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October 25, 2002

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

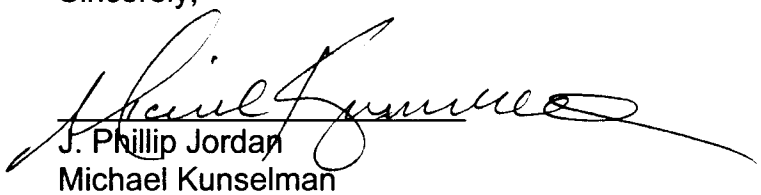
Re: *San Diego Gas & Electric Co., et al.*
Docket Nos. EL00-95-045, *et al.*

Dear Secretary Salas:

Enclosed for filing are one original and fourteen copies of the Reply 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 if you have any questions regarding this filing.

Sincerely,



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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**

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

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Dated: October 25, 2002

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

OTHER

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San Diego Gas & Electric Company,	)	
	)	
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REPLY 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 Reply 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. v. Sellers of Energy and Ancillary Services*, et al., 96 FERC ¶ 61,120, 61,520 (2001) ("July 25 Order"). Although this brief follows the format of the Joint Narrative Stipulation of Issues adopted by the Presiding Judge, for organizational

purposes, certain arguments are addressed under a heading different than the one under which the party at issue made the arguments.

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?

In their initial briefs, Turlock Irrigation District ("Turlock") and the City of Burbank ("Burbank") maintain that their own sets of pre-mitigation data should be used as the baseline for applying the Mitigated Market Clearing Prices ("MMCPs") to their sales to the ISO, rather than the ISO's own pre-mitigation settlements data, which they contend is incomplete or in error. Turlock Brief at 4-5; Burbank Brief at 4. The Presiding Judge should reject these arguments as inconsistent with the Commission's orders in this proceeding. In the July 25 Order, the Commission instructed the ISO to rerun *its* settlement and billing system and to provide those results to the parties to use in determining what refunds are due, and ultimately, who owes what to whom. July 25 Order at 61,519. There is absolutely no indication in any of its orders in this proceeding that the Commission intended that parties should have the ability to submit their own data sets for the ISO to use in determining refunds and amounts owed and owing. If the Presiding Judge were to adopt the findings of Turlock and Burbank it

would mean sifting through numerous sets of data submitted by parties in order to reach some determination as to which – the ISO's or another party's – was the more accurate. This "dueling data set" approach is clearly not what the Commission intended when it instructed the ISO to rerun its settlement and billing system. Moreover, as Mr. Epstein explained in his rebuttal testimony, the ISO already has a process for addressing settlement and billing disputes that arise during the standard settlement production process. Exh. ISO-37 (Epstein) at 112:5-8. It would be both inappropriate and impractical to allow parties such as Turlock and Burbank to burden the present proceeding with disputes that are appropriately raised, if at all, in other forums.

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

As to this issue, the ISO stands on the arguments presented in its initial brief.

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

Not surprisingly, the California Generators ("Generators") devote significant space in their initial brief to this issue. Many of the arguments made by the Generators are addressed in our initial brief, and we will not repeat what we have already said there. Several additional points, however, need to be made. First, the Presiding Judge should ignore the absurd argument that other parties, because they have not performed their own detailed analyses of the scope of potential mis-logging, "have no solid ground from which to rebut Mr.

Tranen's position," and have instead offered only "superficial criticisms" of his approach. Generator Brief at 4. It is true that the ISO and the California Parties, in particular, have not prepared a list of transactions that they believe to have been mis-logged. This is not remarkable, however, given the fact that it is the position of both parties that there should be no finding of mis-logging made pursuant to the May 15 Order. *See* ISO Brief at 7; Cal Parties Brief at 3. That being said, the Generators appear to be suggesting that the only legitimate criticisms of Mr. Tranen's mis-logging analysis are those that are quantitative in nature. The problem with this line of argument, of course, is that it assumes, erroneously, that the Presiding Judge has already made a finding of mis-logging.

In response to Mr. Gerber's explanation that no one (including the Generators) has shown that mis-logging, even if it occurred, would violate any of the provisions of the ISO *Tariff* (as opposed to its operating procedures), the Generators state that Mr. Gerber's position conflicts with the May 15 Order and other Commission precedent. We have addressed much of the Generators' argument on this point in our initial brief, but feel compelled to correct the record in one regard: the Generators contend that Mr. Gerber's criticism makes little sense because he has already conceded that "mis-logging" took place. Generators Brief at 6. This is simply not the case. In the portion of the transcript cited by the Generators to support this proposition, Mr. Gerber explains how the settlement system processed the results of the Project X review to ensure that suppliers were paid their entire price in instances when they had an above-cap bid that was called on. *See* Tr. at 3383:4-10, 3384:8-15. Nowhere in this extended colloquy cited by the Generators, however, did Mr. Gerber state that

mis-logging, as the Commission has defined it under the May 15 Order, took place. In fact, in response to a question from the Presiding Judge, Mr. Gerber explained that, in order to address the question of mis-logging, the Project X data should be scrutinized again and, instead of focusing on whether suppliers were paid their bid, as was done originally, the analysis should ask "what was the purpose of [each] bid" and seek to determine whether it should have been eligible to set the MCP. Tr. at 3386:18-25.

