover, the ISO settlements staff itself not only devoted significant time to answering written discovery posed by these parties, but also worked directly with these parties on a more informal basis to try to assist them in understanding the data and performing their analyses. *See, e.g.,* Tr. at 3259:14-18; 3268:3-10.

The parties and the Commission would be better served by the ISO allocating its limited time and resources to ensuring that future reruns are conducted accurately and consistent with the Commission's directives, rather than engaging in the time-consuming, exceedingly expensive, and unnecessary creation of new databases of settlements data so that a few parties can engage in their own mock reruns, which, in the end, are not necessary to accomplish the goals mandated by the Commission for this proceeding. *See* Tr. at 3252:8-23. However, even if the Presiding Judge and the Commission determine that the type of database proposed by Powerex and the Generators should be created, the ISO should not be burdened with creating this database nor with the cost of its creation. As noted, the ISO has provided to parties

all of the pre-mitigation data that it used to conduct its settlement rerun. Exh. ISO-37 (Gerber) at 14:18-22. There is no reason why other parties or outside consultants (such as the company with which the ISO put Powerex and the Generators in contact) could not use this data to construct they type of database that Powerex and the Generators maintain is necessary.

2. What types of transactions or charge types, if any, did the ISO change or treat improperly as part of its mitigation, or were otherwise mishandled from a policy perspective?

a. [Removed]

b. Non-Spot Transactions – Was the ISO's classification and mitigation of non-spot transactions (sales of more than 24 hours in duration or entered into more than one day prior to delivery) appropriate?

- **Proposed Finding – The Commission has confined these mitigation to spot transactions, which it has defined as those transactions that are 24 hours or less in duration and that were entered into the day of or day prior to delivery. Non-spot transactions were entered into by Pugent Sound, Sempra, AES, BPA, Dynegy, LADWP, Powerex, Redding, and TransAlta.**

In various orders, the Commission has stated that this proceeding is limited to addressing what it refers to as "spot transactions" or "spot market transactions." *See, e.g.,* June 25 Order at 61,499. The Commission has defined spot transactions as those that are "24 hours or less and that are entered into the day of or day prior to delivery."[6] *Id.* A number of entities have claimed that certain transactions are exempt from mitigation as non-spot transactions. Each party's claims will be addressed in turn. However, with respect to Puget Sound, and Sempra, the ISO, the California Parties, FERC Staff, Puget Sound and Sempra have entered into a

[6] *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, et al., 95 FERC¶ 61,418 at 62,452 n.3 (2001).

stipulation that Puget and Sempra's claimed transactions were, in fact, non-spot transactions not subject to mitigation. Exh. JSII-6. Therefore, those transactions will not be addressed herein.

AES

- **Proposed Finding – AES entered into two non-spot transactions with the ISO during the Refund Period, one from HE 16 on December 6 through HE 24 December 7, 2000, and the other from December 9, 2000 through December 12, 2000.**

AES claims that it entered into a "sequence of long-term sales" with the ISO that began on December 6, 2000, and concluded on December 12, 2000. In his rebuttal testimony on behalf of the ISO, Mr. McQuay explained, based on the evidence proffered by AES, that he agreed AES had entered into two long-term sales to the ISO during this time period. Exh. ISO-37 (McQuay) at 66:18-20. Specifically, Exhibit No. AES-3 consists of ISO records that show that the ISO agreed, on December 6, 2000, to purchase energy from AES from HE 16 on December 6 through HE 24 on December 7, a sale which qualifies as a non-spot transaction because it was over 24 hours in length. Exh. AES-3 at 1; ISO-37 (McQuay) at 67:4-8. Also in AES-3 is an ISO record that indicates that the ISO agreed to purchase energy from AES from HE 1 on December 9 through HE 24 on December 12, which, being over 24 hours in duration, also constitutes a non-spot transaction. Exh. AES-3 at 8; ISO-37 (McQuay) at 67:9-14. Based on this evidence, the ISO supports a finding that these two transactions are non-spot transactions not subject to mitigation in the current proceeding.

BPA

- **Proposed Finding – BPA entered into a non-spot transaction with the ISO that began on December 27, 2000, and terminated on December 31, 2000.**

BPA claims that it entered into two non-spot, multi-day transactions with the ISO. Mr. Wolfe, testifying for BPA, states that the first transaction began on December 27, 2000, and continued through December 31, 2000, while the second transaction began on January 3, 2001, and ran through January 8, 2001. Exh. BPA-57 (Wolfe) at 4:19-5:8. In his rebuttal testimony, Mr. McQuay explained that ISO management did recall entering into long-term transactions with BPA during this time period, but that he had been unable to uncover any documentation to substantiate BPA's claims. Exh. ISO-37 (McQuay) at 68:6-13. In response, Mr. Wolfe included with his surrebuttal testimony documentation that corroborated BPA's claim that it had entered into a non-spot transaction with the ISO spanning the period from December 27, 2000, through December 31, 2000. *See* Exh. BPA-222; BPA-223. Therefore, the ISO supports a finding by the Presiding Judge that this transaction is a non-spot transaction exempt from mitigation in this proceeding.

With respect to the January transaction, on cross-examination, Mr. McQuay explained that two ISO upper-level managers recalled a "long-term" deal with BPA during this time, but that there were certain variables that allowed for a variation in quantities delivered and the price charged by BPA, and that the ISO managers could not recall what those variables were. Mr. McQuay noted that Mr. Wolfe addressed these variables in his surrebuttal testimony, and that they consisted of fish and wildlife obligations, temperature, industrial load, and *daily spot market prices*. Tr. at 4314:25-4315:10. The ISO has no documentation suggesting that these sales were

spot transactions. Therefore, ISO does not oppose a finding that the January transactions were also non-spot transaction.

Dynegy

- **Proposed Finding – Any transactions that are determined to have been made pursuant to the 11-day contract between Dynegy and the ISO, entered into in December 2000, are non-spot transactions that should be exempt from mitigation.**

During December of 2000, Dynegy and the ISO entered into a 11-day contract (covering the period December 5 through December 15), which permitted the ISO to dispatch Dynegy units pursuant to certain payment terms. Exh. DYN-16 (Williams) at 22:4-6; DYN-15. The ISO acknowledges that any transactions made pursuant to this contract should be considered non-spot transactions, as they were entered into more than a day prior to delivery. Exh. ISO-37 (Gerber) at 71:20-22. However, the issue of which transactions were actually made pursuant to this contract is currently the subject of good-faith negotiations between the ISO and Dynegy. *Id.* at 71:22-72:3. The ISO and Dynegy both agree that the most appropriate course of action would be for the Presiding Judge and Commission to make a finding that any transactions made subject to this contract will be exempt from mitigation, but to leave the issue of which transactions were, in fact, made pursuant to this contract, for independent resolution by the ISO and Dynegy. Exh. ISO-37 (Gerber) at 72:14-20; DYN-16 (Williams) at 25:13-21. The ISO respectfully requests that the Presiding Judge adopt this approach in his findings to the Commission.

EPME

- **Proposed Finding of Fact – El Paso did not enter into any non-spot transactions with the ISO during the Refund Period.**

El Paso's witness, Mr. Hicks, testified that EPME entered into an agreement with the ISO in late December of 2000 in which EPME would provide to the ISO all of the power that EPME could obtain from a certain "unaffiliated wholesale energy supplier." Exh. EPME-1 Revised (Hicks) at 8:10-9:8. With respect to price, Mr. Hicks states that the ISO set the price during most of the hours that EPME provided energy under this agreement, but that during some hours, EPME set the price "taking into account the *then prevailing market price* and the prices for the immediately preceding hours." *Id.* at 11:10-12 (emphasis added). Mr. Hicks contends that energy delivered under this agreement should be treated as part of one non-spot transaction. *Id.* at 13:6-7.