The Generators also address the criticism that Mr. Tranen failed to remove from his list of alleged mis-logged transactions those OOM transactions that preceded a bid in the BEEP stack from the same unit. In addressing this criticism, the Generators make much of the Commission's order rejecting the ISO's proposal to dispatch generators under its OOM authority when it determined that existing bids were non-competitive. *California Independent System Operator Corp.*, 90 FERC ¶ 61,006,61,011 (2000) ("January 7 Order"). Specifically, the Generators argue that the fact that the Commission concluded in that order that the ISO could not ignore existing bids that were physically able to satisfy the ISO's needs should be read to mean that the ISO cannot, in any circumstance, treat a transaction as OOM if that unit subsequently submits a bid into the BEEP Stack. Generator Brief at 9. The Generators suggest that this must be what the Commission intended, because otherwise, the Commission's decision in the January 7 Order would be undone, since the "ISO would have the unbridled authority to decide days in advance, or even right up to the start of the real-time market, to issue an OOM dispatch and preclude a unit from setting the market clearing price in the real-time market." *Id.* at 10.

The Generators are incorrect. What the Commission emphasized in the January 7 Order was that the ISO's OOM authority was limited to calling on generators in situations when there is a *physical* need for additional energy. January 7 Order at 61,011 (noting that the ISO's OOM authority "is 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"). Therefore, the scenario imagined by the Generators is not realistic, because the ISO can only dispatch generators Out-of-Market in advance of real time if it foresees a physical need for the energy in real time that will not be met in the real-time market. If this physical need exists, however, there is nothing in the January 7 Order that prohibits the ISO from dispatching units as OOM prior to real time, and then compensating those units as OOM as well.

The Generators also point out that the Project X review did not focus on the timing of a unit's bid, but instead, looked only to whether a particular unit had a bid in the BEEP stack. Generators Brief at 10. This proves nothing more than the fact that the Project X list of "GG transactions" is not equivalent to a list of mis-logged transactions for purposes of this proceeding. As the foregoing discussion, as well as the points raised in our initial brief, make clear, *neither* the Project X review nor the analysis performed by Mr. Tranen provides an accurate picture of how many, if any, mis-logged transactions exist. Again, as Mr. Gerber explained at the May 21st discovery conference, an analysis of potential mis-logging should focus on whether a bid was actually eligible to set the market clearing price during a particular interval, rather than whether a unit simply was

not paid as bid, as the Project X review did. Tr. at 3386:18-25.[1]

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?

The Competitive Supplier Group ("CSG"), the Generators, and Commission Trial Staff ("Staff") have addressed this issue in ways that merit response.[2] It helps, in understanding the heart of the ISO's concern on this point, to discuss the three briefs together.

To the extent CSG contends that the ISO should prepare a pre-mitigation database that corrects known errors, uses consistent sign conventions, and reflects results of resolved disputes, *see* CSG Brief at 9-13, the ISO agrees. The ISO shares the parties' desire to have as accurate and up-to-date a "snapshot" of the production database as possible before the next settlement rerun. In addition, the ISO has worked with the parties to provide a computer software "query" that would enable the parties to connect the "A" records in the database (the original transaction records) with the relevant "D" records (for adjustments based on resolved disputes, revised data, etc.). *See* Tr. at 3255:12-3257:7, 3258:21-3259:18. The ISO believes that this should meet CSG's desire for the ISO to "provide the means to link all 'A' records to their associated 'D' records." CSG Brief at 13.

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[1] For example, as discussed herein and in our initial brief, certain transactions might appear to have been mis-logged based on the Project X review and Mr. Tranen's analysis when, in fact, they were properly logged as OOM because there had been an OOM dispatch prior to the interval in which that unit delivered the energy. *See* ISO Brief at 13-14.

[2] The California Parties did not take a position on this issue in their initial brief.

CSG and the Generators, however, do not stop there. They contend that the ISO must provide a *new* database, a "single pre-mitigation database of complete transactions," Generator Brief at 14, in which all "A" and "D" records are *combined*, so that any party may "recreate all of the ISO's pre-mitigation calculations," *id.*, for all Scheduling Coordinators and all transactions. *See* CSG Brief at 12-14; Generators Brief at 13-14. There are at least four reasons the ISO should not be required to do so.

First, the parties have cited to nothing, and there is nothing in the Commission's orders that even suggests the ISO should be required to create this new database. The Commission required the ISO to rerun its settlements and billing process using the MMCPs and provide the results to the parties and the Presiding Judge. July 25 Order at 61,519. The Commission said nothing about the suppliers or any other parties being appointed to "re-create" any of the ISO's processes, or to oversee the ISO's rerun of the settlements process for the entire market, as CSG and the Generators wish to do. Nor did the Commission even hint that the ISO would be required to create new databases to enable any party to be able to do so. It is appropriate for parties to point out errors in the ISO's rerun, as they have done, and for the ISO to correct those in the final rerun; but there is no basis for parties to attempt to impose on the ISO an obligation to create a new database solely to enable those parties to "re-create" the ISO's calculations.

Second, creating the new database would be extremely costly for the ISO, take its personnel away from other important tasks (such as running the normal settlements and billing process), and delay the final rerun necessary to resolve

the issues in this proceeding. Given that the Commission never suggested that other parties were to "re-create" the ISO's calculations, there is no justification for such cost, disruption, or delay. Of course, the ISO is a non-profit corporation with no access to funds beyond its Grid Management Charge,[3] and there is no provision in the Grid Management Charge revenue requirement for the cost of creating such a database.

Third, creation of this new database is unnecessary to ensure that Scheduling Coordinators can determine whether they agree or disagree with the ISO's calculations. Each Scheduling Coordinator already is able to check its invoices from the ISO in the normal course of business without having access to such a database (or even to the separate databases of 'A' records and 'D' records provided to parties here), Tr. at 3252:13-23, 3255:17-3256:2, 3257:14-3258:14, and each Scheduling Coordinator can check the pre-mitigation production numbers and the rerun numbers in this proceeding without such a database, as well. The reason, of course, is that each Scheduling Coordinator *knows* the adjustments that the ISO makes to that Scheduling Coordinator's original transactions, and has its own information concerning the bases for those adjustments and thus knows whether it agrees or disagrees with the ISO. It is only because two parties, CSG and the Generators, wish to "check" the ISO with respect to the entire market by "re-creating" the ISO's calculations, that the issue of the new database has arisen. Such "re-creation" of the ISO's market-wide calculations is simply unnecessary to protect the interests of Scheduling

[3] *See* California Independent System Operator Corp., *et al.*, 99 FERC ¶ 65,001, 65,091, 65,194-195 (2001).

Coordinators.

Fourth, creation of such a database, combining 'A' records and 'D' records into complete transaction records, is not advisable because it would not even accomplish what the proponents claim. They contend it is required because parties have found errors with the ISO's databases to date. Generators Brief at 14; CSG Brief at 11-12. The suggestion is that creation of such a combined database would enable parties to "re-create" the ISO's calculations and thus, by implication, reduce the number of disputes over the ISO's calculations. But if the ISO is the one to produce the combined database, as the parties wish, why should one expect that the parties will accept the ISO's work in creating that database? It seems just as likely that the parties will desire a comprehensive review of the ISO's efforts in creating that database, thus turning this endeavor into just another source of disputes. In other words, all the expense, diversion of resources, and delay caused by the creation of the database would be worse than unnecessary – it would most likely simply result in additional disputes and even further delay.

If, despite all of the reasons given above for not creating the combined database, the Presiding Judge nevertheless concludes that such a database should be created, the ISO urges that Staff's suggestion be heeded. As Staff noted in its brief, and as Mr. Gerber testified, the ISO long ago put the consultants for CSG and the Generators in contact with a company that is fully conversant with the ISO's existing databases and that could – at those parties' expense – create the type of combined database they desire. Staff Brief at 8; Exh. ISO-37 (Gerber) at 16:10-17. Staff suggested that if such a database is to

be created, the parties should work together to do it. Staff Brief at 8-9. The ISO would agree that if the database is to be created, having that company do it under the combined direction of the ISO and consultants for CSG and the Generators, and at the expense of the parties who desire the database, is the most reasonable path to follow.

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?

In its initial brief, El Paso Merchant Energy ("EPME") contends that a number of sales that it made to the ISO during the Refund Period should be considered as non-spot, as that term is defined by the Commission, and therefore exempt from price mitigation in this proceeding. EPME Brief at 3. The Presiding Judge should reject EPME's claim.

The Commission has defined non-spot sales as "sales that are 24 hours or less and that are entered into the day of or day prior to delivery." *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, et al., 95 FERC ¶ 61,418 (2001) at 62,545 n.3 ("June 19 Order"). There is no dispute that sales of energy were made by EPME to the ISO during the Refund Period. The ultimate question, however, is that of timing – when does a "sale" occur pursuant to the Commission's definition of non-spot transactions? EPME argues that there was

one overarching contract, negotiated in advance of the 24 hour "window" for spot transactions, akin to "an output contract, where one party agrees to purchase the available output from a generating unit at a price based on other factors" Exh. EPME-4 (Revised) (Hicks) at 5:20-6:1. Contrary to EPME's argument, evidence in the record, contract law, and most significantly, the Commission's underlying rationale for excluding non-spot sales support a finding that contracts for sale of energy between the ISO and EPME were not consummated until closer to real-time, when employees for the ISO and EPME actually agreed on all of the essential terms of these sales.