The Presiding Judge should reject EPME's contention that these sales were part of a single non-spot transaction. Instead, these sales constituted individual transactions, the terms of which were negotiated less than 24 hours in advance of delivery. As Mr. McQuay explained in his rebuttal testimony, the agreement between EPME and the ISO was nothing more than an agreement to conduct business, in that the only conditions were that EPME would continue to do business with the ISO by purchasing energy from available resources and then re-selling that energy to the ISO. Exh. ISO-37 (McQuay) at 74:5-13. Because both price and quantity, which are the most important terms in any energy transaction, were determined on a spot basis, there is no legitimate rationale for concluding that these transactions were part of a single non-spot transaction. *Id.* at 74:11-13.

Mr. Hicks contends that the nature of this deal was not "check back with us [*i.e.,* the ISO] each hour and we will let you know if we want to buy for that hour," but rather "we'll keep this going as long as we can and we'll set the volume and price each hour." Exh. EPME-1 Revised (Hicks) at 9:20-10-1. Mr. Hicks also suggests that this deal was akin to an output contract, in which a party agrees to purchase all available output from a generating unit. Exh. EPME-4 Revised (Hicks) at 5:21-6:1. However, telephone conversations between operators for the ISO and EPME arranging these sales do not bear out this interpretation. *See* Exh. CAL-101. In fact, a number of these conversations show that the ISO was not locked into a deal in which it was required to purchase all of the energy that EPME could obtain, regardless of the circumstances. For example, on page 7 of that exhibit, a representative of EPME (Greg), asks whether the ISO "wanted to roll another hour." Likewise, on pages 13, 14, and 15 of the same exhibit, Greg from EPME again inquires of the ISO operator whether the ISO wants to continue to purchase energy from EPME. *Id.* at 13-14. Obviously, if the ISO and EPME had entered into an output contract, there would have been no need, or reason, for EPME to inquire with the ISO whether it wanted to continue to transact with EPME – the ISO would have been contractually required to purchase whatever energy EPME was offering. For these reasons, the Presiding Judge should decline to find that any EPME sales to the ISO during the Refund Period constituted non-spot transactions.

LADWP

- **Proposed Finding – LADWP entered into 13 non-spot transaction with the ISO during the Refund Period, which are set forth in Exhibit No. DWP-22.**

LADWP claims that it engaged in 13 non-spot transactions with the ISO during the Refund Period. Exh. DWP-21R (Ward) at 3:18-9:7. In support of this claim, LADWP produced transcripts of conversations between operators for LADWP and the ISO in which the transactions at issue were arranged. Exh. DWP-22. These transcripts verify LADWP's claim that these transactions were, in fact, arranged more than 24 hours in advance and/or more than the day of or day prior to delivery. For this reason, Mr. McQuay, in his rebuttal testimony, indicated his agreement that these 13 transactions constituted non-spot transactions that should be exempt from mitigation, Exh. ISO-37 (McQuay) at 75:4-21, and the ISO therefore supports such a finding by the Presiding Judge.

Powerex

- **Proposed Finding – Powerex engaged in several non-spot transactions during the Refund Period, as set forth in Exhibit No. PWX-59.**

Powerex claims that it sold power to the ISO through non-spot transactions from December 4 through December 31, 2000, in the quantities and at the prices identified in Exhibit No. PWX-59. Exh. PWX-56 (Cardell) at 9:18-24. In his rebuttal testimony, Mr. McQuay explained that the ISO has concluded, based on its own internal review process, that certain of these Powerex sales constituted non-spot transactions, and that he concluded that the remainder were non-spot transactions based on a review of taped conversations between ISO and Powerex operators

which Powerex provided to the ISO during the discovery process. Exh. ISO-37 (McQuay) at 76:17-77:2. Based on this evidence, the ISO supports a finding that these sales constitute non-spot transactions that are exempt from mitigation.

City of Redding

- **Proposed Finding – The City of Redding engaged in two non-spot transactions with the ISO during the Refund Period.**

In his testimony filed during the surrebuttal round, the witness for the City of Redding, Mr. Hurley, claims that "on at least two occasions" during December 2000, Redding engaged in long-term sales of energy to the ISO. Exh. REU-6 (Hurley) at 5:8-6:22. To support this claim, Redding introduced records from the ISO's SLIC database, as well as what are purported to be telephone conversations between operators for the ISO and Redding. *See* Exh. REU-7; REU-8; REU-9. Based on these records, Redding's claim appears legitimate. Mr. McQuay, on cross-examination, agreed that these transactions appeared to be non-spot transactions, but because he had not had sufficient opportunity to review the records produced by Redding, he wished to follow up back at the ISO to confirm that these sales, were, in fact, non-spot transactions. Tr. at 4306:25-4307:10. Having found nothing that contradicts the records presented by Redding, the ISO supports a finding that Redding engaged in two non-spot transactions during the Refund Period: (1) a sale of 28 MW each hour beginning on December 5, 2000, HE 4, and running through December 12, 2000, and (2) a sale of 24 MW for HE 6-22 on December 8 through December 11, 2000.

TransAlta

- **Proposed Finding – TransAlta engaged in several non-spot transactions with the ISO from December 5 through December 8, 2000.**

TransAlta claims that it entered into four "balance of month" transactions with the ISO, scheduled to commence on December 4, 2000, and continue until December 31, 2000, the details of which are set forth in Exhibit No. TRA-5. Exh. TRA-1 (Bourne) at 5:15-17. Based on recordings of telephone conversations between operators for the ISO and TransAlta provided by TransAlta in discovery, the ISO was able to confirm that such deals were, in fact, arranged. Exh. ISO-37 (McQuay) at 79:7-10. However, as TransAlta itself acknowledges, delivery pursuant to these transactions was actually terminated at the end of December 8, 2000. *Id.* at 78:13-15; TRA-1 (Bourne) at 7:1-2. Additionally, the ISO was unable to find any records or data showing that TransAlta actually delivered any energy to the ISO on December 4, 2000. Exh. ISO-37 (McQuay) at 79:1-4. Therefore, the ISO would support a finding by the Presiding Judge that the energy delivered by TransAlta to the ISO on December 5 through December 8, 2000, as set forth in Exhibit No. TRA-5, was part of a series of non-spot transactions that are not subject to mitigation in this proceeding.

c. [Removed]

d. [Removed]

e. [Removed]

f. [Removed]

g. Energy Exchange Transactions - How should Energy Exchange Transactions be accounted for?

- **Proposed Finding – Energy exchange Transactions should be accounted for pursuant to the ISO's methodology as set forth in the ISO's filing of its energy exchange agreement with BPA in Docket No. ER01-2886. Energy exchanges must be handled identically in the ISO's production system and refund calculation to ensure symmetrical treatment.**

During the Refund Period, the ISO engaged in a number of energy exchange Transactions, in which the ISO would import energy from suppliers outside of the ISO Control Area and then, instead of paying that supplier a certain sum of money, would return to the supplier an equal or greater amount of energy at another time (usually during an off-peak period). *See* Exh. GEN-36 (Tranen) at 30:6-9. In order to make good on its return obligation, the ISO purchased energy, the cost of which was charged to the market. Originally, the ISO settled these transactions through Charge Types 1010 (neutrality), 407 (uninstructed energy) and 487 (allocation of excess costs for instructed energy). *Id.* at 30:18-20. Subsequently, the ISO decided to change the manner in which it accounted for these transactions, and filed with the Commission an energy exchange agreement with BPA in which it set forth its new proposed energy exchange allocation methodology. Exh. ISO-37 (Gerber) at 31:5-11. The Commission issued a letter order on October 17, 2001, accepting the filing of this agreement. *Id.* Under this new methodology, the ISO assigned amounts previously handled through Charge Types 1010, 407, and 487 to a temporary holding account, with the intention of settling these amounts through the newly established Charge Type 1487, which allocates the cost of returning energy exchanges to market participants with net negative deviations during hours in which the ISO obtained energy from suppliers via exchanges. Exh. GEN-36 (Tranen) at 31:2-7.