EPME freely admits that no agreement was ever reached in advance as to the amounts of energy to be delivered, arrangements for scheduling or delivering that energy, or the price to be charged.[4] EPME Brief at 3-5. Moreover, there is no evidence in the record as to the duration of this so-called "output contract." Historically, if parties left open the essential terms of a contract such as quantity, price, and the term of the contract, without providing for any mechanism to determine those terms, such an agreement was likely to be found too indefinite for enforcement. *See* Arthur L. Corbin, Corbin on Contracts at § 95 (One Volume Ed. 1952). Section 2-204(3) of the Uniform Commercial Code is more liberal in this respect, but still provides that a contract can fail for indefiniteness if the parties did not intend to contract and there is no "reasonably certain basis for giving an appropriate remedy." As we pointed out in our initial brief, the

[4] EPME notes that the price was "dependent upon the price that it would be charged" by the third-party supplier from which EPME was obtaining the energy that it sold to the ISO. EMPE Brief at 3-4. In this respect, the series of transactions is no different than other commercial transactions in which a third-party purchases a commodity and re-sells it to an end user, and certainly does not suggest that the price charged to the ISO was set based on any agreed-to formula.

transcripts of conversations between operators for the ISO and EPME suggest that there was no intent on the part of the ISO to commit to purchasing, without any option to decline, whatever power that EPME made available. *See* ISO Brief at 28; Exh. CAL-101. Moreover, the fact that price, quantity, delivery, and duration were all left to be set in real time would make it especially difficult to calculate what an appropriate remedy might be if either party failed to perform. Instead, it is much more reasonable to find that the "contract" with respect to these sales was the agreement reached between the operators for the ISO and EPME as to the terms of each sale, near to or in real time.

Putting aside contract law, it is important not to lose sight of the purpose of this proceeding, and the reason why non-spot sales are exempted from refund liability. Ultimately, in order to give the best effect to the Commission's intentions and goals, these considerations should trump abstract arguments concerning output contracts and the like. In one of its earliest orders in this docket, the Commission made its seminal finding that the "electric market structure and market rules for wholesale sales of electric energy in California are seriously flawed and that these structures and rules, in conjunction with an imbalance of supply and demand in California, have caused, and continue to have the potential to cause, unjust and unreasonable rates for short-term energy . . . under certain conditions." San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services, et al., 93 FERC ¶ 61,121, 61,350 (2000) ("November 1 Order"). This finding became the foundation on which this entire proceeding has been based, including, most significantly, the subsequent finding that spot transactions in the ISO and PX markets would be subject to refund.

The Commission has not attempted in this proceeding to address the issue of the justness and reasonableness of transactions made outside the spot markets, and therefore, did not subject those transactions to refund. It is evident, however, from the foregoing language of the November 1 Order that the cardinal factor in determining whether a sale constituted a "spot" sale was the moment at which the price was determined. With respect to transactions for which the price is set in real time, it would do injustice to the Commission's findings – and its intent – to remove those transactions from mitigation even if those transactions could be characterized as part of a larger "output contract." This is the case because suppliers were just as free to charge unjust and unreasonable rates for these sales as they were with respect to sales which were arranged entirely in real time. Simply put, the fact that these sales might have been part of a "long-term" transaction has no bearing on the question of whether the prices for those sales – which were set within the 24-hour window for spot sales – were just and reasonable.

The prices for the sales made to the ISO from EPME were set less than 24 hours prior to delivery at levels entirely within the discretion of EPME. EPME's witness, Mr. Hicks, testified that the prices that EPME charged the ISO were based on what the third-party supplier charged EPME originally, the risk that EPME would not be paid for the energy sold, and the "then prevailing market prices." Exh. EPME-1 (Revised) (Hicks) at 10:17-22, 11:4-12; Exh. ISO-37 (McQuay) at 74:11-13. There was, however, no agreement between the ISO and EPME that prices for these sales would be based on a pre-determined formula or independent criteria. Instead, EPME was free to include whatever

mark-up it wished. Therefore, there was no check on EPME's ability to charge "unjust and unreasonable rates for short-term energy," and the Presiding Judge should therefore find that EPME's sales to the ISO during the Refund Period do not qualify as non-spot transactions.

c. [Removed]

d. [Removed]

e. [Removed]

f. [Removed]

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

In their initial brief, the California Parties contend that the ISO is violating the July 25 Order by accounting for energy exchange transactions using the methodology set forth in its energy exchange agreement with BPA, which was filed with the Commission. Cal Parties Brief at 20-21. The crux of the California Parties' rationale for this conclusion is their belief that the ISO's decision to account for energy exchange transactions in this manner is inconsistent with the ISO Tariff, and that the Commission did not approve any change to the ISO Tariff in its acceptance of the BPA energy exchange agreement. *Id.* at 20-21.

Because the California Parties are mistaken as to their underlying rationale, their argument must fail. The ISO Tariff does not mention energy exchange transactions specifically. Nevertheless, Section 2.3.5.1.5 of the ISO Tariff grants the ISO broad authority to enter into contracts with suppliers when necessary to secure the reliability of the ISO Controlled Grid. And, as we explained in our initial brief, the ISO Tariff also provides a mechanism for

collecting the costs of those contracts. *See* ISO Brief at 33-34. This mechanism is consistent with the methodology proposed in the BPA agreement. Therefore, the Presiding Judge should reject the California Parties' contention that the ISO seeks to account for exchange transactions in a manner that lacks Commission approval, and allow the ISO, in any future settlement rerun, to complete the process of allocating costs associated with these transactions in the manner set forth in the BPA exchange agreement.

h. [Removed]

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

In its initial brief, CSG contends that the ISO improperly "applied interval ceiling prices to each 10-minute interval of imported energy." CSG Brief at 16. CSG suggests that mitigating imports based on ceiling prices for intervals was improper because imported energy is an "hourly product," and therefore, should be mitigated on an hourly average basis, rather than on an interval basis. *Id.* at 17. CSG also argues that imports are hourly products because they cannot be scheduled for less than a single hour, that the ISO BITS dispatch and settlement system was unable to distinguish the amount of imported energy delivered on a 10-minute basis, and that ISO operating procedures expressly provide for paying OOM imports on an hourly basis. *Id.* at 17-18.

As we pointed out in our initial brief, however, it makes no difference, mathematically, whether prices for imports are mitigated using an interval or average mitigated price, because the average mitigated price is just the simple

average of the six interval prices. ISO Brief at 35. This is especially true with respect to import transactions sold outside of the ISO's formal markets (*i.e.* OOM imports), because the price for such transactions was set at a negotiated price, rather than by the clearing prices set in the ISO real-time markets during an hour. *Id.* at 36.

CSG, however, proposes an additional step that *does* lead to a different result with respect to imports sold through the ISO real-time markets. Specifically, CSG argues that the ISO should calculate refunds for these transactions by first taking the average of the *original prices* of the imports across each hour and then mitigating that amount with the average mitigated price. CSG Brief at 21; Exh. PWX-53 (Tabors) at 12:20-13:10. Such a step would be inconsistent with the way in which the ISO priced these transactions in its original settlements system. As Mr. Gerber explained both in his prepared testimony and during cross-examination, imports bid into the ISO's real-time market were settled and paid on a 10-minute interval basis during the refund period. Exh. ISO-37 (Gerber) at 24:12-16; Tr. at 4270:14-16.[5] Boiled down, CSG's argument is essentially that because imports are hourly products, they should not have been originally priced in the manner that they were. However, this argument has no weight in this proceeding, which is concerned with the ISO's rerunning of its settlement and billing system as that system existed and operated historically. It would be inconsistent with the Commission's July 25 Order for the ISO now to

[5] CSG notes that the ISO's Operating Procedure M-403 provides that OOM energy will be paid the Hourly Ex Post Price rather than the Ten-Minute BEEP Interval Ex Post Price. However, this does not help CSG's argument, because imported energy bid into the ISO's markets, by definition, not an OOM ("Out-of-Market") transaction. Imports that were bid into the ISO's formal market for real-time energy were paid the 10 minute interval prices.

assign a new historical price to import transactions in the manner proposed by CSG.

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?

In a jointly filed brief, Avista, IDACORP, and Portland General argue that sales of ancillary services capacity should not be mitigated in this proceeding because the MMCP "is a proxy energy price" that has "no relationship to payments made for capacity." Avista, IDACORP and Portland General Brief at 2-3. These parties ignore the fact that the Commission has made abundantly clear in its various orders in this docket that ancillary services capacity transactions are to be mitigated.

In the April 26 Order, the Commission adopted a "new price mitigation for sales in the California Independent System Operator's (ISO) *ancillary services* and imbalance energy markets (spot markets)." See June 19 Order at 62,545 (emphasis added). That price mitigation was extended in the June 19 Order to markets across the Western interconnection. Then, in the Chief Judge's July 12 Report and Recommendation to the Commission,[6] the Chief Judge stated that "[c]onsistent with the June 19th Order, ancillary service prices should be capped at the market clearing price established in the real-time imbalance energy market." July 12, Order at 65,040. 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 25 Order at 61,516. The Commission contemplated that ancillary services transactions would be mitigated. The Presiding Judge should therefore reject the arguments of Avista, IDACORP and Portland General on this issue.

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

In its initial brief, CSG argues that the ISO "erroneously included certain energy charges, and in particular charges related to OOM purchases, for collection through the neutrality charges during some part of the refund period" and that the ISO should not mitigate neutrality charges, but instead back out from the neutrality charge types those amounts relating to OOM purchases, and include them under charge types relating to energy. CSG Brief at 22. SRP, on the other hand, argues that neutrality adjustment charges must be mitigated because they "contain substantial energy charges that must be mitigated in this proceeding." SRP Brief at 6-7.

CSG's argument that the ISO should "back out" charges relating to OOM transactions from neutrality charges is misplaced. First, as we explained in our initial brief, neutrality adjustment charges were not directly "mitigated," in that the

[6] San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services, et al. 96 F.E.R.C. ¶63,007 (2001) ("July 12 Order").