The ISO acknowledges that there has been an inconsistent and incomplete application of the new allocation methodology for the Refund Period time frame, both in production and in the settlement rerun. Exh. ISO-37 (Gerber) at 31:9-11. Namely, the ISO only partially applied its revised exchange methodology in production and in the settlement rerun. Exh. ISO-45 (Gerber) at 9:14-16. The ISO intends to reconcile these inconsistencies in its production database prior to any subsequent rerun of the settlements system for purposes of this proceeding. In order to ensure symmetrical treatment, it is essential that any subsequent reruns treat energy exchanges in the same manner in which they are treated in the ISO's production database. *Id.* at 9:17-20.

Dr. Berry, testifying on behalf of the California Parties, disagrees with this approach, and contends that the ISO should allocate the costs of energy exchange transactions "using the 'standard settlement accounting method' rather than developing new accounting methods that are not provided for in the ISO Tariff and that are outside the scope of the Refund Proceeding." Exh. CAL-54 (Berry) at 48:6-9. Dr. Berry claims that the ISO's revised exchange methodology will "shift substantial costs between market participants." *Id.* at 47:3-8.

Dr. Berry alleges that the ISO's revised exchange accounting methodology is not provided for in the ISO Tariff. In fact, however, the ISO has broad authority under its Tariff to negotiate contracts with suppliers (such as energy exchange agreements) to ensure the reliability of the grid. *See* California Independent System Operator Corp., FERC Electric Tariff, Section 2.3.5.1.5. Sheet No. 50 (October, 2000) ("ISO Tariff"). The Tariff provides that the ISO will charge Scheduling Coordinators for those costs pro rata based on each Scheduling Coordinator's negative deviations. ISO Tariff, Section 2.3.5.1.9. This mechanism is consistent

with the revised methodology for accounting for energy exchange transactions that the ISO set forth in its BPA exchange agreement filing with the Commission. Moreover, the Commission's letter order, accepting that agreement for filing, did not express any objection to the ISO's settlement treatment for energy exchanges. Exh. ISO-37 (Gerber at 31:5-8). In any event, if the California Parties had an objection to the ISO's revised energy exchange accounting methodology, they had the option of protesting the ISO's original filing. The only issue that should be addressed in this proceeding is whether the ISO accounts for energy exchanges in its settlements rerun in a manner consistent with its pre-mitigation treatment of those transactions. Again, the ISO intends to do so.

h. [Removed]

i. Energy Imports – Did the ISO improperly mitigate imported energy based on intervals as opposed to hourly average MMCPs?

- **Proposed Finding – The ISO properly mitigated imports using the interval mitigated prices.**

Two parties (Powerex and PPL Montana) argue that the ISO should have mitigated imports at the hourly average MMCP, rather than at the 10-minute interval MMCP. Witnesses for Powerex and PPL reason that this is the appropriate treatment for imports because imports are hourly products, and those entities delivering imports to the ISO are not capable of operating on a 10-minute basis. Exh. PWX-53 (Tabors) at 11:23-12:3; PPL-21 (Bradshaw) at 5:1-16. Also, these witnesses argue that the Commission's July 25 and December 19 Orders support this treatment. Dr. Tabors, on behalf of Powerex, maintains that rather than applying each interval price to an import transaction, the ISO should "mitigate the average of the six time blocks, not each individual block." Mr. Bradshaw, on behalf of PPL,

suggests that the ISO should apply to imports the average hourly mitigated prices that it has calculated.

With respect to imports that were bid into the ISO's supplemental energy market, and 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.

With respect to imports that were handled as OOM sales, although those transactions were priced on an hourly basis historically, there is no inequity in mitigating those transactions on an interval basis for two reasons. First, as Mr. Gerber explained in his surrebuttal testimony, importers were not making bidding decisions based on knowledge of what the mitigated prices would be. Exh. ISO-45 (Gerber) at 5:10-16. More importantly, however, is the fact that the same result is reached by using either the average hourly mitigated prices calculated by the ISO (as Mr. Bradshaw proposes) or using the six interval prices. This is the case because the ISO, consistent with the July 25 and December 19 Orders, calculated the average hourly mitigated prices by taking the simple average of the interval prices during each hour. Exh. ISO-1 (Hildebrandt) at 55:13-56:6. Therefore, mitigating an import using one average hourly price or six individual interval prices makes absolutely no difference in the amount of refunds that are calculated with respect to that transaction.

Dr. Tabors, however, proposes an entirely different methodology for mitigating imports. Dr. Tabors maintains that the average hourly prices should be

determined by first averaging the six *historical* interval prices and then mitigating that average price. This proposal, however, is inconsistent both with Commission precedent and the manner in which imports were paid historically. In the July 25 Order, the Commission instructed the ISO to calculate the average hourly prices by taking "the average of the maximum heat rates for the six 10-minute periods." July 25 Order at 61,518 n.68. In the December 19 Order, the Commission modified the calculation of the mitigated price to require that the ISO select the marginal unit based on the unit with the highest costs, rather than the highest heat rates. December 19 Order at 62,203. Therefore, the ISO re-calculated the average hourly mitigated prices by taking the simple average of the *highest cost units* for the six 10-minute periods.[7] Because the cost of the marginal unit establishes the MMCP, the ISO was correct to take the average of the six interval MMCPs during each hour in order to arrive at the average hourly price, and Dr. Tabors' argument that the ISO should first average the historical prices and then mitigate that result must fail. Moreover, as illustrated by his own example, Dr. Tabors' proposal simply does not comport with the manner in which imports were paid historically. In the case of imports bids into the ISO's markets, those bids, when accepted, were paid on a ten-minute basis using the interval market clearing price, pursuant to the ISO Tariff. *See* Exh. ISO-37 (Gerber) at 24:12-13. There is no justification or rationale for now averaging those prices across the hour for purposes of applying mitigation. In the case of imports settled as OOM and paid a single, negotiated price, Dr. Tabors' proposal makes even less sense, because those transactions were not paid based

[7] Although the ISO did re-calculate the interval and average mitigated prices in order to reflect the highest cost unit (rather than the highest heat rate unit), pursuant to the Presiding Judge's ruling, the ISO did not rerun its settlement and billing system again to reflect these re-calculated prices.

on the historical market clearing price, and it would therefore be incongruous to apply mitigation to them based on historical MCPs.

j. Capacity Charges for Ancillary Services and Other Non-Energy Charges – Should the ISO mitigate capacity charges for ancillary services or other non-energy charges?