ISO did not apply the mitigated price as a cap to reduce amounts collected through the neutrality charge. ISO Brief at 39-40. This was no error. Normally, the neutrality charge represents a balancing mechanism that the ISO uses to maintain revenue neutrality. Exh. ISO-24 (Gerber) at 11:8-14. When used for this purpose, it makes no sense to mitigate neutrality charges, because they are unrelated to sales of energy or ancillary services. Additionally, as Mr. Gerber pointed out, during the Refund Period, the ISO did *recover* the costs of OOM purchases through the neutrality Charge Type 1010. *Id.* at 12:3-12:9. The ISO did not, however, *pay* suppliers for these transactions through neutrality, but rather, *collected* amounts related to these transactions through neutrality. ISO Brief at 40. For this reason, the ISO did not, *per se*, mitigate neutrality charges, but instead, mitigated the Charge Types associated with the payments to suppliers for these transactions. *Id.* There is no need to "back out" any amounts from neutrality charges, and CSG's proposal to do so amounts to an attack on the manner in which the ISO originally settled and billed these sales, which is not at issue in this proceeding. The Presiding Judge should, for these reasons, find that the ISO appropriately handled neutrality charges consistent with the Commission's direction to rerun its settlement and billing system as it existed historically.

I. [Removed]

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

The Generators, in their initial brief, contend that the ISO, by re-allocating charges from Charge Type 401 to Charge Type 481, "reprogrammed its settlement system during its refund calculations in a way that shifts among purchasers payments associated with these non-mitigated transactions." Generator Brief at 19-20. The Generators contend that in doing so, the ISO has "disregard[ed] its pre-existing settlement procedures during this proceeding without even bothering to justify its departure." *Id.* at 21. Finally, the Generators argue that this re-allocation is inconsistent with the Commission's decision in the May 15 Order that the MMCP was to act as a cap rather than a new clearing price. *Id.*

The Generators' argument that the ISO "re-programmed" and "disregarded" its original settlements system in re-allocating amounts between Charge Types 401 and 481 is simply untrue. Instead, as Mr. Gerber explained, the re-allocation between Charge Types 401 and 481 relating to non-mitigated transactions was an unintended consequence that came about because of the different treatment of transactions, *i.e.* some being mitigated and others not. Exh. ISO-37 (Gerber) at 22:4-7. In rerunning its settlement system, the ISO simply set the *breakpoint* price at the lower of the MMCP or the historical MCP, consistent with the May 15 Order, and it is this *breakpoint* price, in both the original and rerun settlements schemes, that determines the allocation between Charge Types 401 and 481. *See* ISO Brief at 42. Because the MMCP operates as a hard cap with respect to mitigated transactions, there is no further need, in

the rerun process, to re-allocate additional amounts associated with those transactions to Charge Type 481 (although whenever the historical MCP is lower than the MMCP, the amount charged under Charge Type 481 is reduced by the operation of the MCP as a hard cap).[7] However, with respect to transactions that are not mitigated, and for which the price exceeds the MMCP, the *global* replacement of the breakpoint in the settlement rerun resulted in a re-distribution of amounts from Charge Type 401 to Charge Type 481. Therefore, the ISO did not "disregard" its original settlements system in arriving at these results.

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

In their initial brief, the California Parties argue, consistent with Dr. Berry's testimony, that the ISO should, in rerunning Charge Type 485 penalties, "consider every price to every entity from which the ISO purchased energy during each hour of the Refund Period, including prices paid for long-term purchases and all other unmitigated purchases." Cal Parties Brief at 26. Specifically, the California Parties point to non-spot transactions and sales made pursuant to

[7] For example, assume that the historical clearing price during a particular interval was $150 (the soft cap breakpoint) and the MMCP is $200. A transaction subject to mitigation was historically paid $300. Originally, $150 would have been allocated to Charge Type 401, while the $150 "above cap" amount would have been allocated to Charge Type 481. That transaction will now be paid, consistent with the May 15 Order, the lower of its bid or the MMCP price, or $200. Because the "breakpoint" is still $150 (i.e. the lower of the historical MCP or the MMCP), $150 will still be collected through Charge Type 401, while only $50 will be collected through Charge Type 481. Next, assume that the historical clearing price was $150 under the soft cap, and the MMCP is $80. In this case, the new breakpoint becomes $80 and no amounts would be collected through Charge Type 481 for any mitigated transactions. However, because $80 is the new

Section 202(c) of the Federal Power Act as transactions that should be counted in the calculation of Charge Type 485 penalty amounts. *Id.* at 27. The Generators, however, argue that including certain non-mitigated transactions (specifically, CERS purchases and Section 202(c) transactions) in the calculation of Charge Type 485 penalties would contradict the Commission's orders in this proceeding. Generator Brief at 22-24. The Generators also suggest that including Section 202(c) transactions in the calculation of Charge Type 485 penalties might violate the ISO Tariff provisions governing those penalties.

The Generators' contention that unmitigated transactions should be excluded from the calculation of Charge Type 485 penalties demonstrates a misunderstanding on their part of the very reason that those penalties are imposed. Charge Type 485 penalties are premised on the notion that the failure of a generator to perform during an emergency situation requires the ISO to purchase additional energy in real time under tight supply conditions. When all is said and done, energy purchased for the purpose of meeting real-time load requirements is charged to load regardless of whether that energy purchase is mitigated or not. Purchases arranged by CERS or any other Scheduling Coordinator are allocated to real-time loads and are not designated for any particular load, *see* Exh. ISO-24 (Gerber) at 9:4-10:8, 21:10-19, and as such, it is logical that all costs of covering real-time load be included in calculating Charge Type 485 penalties.

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breakpoint price, amounts over $80 with respect to non-mitigated transactions will be allocated to Charge Type 481.

The Generators' arguments that including Section 202(c) transactions specifically in the calculation of Charge Type 485 penalties would violate the Commission's orders or the ISO's Tariff is also without merit. The fact that the Commission excluded Section 202(c) transactions from mitigation in this proceeding does not, as the Generators claim, mean that those transactions should not be factored into Charge Type 485 penalty calculations. It is an undisputed fact that Section 202(c) transactions constitute purchases of energy made by the ISO. Therefore, there is no reason, under the ISO Tariff provisions for Charge Type 485 penalties, to exclude them. In fact, such a result would be inconsistent with the Commission's July 25 Order, since the Commission directed the ISO to rerun its settlement and billing process, and that process is governed by the ISO Tariff. Therefore, a finding that Section 202(c) transactions should not be factored into the Charge Type 485 penalty calculation is tantamount to a finding that the ISO should make a specific exception from its Tariff. The Commission has made no suggestion that such a change is necessary or appropriate. Therefore, the Presiding Judge should find that Section 202(c) transactions should be included in any re-calculation of Charge Type 485 penalties.

The Generators' argument that including Section 202(c) transactions in Charge Type 485 re-calculations is inappropriate under the ISO Tariff is even less convincing. True, the ISO was able to make certain purchases by virtue of the fact that the Secretary of Energy issued orders under Section 202(c) which permitted the ISO to compel suppliers to make energy available. There is nothing, however, about these transactions that distinguishes them from the

broad category of energy purchases made by the ISO. Moreover, payment for these transactions was handled through the ISO's normal settlement and billing system in the identical manner as other OOM purchases. [8]

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

In its initial brief, Turlock contends that the ISO did not properly account for manual adjustments related to Turlock's sales to the ISO during the Refund Period, and therefore, the Presiding Judge should rely on Turlock's data in determining amounts owed and owing to Turlock. Turlock Brief at 7. Moreover, Turlock argues that if the ISO's data is used, the ISO should be required to "provide a corrected pre-mitigation transaction database and rerun its settlements to account for all Manual Adjustments." *Id.* To support these proposed findings, Turlock points to Mr. Gerber's acknowledgement that the ISO failed to re-introduce certain manual adjustments during the settlement rerun. *Id.* at 8.

Turlock, however, completely misunderstands the point made by Mr. Gerber. Mr. Gerber's testimony addressed an error that occurred with respect to the rerunning of the ISO's settlement system for this proceeding, not its calculation of pre-mitigation amounts. As he explained in his rebuttal testimony, during the *settlement rerun process*, after reversing out manual adjustments relating to amounts paid above the historical MCP, the ISO sometimes failed to

8 Additionally, the California Parties are correct that non-spot transactions should also be included in the calculation of Charge Type 485 penalties. They reflect purchases of energy by the ISO, and no party has offered any reason for not including them.

add back in an amount above the historical MCP but below the MMCP. Exh. ISO-37 (Gerber) at 21:3-8; *see also* ISO Brief at 44-45. Mr. Gerber also acknowledged that this error affected certain Turlock transactions. The ISO would concur that it should correct this oversight in any subsequent rerun with respect to all Market Participants, including Turlock.

It does not follow, however, that the ISO's data with respect to Turlock's *pre-mitigation* obligations is in any way inaccurate. In fact, Mr. Epstein responded to the contentions of Turlock's witness, among others, who challenged the ISO's pre-mitigation figures without alleging any particular flaws in the ISO's process for calculating those pre-mitigation amounts. Mr. Epstein explained that the ISO determined these amounts in accordance with the ISO Tariff, and that any alleged discrepancies relating to pre-mitigation amounts owed are simply outside the scope of the current proceeding. Exh. ISO-37 (Epstein) at 111:1-112:8. For these reasons, the Presiding Judge should reject Turlock's proposed findings 3 and 4.[9]

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

As to this issue, the ISO stands on the arguments presented in its initial brief.