- **Proposed Finding – The Commission has required that capacity charges for ancillary services be mitigated, and the ISO properly did so.**

One party, the Sellers, argues that the ISO has improperly mitigated certain ancillary services, namely regulation, spinning reserves, non-spinning reserves, and replacement reserves, contending that such products are not subject to mitigation because they represent sales of capacity rather than energy. Exh. SEL-19 (Cicchetti) at 22:9-23:3. Dr. Cicchetti argues that the July 25 Order only subjected to refund liability sales for energy, and not capacity. *Id.* at 23:7-15. Dr. Cicchetti's interpretation of that order is flawed. In the July 25 Order, the Commission, in setting forth its refund methodology, explained that it would "adopt the recommendations of the Chief Judge, as modified below, and apply the methodology set out in the June 19 Order from the October 2, 2000, refund effective date, through June 20, 2001 to determine the amount of refunds due to the customers in the ISO and PX spot markets." July 28 Order at 61,516 The methodology set forth in the June 19 Order was, itself, based on the Commission's April 26 Order, in which the Commission, in its own words, adopted "new price mitigation for sales in the California Independent System Operator's (ISO) *ancillary services* and imbalance energy markets (spot markets)." June 19 Order at 62,545 (emphasis added).

See Report, Recommendation to the Commission, and Certification of Transcript, 98 FERC ¶ 63,003 (2002)

Therefore, because the July 25 Order applied that price mitigation methodology for the purposes of determining refunds, the Commission contemplated that the mitigated price would be applied to ancillary services.

Moreover, in the December 19 Order, the Commission specifically addressed several points raised in rehearing requests concerning how ancillary services were to be mitigated under the methodology laid out in the July 25 Order. December 19 Order at 62,216. If the Commission did not believe that ancillary services transactions were subject to refund in the first instance, it would not have needed to even address such issues. Finally, in none of its various orders in this docket has the Commission in any way distinguished capacity transactions from energy transactions, or suggested that capacity transactions should not be mitigated. Therefore, the Sellers' argument that certain ancillary services capacity transactions are exempt from refund liability should be rejected.

k. Neutrality Charges - How should neutrality charges be mitigated, adjusted, and/or offset against refund amounts?

- **Proposed Finding – Neutrality adjustment charges should not be directly mitigated, although the cost of certain transactions collected through neutrality are subject to refund. Neutrality adjustment charges, however, will properly change as a result of the application of the MMCP.**

Because the ISO is required to maintain cash neutrality during every settlement period, charges and credits flow through to ISO Scheduling Coordinators through a neutrality adjustment charge. Exh. ISO-24 (Gerber) at 11:8-12. This load-based charge accounts for, among other things, mismatches between amounts charged and amounts credited for specific services. The Neutrality Adjustment charge is allocated to Scheduling Coordinators based on their pro-rata share of

system load. *Id.* at 11:12-15. As Mr. Gerber explained in his Direct Testimony, the ISO did not directly mitigate the Neutrality Adjustment charge in the ISO's settlement rerun. *Id.* at 36:4-19. However, during normal settlements operations, significant dollars can accumulate in the neutrality charge type when there are differences between the prices for Instructed Energy and Uninstructed Energy, and a substantial amount of real-time load is being met by Uninstructed Energy. When the application of the MMCP eliminates or changes the difference between the Instructed and Uninstructed prices, the result is a fluctuation in the neutrality charges and credits to Scheduling Coordinators. *Id.* To summarize, while neutrality charges are not directly mitigated in the settlement rerun, the amounts collected through those charges may change significantly due to the application of the mitigated price to other charge types.

Dr. Cicchetti, testifying on behalf of the Sellers, argues that the neutrality charge types should not be mitigated. Exh. SEL-19 (Cicchetti) at 24:19-25:2. Mr. Nichols, on behalf of SRP, testifies to the contrary, contending that "neutrality adjustment charges capture substantial energy charges and hence must be mitigated per the Commission's orders in this proceeding." Exh. SRP-5 (Nichols) at 4:7-11. Dr. Stern makes a similar argument, stating that "to the extent that the ISO included in the neutrality adjustment charge the cost of transactions that are subject to refund the ISO was correct to calculate refunds for those charges. There is no basis for excluding such transactions from refund on the ground that they were recovered through the ISO's neutrality charge." Exh. CAL-53 (Stern) at 14:16-15:5.

This is less a live dispute then a misunderstanding of the manner in which refunds are calculated. In the ISO's settlement rerun, the historical prices for sales made to the ISO or through the ISO's markets during the Refund Period are

compared with the MMCPs calculated pursuant to the Commission's refund methodology. If the historical sales price for a transaction is greater than the MMCP, then the price for that sale is set at the level of the MMCP, and the recalculated settlements statement for the supplier in question would reflect a proportional reduction in payment . *See* Exh. ISO-24 (Gerber) at 24:11-18. The flip-side of this proposition is that market participants who were charged for the energy or capacity associated with this transaction would, as a result of mitigation, owe less. However, in the parlance of this proceeding, the ISO would not characterize the amounts owed by purchasers as having been "mitigated," although they will obviously be reduced as a result of the mitigation of payments to suppliers. As Mr. Nichols, the witness for SRP, points out, significant charges associated with OOM purchases were invoiced to buyers through neutrality charges. Exh. SRP-5 (Nichols) at 4:7-11, 4:20-5:12. Mr. Nichols is entirely correct that these OOM purchases must be mitigated; indeed, the ISO has done just that. Correspondingly, the amounts invoiced to buyers such as SRP through neutrality charges will be reduced. However, the neutrality charges themselves are not mitigated, *per se*, but decrease by virtue of the fact that the underlying transactions *are* mitigated.[8] Therefore, the ISO's treatment of neutrality charges in the settlement rerun was appropriate.

I. [Removed]

[8] For these same reasons, there is no reason to engage in the exercise proposed by Dr. Cicchetti of backing out OOM costs collected through neutrality during the period December 8 through December 12, 2000, and then retroactively moving those costs into Charge Type 487. *See* Exh. SEL-48 (Cicchetti) at 9:10-16. The mitigation of the price of the OOM transactions themselves will serve to reduce the amounts collected through neutrality charges during this period.

m. Charge Types 401 and 481 – How should Charge Types 401 and 481 be mitigated or adjusted, if at all?

- **Proposed Finding – The ISO properly allocated payments between Charge Types 401 and 481.**

Mr. Tranen, on behalf of the California Generators, contends that the ISO, in conducting its settlement rerun, erroneously reallocated charges from Charge Type 401 to Charge Type 481 for certain transactions. Specifically, Mr. Tranen argues that the ISO should not have reallocated amounts associated with non-mitigated charges from CT 401 to CT 481 in cases when the MMCP is lower than the MCP. Such instances occurred as a result of the soft-cap breakpoint mechanism under which the ISO's markets operated during a significant portion of the refund period. Under this mechanism, suppliers were permitted to submit bids above the level of the soft-cap and were eligible to be paid their full bid price, but such "above-cap" bids would not set the market clearing price. 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 (known as the as-bid portion of a transaction) were charged to net negative deviations under Charge Type 481, while amounts paid up to the breakpoint were collected under Charge Type 401. Exh. ISO-37 (Gerber) at 21:20-22:4. When the ISO applied the MMCP to these transactions, and the MMCP was lower than the historical MCP, the result was that the as-bid portion of these transactions was recalculated to equal the difference between the MMCP and the price paid, rather than the historical MCP and the price paid.

Mr. Tranen argues that this treatment was inappropriate, contending that:

> the 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.

As Mr. Gerber explained in his rebuttal testimony, however, 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 respect 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.

n. Charge Type 485 – Were Charge Type 485 penalties properly mitigated or adjusted and, if not, how should these penalties be adjusted and calculated?

- **Proposed Finding – The ISO acknowledges that original, unmitigated 485 penalty amounts were sometimes not removed, and that mitigated 485 penalties were sometimes double-counted. 485 penalties should also be re-calculated to reflect the cost of unmitigated transactions such as 202(c) transactions and non-spot transactions.**

In the July 25 Order, the Commission instructed the ISO, in addition to rerunning energy and capacity transactions, to reprocess penalties to reflect the application of the MMCP. July 25 Order at 61,519 ("Once the ISO has calculated the hourly market clearing prices for the Refund Period, this data should be used by both the ISO and PX to rerun their settlement/billing processes *and all penalties*."). The ISO did so. Exh. ISO-24 (Gerber) at 28:18-20. However, after the settlement rerun, it became apparent that errors had occurred with respect to penalties. First, the original, unmitigated amounts associated with Charge Type 485 penalties (levied on generators that failed to respond to ISO dispatch instructions during emergencies pursuant to Section 5.6.3 of the ISO Tariff) were sometimes not removed from the rerun settlements records. Exh. ISO-37 (Gerber) at 20:11-14. Indeed, the ISO discovered and acknowledged this error quite some time prior to the filing of testimony in this hearing. Likewise, the ISO also acknowledged that there occurred limited instances in which mitigated penalties were double-counted for the month of

January, 2001. *Id.* These errors were easily corrected by the parties in their own calculations, *see* Exh. GEN-67, and are likewise easily corrected by the ISO in any compliance rerun.

In testimony, the California Parties contend that the ISO incorrectly calculated refunds associated with Charge Type 485 penalties because, although these penalties are based on the highest price paid for energy by the ISO in an hour, the ISO did not include non-mitigated transactions in the calculation. On cross-examination, Mr. Gerber acknowledged that including these transactions in the calculation of 485 penalties would be appropriate, as non-mitigated transactions, such as 202(c) transactions, do represent energy procured by the ISO during an hour. Tr. at 187:11-4188:7. Including such transactions in the calculation is also easily accomplished in any compliance rerun.

o. Manual Adjustments – Has the ISO properly accounted for Manual Adjustments in the settlement rerun process?

- **Proposed Finding – During the mitigation process, the ISO sometimes miscalculated the payment to a seller whose bid it had accepted above the MMCP.**

As Mr. Tranen points out, the ISO, prior to its settlement rerun, made manual adjustments to certain transactions in order to ensure that the portion of these transaction above the MCP (the "as-bid" portion) was paid to sellers. Exh. GEN-36 (Tranen) at 27:6-11. During the mitigation process, the ISO reversed the entire amounts that it paid above the historical MCP with respect to these transactions. Exh. ISO-37 (Gerber) at 21:3-5. However, in some instances, the ISO did not take the necessary additional step of adding back in the mitigated amount above the historical MCP (*i.e.*, the amount that was more than the historical MCP, but less than

the MMCP). *Id.* at 21:5-8. The ISO recognizes that these amounts will have to be included in a future settlements rerun in order that suppliers are paid the appropriate amounts with respect to these transactions.

p. Should any transactions made pursuant to long-term Reliability Must-Run ("RMR") contracts be subject to mitigation in this proceeding?

As Mr. Gerber explained in his surrebuttal testimony, RMR Owners have two options for payment when they receive a dispatch from the ISO: (1) a "contract path," under which an RMR Owner receives payment based on a cost-of-service formula contained in the RMR contract; or (2) a "market path," in which the RMR Owner bids the energy into the ISO's real-time market and is paid the applicable clearing price. Exh. ISO-45 (Gerber) at 20:16-21:2. However, when the ISO dispatches RMR generation in real-time, it settles all RMR energy, at least initially, as instructed imbalance energy, and pays the RMR Owner through the standard settlement process. *Id.* at 21:2-6. In the settlement rerun of its markets, the ISO did not distinguish between RMR and non-RMR transactions, meaning that all RMR transactions that were settled in real-time under Charge Type 401 were mitigated in the ISO settlement rerun. *Id.* at 22:1-5.

i. Contract path pricing (cost-of-service).

- **Proposed Finding – If contract path RMR transactions are to be mitigated, then the results of mitigation should be passed through the ISO's invoicing process to ensure that RMR owners are not deprived of a portion of their contract payment.**

As explained above, even when an RMR Owner opts for payment under the RMR contract, if the ISO dispatches the RMR unit in real-time, that transaction is initially settled under Charge Type 401 through the standard settlement process.

The RMR Owner then invoices the ISO for the amount of the contract payment. Exh. ISO-45 (Gerber) at 21:6-9. Because the RMR Owner has already been paid by the ISO under the normal settlements process, however, the RMR Owner must then credit the amount received through the normal settlements process to the applicable Investor-Owned Utility ("IOU") to avoid receiving a double-payment. *Id.* at 21:9-16. Therefore, if the Presiding Judge and Commission determine that the Charge Type 401 payments associated with contact-path RMR transaction should be mitigated, the results of this mitigation should then be passed through the ISO's RMR invoicing process in order to avoid RMR Owners' being deprived of a portion of their contract payment. *Id.* at 23:18-22. This would involve requiring the IOU who was credited by the RMR Owner to return to the RMR Owner an amount equal to the refund associated with the original 401 payment to the RMR Owner. *Id.* at 24:3-10.

ii. Market path pricing.

- **Proposed Finding – RMR Owners who chose market path pricing assumed a certain risk of market outcomes, but also made this election based on prevailing market prices as they existed at the time that the election was made.**

On the issue of whether to mitigate RMR sales made under the market path mechanism, the ISO has taken no position in testimony. However, in deciding this issue, the Presiding Judge and the Commission should take the following into account. First, it is undoubtedly true that RMR Owners who elected a market path payment assumed a certain risk of spot market outcomes. Exh. ISO-45 (Gerber) at 23:5-8; Exh. CAL-54 (Berry) at 32:14-20. On the other hand, it also seems clear 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. Exh. ISO-45 (Gerber) at 23:8-11. Additionally, these units were

obligated to respond and run pursuant to their long-term RMR contracts when dispatched by the ISO. *Id.* at 23:11-13.

3. What other errors, if any, did the ISO make in implementing its settlement reruns?

The ISO has taken no position and offered no testimony on this issue, and therefore, offers no argument concerning this issue at this time.

B. Did the PX Correctly Rerun its Settlements and Billing Processes?

The ISO has taken no position and offered no testimony on this issue, including all of the sub-issues under this heading, and therefore, offers no argument concerning these issues at this time.

1. Congestion

a. How, if at all, should the PX have dealt with congestion in its markets, including Congestion Usage Charges?

b. Should the PX have based its calculations on unconstrained market clearing prices?

c. How should congestion-related shortfalls in the PX markets be allocated?

2. Block Forwards – How should Block Forward Transactions be handled and how, if at all, should that affect the mitigation of PX Day-Ahead Transactions?

3. Application of Breakpoint – Did the PX properly apply the $150/MWh breakpoint for January 2001 transactions?

4. Spot Transactions – Should certain short-term (24 hours or less) bilateral sales to the PX be exempt from mitigation, and if so, which transactions?

5. **Where a participant has both sales and purchases within the same zone, within the same hour, and within the am market, e.g., PX Day-Ahead Market, should the net purchase or sale for that hour, rather than gross sales and purchases, be used in the calculation of refunds and apportionment of shortfalls in refunds among purchasers?**

6. **Errors- What other errors, if any, did the PX make in implementing its refund methodology?**

C. **Other Amounts**

1. **PX Default Chargebacks – How should default chargeback amounts held by the PX, inclusive of interest, be treated?**

2. **[Removed]**

II. WHAT EMISSIONS AMOUNTS SHOULD BE OFFSET AGAINST REFUND CALCULATIONS?

The ISO has taken no position and offered no testimony on this issue, including all of the sub-issues under this heading, and therefore, offers no argument concerning these issues at this time.

A. **Which Emissions Amounts, if any, Should be Offset Against Refund Calculations?**

B. **How Should Emissions Costs be Applied?**

III. WHAT REFUND AMOUNTS ARE OWED BY EACH SUPPLIER, AND WHAT AMOUNTS ARE CURRENTLY OWED TO EACH SUPPLIER BY THE ISO, THE PX, THE INVESTOR OWNED UTILITIES, AND THE STATE OF CALIFORNIA?

A. How Should Refunds and Amounts Owed and Owing be Computed?

- **Proposed Finding – Refunds and amounts owed and owing should be determined by first rerunning the ISO and PX settlement and billing systems, consistent with the procedures specified in their respective Tariffs, using the appropriate MMCP to replace the historical price, when appropriate, for those transactions subject to mitigation, and then applying emissions offsets and appropriate interest amounts to the results of those reruns. These figures should then be applied to the cash position of parties to determine the final amounts owed and owing for each party.**

In large part, the answer to the question posed by this issue has already been answered by the Commission. In the July 25 Order, the Commission directed the ISO and PX to rerun their settlements and billing processes, and stated that the revised settlements would then be used by the Presiding Judge and parties "to form the basis of any offsets (*i.e.* the amounts to be refunded against the payments past due)." July 25 Order at 61,519. Thus, for transactions in the ISO markets, it is the ISO's settlements rerun, in which the historical transaction price is replaced with the MMCP for appropriate transactions, that is the key component to determining refunds and amounts owed and owing.

Because the Commission has designated the ISO's settlements system as the mechanism by which refunds and offsets are to be calculated for transactions in the ISO's markets, it is most appropriate that the rerun be conducted, to the extent possible, in a manner consistent with the provisions for the operation of the normal settlements and invoicing production process as set forth in the ISO's Tariff and Protocols. Indeed, it is this approach that the ISO took in rerunning its settlements system in this proceeding. As Mr. Gerber explained in his Prepared Direct

Testimony, to the extent possible, all of the data "was handled in a similar manner and sequence normally followed in a standard production settlement calculation and published in the format used for standard daily settlement statements." Exh. ISO-24 (Gerber) at 31:9-13.

The primary difference between the rerun calculations and the ISO's production settlements process is that the rerun calculations only affected a subset of the Charge Types that are normally computed in the ISO's settlement process, and even within certain Charge Types, do not implicate all of the transactions that were settled in the ISO's markets during the Refund Period. *See* Exh. ISO-24 (Gerber) at 8:10-16, 24:11-18. This is the case for two reasons. First, certain ISO Charge Types do not reflect market activity (*i.e.*, the sale and purchase of energy or capacity products), and therefore, are not subject to mitigation. This category includes Charge Types associated with items such as transmission Access Charges and Grid Management Charges. *See id.* at 8:10-18, Exh. ISO-27. Second, the Commission has exempted certain types of transactions from mitigation in this proceeding, including non-spot transactions and transactions conducted pursuant to Section 202(c) of the Federal Power Act. Therefore, these specific transactions will not be affected by the ISO's settlements rerun.

Several parties in this proceeding have offered testimony proposing multi-step processes which they advocate should be followed in order to determine refund amounts and amounts owed and owing. *See, e.g.*, Exh. GEN-36 (Tranen) at 5:4-31 (advocating a "seven-step program" for determining refund and amounts owed and owing); Exh. SEL-19 (Cicchetti) at 4:6-5:6 (suggesting that eight steps need to be taken to make a determination as to amounts owed and owing); Exh. PWX-53 (Tabors) at 7:6-8:19 (stating that 11 steps need to be taken to meet the

Commission's directives in this case). For the most part, these proposals are consistent, at least in that they identify most of the same considerations that must be addressed in order to reach an answer to the questions that the Commission has set for resolution in this proceeding. At their core, these proposals can be summarized as follows: select an appropriate set of pre-mitigation baseline settlements data, determine the appropriate MMCP, determine which transactions and charge types should and should not be mitigated, apply the MMCP to the baseline data as appropriate, take into account emissions offsets, add interest as appropriate, and apply the results against the cash positions of each party as they stood at a certain point in time. This scheme is consistent with the approach that the ISO has advocated. Of course, there is significant dispute concerning *how* each of these steps should actually be executed, but those disputes are addressed in other sections of this brief.

B. How Should Refunds be Applied as Offsets Against Amounts Owed and Owing?

- **Proposed Finding – Offsets against amounts owed and owing in the ISO Markets can be calculated by comparing the cash position of parties on a monthly basis with the results of the ISO's settlements rerun.**

One of the major complications in this case is the fact that many suppliers in the ISO's markets, even after taking account of the reduction in payments due to the substitution of the MMCP for historical prices, are owed significant amounts of money, rather than universally owing refunds. However, the ISO, since the time at which it was unable to pay suppliers in full due to defaults by purchasers, has tracked, on a monthly basis, the current cash positions for each market participant in the ISO markets. In this proceeding, the ISO has assembled this information into

two exhibits, both of which show, in a tabular format, the cash position of each market participant in the ISO markets by month. *See* Exh. ISO-32, Exh. ISO-42. With this information, the process of determining offsets should be relatively simple. One simply aligns the restated monthly invoice amounts that result from the rerun of the ISO's settlements system with the monthly cash positions as provided by the ISO, to reach a result that shows what each individual market participant either owes or is owed by the ISO market. Exh. ISO-24 (Gerber) at 40:14-19. It should be understood, however, that these amounts have and will continue to change as time passes and additional payments are made by market participants on amounts past due. *See id.* at 41:9-10.

C. How Should the Cash Positions of Parties in the ISO and PX Markets (Including Cash Held by the PX) be Accounted For, if At All?

- **Proposed Finding – The cash positions, through March, 2002, of all parties that transacted with the ISO during the Refund Period are set forth in Exhibit No. ISO-42. These figures are based on the ISO's production settlement and invoicing process, operated in accordance with the ISO Tariff, and the amount of money paid to the ISO by market participants.**

In his Direct Testimony, Mr. Gerber explained that the ISO provides Scheduling Coordinators each month an invoice that aggregates all of the settlement statements received by a Scheduling Coordinator during that month, and provides line-item detail as to charges and credits by Charge Type, and that the net amounts of these charges and credits indicates whether a Scheduling Coordinator is owed or owes the ISO market for that particular month. Exh. ISO-24 (Gerber) at 37:23-38:5. If the Scheduling Coordinator owes the ISO market for a particular month, it is obligated to make payment on a date set by the ISO. *Id.* at 39:2-4. To the extent that amounts collected from "due ISO" Scheduling Coordinators are insufficient to

pay "due Scheduling Coordinator" invoices for a given month, the ISO calculates a pro-rata share for each Scheduling Coordinator to which the market owes money, and provides a certification of who the defaulting parties are, and what portion of the defaulting parties' outstanding amount each Scheduling Coordinator has a claim to. *Id.* at 39:6-11; Exh. ISO-37 (Epstein) at 107:11-21.

In this proceeding, to assist the Presiding Judge, Commission, and parties in understanding the existing cash positions of the Scheduling Coordinators with respect to the ISO's markets, the ISO aggregated the monthly invoices of each Scheduling Coordinator and presented this information in a tabular format. That document, in the record as Exhibit No. ISO-42, shows the pre-mitigation net cash position of each Scheduling Coordinator through the end of March, 2002.

As Mr. Epstein pointed out in his rebuttal testimony, however, this information is only a "snapshot" of amounts owed and owing at a particular point in time. These amounts have and will continue to change as time passes. Exh. ISO-37 (Epstein) at 104:8-12.

Some parties in this proceeding have calculated net cash positions that differ from those presented by the ISO. *See id.* at 110:1-9; Exh. ISO-43. Some of these parties appear to arrive at their results simply by virtue of the application of a different methodology than that used by the ISO to determine cash positions. Exh. ISO-37 (Epstein) at 111:5-8. Such calculations should be given no weight, as the Commission has made clear that it is the *ISO's* settlements and billing process that is to be the basis for determining amounts owed and owing, rather than some alternative mechanism. *Id.* at 111:10-20. Some parties appear to calculate different net cash positions due to alleged discrepancies in the ISO's pre-refund settlements results. Again, these results should be given no weight by the Presiding Judge and

the Commission, because the consideration of such discrepancies is outside the scope of this proceeding, which is concerned with amounts owed and owing based on the rerun of the ISO's settlements and billing process. *Id.* at 112:1-5. The ISO Tariff contains existing mechanisms for the resolution of such disputes, and this proceeding should not provide a new forum for parties to raise them. *Id.* at 112:5-8.

D. How Should Interest be Calculated and Applied?

- **Proposed Finding – The Commission has required that interest be assessed on amounts unpaid and on refunds using the interest rate set forth in the Commission's regulations. Any specific method of implementing this directive should preserve the ISO's position as a cash-neutral entity. The proposal to combine the ISO and PX markets for purposes of calculating interest may not be workable because of the legal claims that the ISO and market participants have with respect to the PX bankruptcy.**

In the July 25 Order, the Commission directed the "calculation of interest on both refunds and receivables past due, pursuant to the methodology for the calculation of interest under Section 35.19a of the *Code of Federal Regulations.*" July 25 Order at 61,519. The Commission confirmed this approach in the December 19 Order. December 19 Order at 62,223.

Several witnesses have proposed mechanisms to implement this directive. Dr. Stern, for the California Parties, suggests that interest could be calculated:

> based on the total amount originally invoiced (without mitigation) from the date that the payment was due until the date that the customer made the payment. Interest on refunds would then be calculated from the date that payment was due on the unjust and unreasonable charge. The other way would be to calculate the interest on unpaid charges based on the amount that would have been due after applying the MMCP (the mitigated charges). Interest on refunds would then be calculated only where the seller had been paid its charges, with interest on the refund amount calculated from the date the seller received payment.

Exh. CAL-35 (Stern) at 10:19-11:9.

Dr. Tabors, on behalf of Powerex, takes the position that interest should be applied to the post-mitigation amounts owed and owing to each supplier using the ISO and PX preliminary invoice date as the point at which interest begins to accrue. Exh. PWX-53 (Tabors) at 16:2-17:1. Mr. Tranen, for the Generators, proposes to aggregate all pre-mitigation obligations by trade date, and then apply interest against the "full transaction" as if it had occurred on the trade date. Exh. GEN-89 (Tranen) at 23:6-14. Interest would then begin to accrue on pre-mitigation obligations beginning on the preliminary invoice date associated with each trade date. *Id.* at 26:5-13. With respect to refunds, Mr. Tranen also suggests using the preliminary invoice date as the date on which interest on refund obligations begins to accrue. *Id.* at 25:13-21. Mr. Tranen suggests combining the ISO and PX markets over the entire Refund Period for purposes of calculating interest. Exh. GEN-83 (Tranen) at 34:10-12.

The methodologies proposed by these and other witnesses appear to be consistent with the Commission's directive concerning the calculation of interest. The critical concern, however, from the ISO's perspective, is that any mechanism 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 129:3-6. This means that the amount of interest that will be paid or accrued to those parties owed money by the ISO market ("ISO creditors") must be equal to the amount of interest that is due and will be collected from those parties that owe money to the ISO market ("ISO debtors"). *Id.* at 129:6-9. The difficulty arises in applying the Commission's directive because the Commission, in the July 25 and December 19 Orders, did not provide for any adjustment where there is an imbalance between

receivables and payments in the ISO marketplace. Because such imbalances exist, applying the methodology for calculating interest set forth in the December 19 Order will not permit the ISO to remain cash-neutral. Therefore, the ISO respectfully suggests 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. This dilemma could be resolved by a ruling that ISO creditors are entitled to receive interest only to the extent that the ISO collects interest from defaulting participants, which is the approach that the Commission adopted in its June 3, 2002 order addressing the payment of interest by the ISO.[9] *Id.* at 130:15-22.

Another major uncertainty with respect to calculating interest on refunds and amounts unpaid is whether the ISO can levy interest on amounts owed by bankrupt parties (namely, PG&E and the PX), after their bankruptcy dates. It is possible that such an action would violate bankruptcy law. Exh. ISO-37 (Epstein) at 130:24-131:5; Exh. ISO-45 (Epstein) at 32:17-33:11. If the ISO was, in fact, prohibited from collecting interest from bankrupt entities, but was required to pay out interest to creditors associated with amounts owed by those entities, then the ISO would be unable to maintain its cash-neutrality. Neither the Commission's July 25 Order or its December 19 Order, or any of the mechanisms for calculating interest proposed by parties to this proceeding, suggests a resolution to this problem, and the ISO therefore respectfully suggests that the Commission address this issue.

Finally, Mr. Tranen's proposal to commingle the ISO and PX markets for purposes of determining interest is unlikely to be workable. The ISO and PX are separate legal entities, and the PX is currently in bankruptcy proceedings. Exh. ISO-

[9] *California Independent System Operator Corp.*, 99 FERC ¶ 61,253 (2002).

45 (Epstein) at 32:7-8. In those proceedings, the ISO and participants in the ISO markets have specific legal claims which might be compromised if the ISO and PX markets were combined. *Id.* at 32:8-10. This would also leave the ISO in a situation in which it would be unable to identify the amounts legally owed from and to its market participants because the distinction between ISO claims and PX claims would be lost. *Id.* at 32:11-12.

E. Should Bilateral Obligations That Look Through the ISO and PX Markets be Determined and, if so, How Should They be Determined?

- **Proposed Finding – If amounts owed and owing to parties are to be determined via bilateral obligations between parties, then that process must be done in a manner that substitutes those obligations for obligations vis-à-vis the ISO market.**

As Mr. Gerber explained in testimony, the ISO makes no attempt to match specific sellers of energy or other services in its markets to specific purchasers of those services from its markets. ISO-24 (Gerber) at 38:12-13. The ISO takes no position on whether bilateral obligations between individual suppliers and sellers that look through the ISO markets should be established. However, if the Presiding Judge and the Commission determine that such bilateral obligations should be established, then that process should completely substitute those bilateral obligations for obligations vis-à-vis the ISO markets. Because the ISO settlement and invoicing process operates more akin to a "swap meet," in which amounts owed and owing to market participants are accounted for on an aggregate basis, it would be impossible to establish bilateral obligations with respect to only certain parties and continue to express obligations for other parties in terms of the ISO marketplace. *See id.* at 21:9-22:3, 38:12-14.

F. What Are the Results of Properly Applying the Above Methodologies?

- **Proposed Finding - Due to changes in the mitigated Price and Other necessary changes, it is not presently possible to determine the results of the commission's required methodology for calculating refunds.**

Several parties have attempted some type of re-creation or simulation of the ISO's settlement rerun process in order to quantify, in their view, the level of refunds that are due from suppliers or amounts owing to suppliers after offsets. See, e.g., Exh. GEN-98 – GEN-104; Exh. PW72, PWX-73, PWX-77; Exh. SEL-46, SEL-47. While these numbers might be useful for some purposes, at this point in the proceeding, they are purely illustrative in nature. The fact that there exist necessary modifications to the MMCP, in and of itself, renders any "bottom line" calculations of refund liability and amounts owed and owing, including the ISO and PX settlements reruns, out-of-date. No party disputes this fact. Moreover, the ISO has conceded that certain discrepancies have occurred during the settlement rerun process, which it intends to correct in a future rerun that incorporates the findings of the Presiding Judge and decision by the Commission as to issues dealing with the MMCP as well as issues regarding the manner in which the MMCP is to be applied.

G. [Removed]

H. [Removed]

IV. WHAT COMPANY SPECIFIC POLICY ISSUES, NOT ADDRESSED ABOVE, AFFECT THE CALCULATION OF REFUNDS AND AMOUNTS OWING?

A. AES NewEnergy, Inc.

1. Did the ISO properly "zero out" $496,140.07 of charge type 401 on December 8, 2000?

- **Proposed Finding – The ISO did not properly account for this transaction in its settlement rerun, but will correct this error in any subsequent rerun.**

As Mr. Gerber explained in his rebuttal testimony, the ISO acknowledges that in attending to manual adjustments during the settlement rerun, the ISO did not properly account for this particular transaction, leading to the results described by AES. Exh. ISO-37 (Gerber) at 29:18-30:2. The ISO will correct this oversight in any subsequent rerun.

B. Automated Power Exchange, Inc.

Briefing on this issue has, pursuant to the procedural schedule adopted by the Presiding Judge, been deferred until a later date.

1. Should APX be liable for refunds in this proceeding, or should such refund calculation look through APX to its participants?

2. If this proceeding is to render findings concerning the APX participants, how should the refunds and amounts owed and owing for such participants be determined?

C. CERS

1. Should refunds associated with ISO charges satisfied by CERS be owed to CERS?

- **Proposed Finding – Refunds associated with ISO charges that were paid by CERS should be owed to CERS.**

As Mr. Gerber explained in his rebuttal testimony, the ISO supports the proposition that refunds for ISO charges satisfied by CERS are properly owing to CERS. Exh. ISO-37 (Gerber) at 38:3-5. However, the ISO has not made any attempt so far to consolidate the individual Scheduling Coordinators for which CERS paid amounts owed by those Scheduling Coordinators. *Id.* at 38:6-9. Additionally, the witness for CERS, Mr. Ostrover, suggested in his testimony that he may have only considered a subset of ISO charge types in his analysis. The ISO has not performed any analysis to determine whether Mr. Ostrover included all of the charge types affected by the ISO's settlement rerun. *Id.* at 38:14-18. For these reasons, the calculations performed by Mr. Ostrover are merely illustrative.

D. Dynegy

1. Are transactions under the 11-day bilateral contract between the ISO and Dynegy subject to mitigation?

The ISO has addressed this issue above, under Issue I.A.2.a.

2. Should the ISO have reversed the manual adjustments totaling $1.4 million in true up charges associated with certain Dynegy January 2001 transactions that were based on acknowledged, rather than actual, megawatthours?

- **Proposed Finding – The ISO did not properly account for this transaction in its settlement rerun, but will correct this error in any subsequent rerun.**

As Mr. Gerber explained in his rebuttal testimony, the ISO acknowledges that in attending to manual adjustments during the settlement rerun, the ISO did not

properly account for this particular transaction, leading to the results described by Dynegy. Exh. ISO-37 (Gerber) at 29:18-30:2. The ISO will correct this oversight in any subsequent rerun.

E. Midway Sunset Cogeneration

1. Should the PX have mitigated the transactions of Midway Sunset with Edison and PG&E pursuant to long-term contracts?

The ISO has taken no position and offered no testimony on this issue, and therefore, offers no argument concerning this issue at this time.

F. [Removed]

G. [Removed]

H. Salt River Project

1. Are the ISO and PX calculations of the amounts owed to SRP too low because the ISO and PX failed to reflect the full refund amounts due to SRP and the data provided by the ISO and PX are incomplete or in error?

The ISO addresses this issue under issue I.A.2.k.

2. What are the correct amounts owed to SRP?

- **Proposed Finding – As with all other SCs, the correct amounts owed to SRP will not be known until a final settlements rerun takes place using the Commission-approved MMCPs.**

As to the correct final amounts owed to SRP, the ISO takes no position at this time, because, as is the case with all other Scheduling Coordinators, the correct amounts will not be known until the final settlement rerun of the ISO and PX markets are undertaken using Commission-approved MMCPs. See Exh. ISO-37 (Gerber) at 125:5-7.

I. [Removed]

J. Southern California Edison Company

1. Has SCE fully satisfied its Refund Period invoices from the ISO and PX?

- **Proposed Finding – With respect to the ISO, SCE has fully satisfied its Refund Period invoices.**

As Mr. Epstein explained in his rebuttal testimony, SCE has fully satisfied its Refund Period invoices for transactions in the ISO's markets. Exh. ISO-37 (Epstein) at 119:1-4. This is reflected on Exhibit No. ISO-42.

K. City of Vernon

1. In its settlement reruns did the ISO err in mitigating Record Type D entries for Charge Type 0004 Replacement Reserve Capacity for Vernon for June 16, 17, and 18, 2001 while not mitigating Type A charges? If so, how should this be corrected?

- **Proposed Finding – The ISO did err in applying the MMCP to some Vernon items during the settlement rerun, including replacement reserves, but will correct this error in any subsequent rerun.**

As Mr. Gerber explained in his rebuttal testimony, the ISO acknowledges that in re-running its settlement system, it did err in applying the MMCP to certain Vernon transactions, including replacement reserves, as Vernon's witness has testified. Exh. ISO-37 (Gerber) at 29:12-16. The ISO will correct this oversight in any subsequent rerun.

L. Western Area Power Administration

1. Did the ISO fail to properly account for a settlement between the ISO and the Western Area Power Administration (for SCID WAMP) of an error in CT 401 on Western's (WAMP) December 2000 invoice?

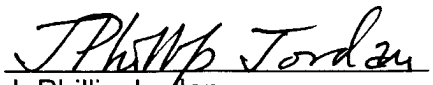
- **Proposed Finding – The ISO did not properly account for this transaction in its settlement rerun, but will correct this error in any subsequent rerun.**

As Mr. Gerber explained in his rebuttal testimony, the ISO acknowledges that in attending to manual adjustments during the settlement rerun, the ISO did not properly account for this particular transaction, leading to the results described by Western. Exh. ISO-37 (Gerber) at 29:18-30:2. The ISO will correct this oversight in any subsequent rerun.

V. CONCLUSION

For the reasons set forth above, the ISO respectfully requests that the Presiding Judge issue proposed findings of fact adopting the positions set forth herein.

Respectfully submitted,



J. Phillip Jordan
Michael Kunselman

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

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

Dated: October 4, 2002

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the restricted service list compiled by the Presiding Administrative Law Judge in this proceeding.

Dated at Washington, DC, this 4th day of October, 2002.

Michael Kunselman
(202) 295-8465