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

Several parties, in their initial briefs, make the non-controversial point that the MMCPs used by the ISO in the rerun will need to be updated to reflect, for

9 See also supra Section I.A.1.

instance, the requirement in the December 19 Order that the MMCP be set based on the highest cost unit in each interval, as well to take into account agreements reached between the parties earlier in this proceeding with respect to the MMCP methodology. *See, e.g.*, CSG Brief at 25; LADWP Brief at 9-10. Additionally, CSG argues that the ISO made various "miscellaneous errors" in its settlement rerun. CSG Brief at 28. Specifically, CSG contends that "the ISO made errors respecting quantity in its settlement reruns for Puget for the months of October, November, and December 2000," the result of which would be to increase payments to Puget. *Id.* CSG, however, provides no documentation or evidence to substantiate these alleged quantity errors. CSG's argument appears to go to the accuracy of the underlying pre-mitigation data rather than whether the ISO correctly implemented the rerun with respect to these transactions. As we have explained numerous times, disputes relating to pre-mitigation data are simply beyond the scope of this proceeding.

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

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 same 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?

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?

As to this issue, the ISO stands on the arguments presented in its initial brief.

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

In its initial brief, the City of Seattle proposes a finding that "[a]mounts owed by the ISO to the City of Seattle should not be calculated based on unverifiable offsets the ISO applied without notice or documentation to the City of Seattle." Seattle Brief at 3. Interestingly, several pages later, Seattle states that it "accepts the ISO's calculation" as to its historical cash position with respect to the ISO markets. *Id.* at 5. The testimony that Seattle cites in support of this finding suggests that what is really at issue is that Seattle finds the ISO's accounting system difficult to understand and, as a result, has had problems verifying the ISO's figures as to what Seattle is owed on a pre-mitigation basis. *See* Exh. SCL-7 (Stone) at 2:10-4:21. As Mr. Epstein explained in his rebuttal testimony, the ISO calculated amounts owed to parties based on the procedures set forth in the ISO Tariff. Exh. ISO-37 (Epstein) at 111:10-13. If Seattle finds those procedures confusing, it should raise that issue outside of this case. It would be improper to attempt to modify the ISO's underlying settlement and billing process, or its historical results, through this proceeding, and, in any event, Seattle has articulated no good reason for doing so.

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?

SRP, in its initial brief, suggests that the cash positions of parties should not be updated to reflect changes after the Refund Period, and that the ISO's most recent statement of cash positions, as reflected in Exhibit No. ISO-42, "does not conform to the Commission's directions." SRP Brief at 23 ("When cash positions from long after the end of the refund period are used, this important distinction is blurred, resulting in a substantial risk of cost shifting."). It is entirely illogical, as well as inequitable, however, to use cash positions as they stood during the Refund Period in determining amounts owed and owing. To do so would entirely ignore amounts paid by Market Participants since the end of the Refund Period (some of which amounts were for transactions that occurred during the Refund Period). For example, assume that at the conclusion of the Refund Period, a specific Market Participant owed the ISO markets $5 million for transactions that took place during the Refund Period. Subsequently, that Market Participant paid those amounts to the ISO, and the ISO, in turn, paid suppliers. It would clearly be inequitable to calculate amounts owed by and owing to that participant, after taking into account refunds, based on that participant still owing this $5 million. Moreover, there is nothing in the Commission's orders that suggests that this should be the result. It is even difficult to believe that this is the result that SRP actually intended. Nevertheless, the Presiding Judge should not adopt a finding that the calculation of the cash positions of parties should be limited to amounts received during the Refund Period.

D. How Should Interest be Calculated and Applied?

In addressing this issue in its initial brief, CSG maintains that the Presiding Judge should certify the "full amounts of interest owed parties . . . without reduction for 'revenue neutrality' concerns for alleged cash shortfall positions that some parties have speculated may occur in some markets." CSG Brief at 54. CSG states that the ISO "has suggested . . . that its creditors may not receive all of the interest they are due under the Commission's orders, but rather may be limited to receiving only those amounts 'collected by the CAISO from defaulting parties' or from 'SC debtors' so that the ISO remains [a] 'cash-neutral entity.'" *Id.* CSG claims that this argument is not supported by the Commission's orders. *Id.* CSG, however, completely mischaracterizes the ISO's testimony on this issue. Mr. Epstein did not propose that the ISO would unilaterally limit the amount of interest paid to Market Participants pursuant to the Commission's orders. Rather, he pointed out that the overriding concern of the ISO was to remain cash neutral, but expressed concern that the methodology established in the Commission's orders would violate the ISO's cash neutrality. Exh. ISO-37 (Epstein) at 130:5-23. For this reason, the ISO, in its initial brief, requested that the Presiding Judge bring this issue to the Commission's attention. ISO Brief at 55-56. CSG, however, appears not to understand – or not to accept – a basic and overriding fact of the ISO's operation: as a non-profit, cash-neutral entity, the ISO can only pay out that money which it collects from its Market Participants. If a methodology is adopted that requires the ISO to pay out as interest amounts greater than the amounts it collects, that additional amount will

have to be *collected from Market Participants* in some manner – the ISO cannot simply absorb that cost.

In any event, CSG is well ahead of the present state of this proceeding to suggest that the Presiding Judge certify actual interest amounts to the Commission, given the fact that there is no final set of obligations between suppliers and purchasers to use in calculating interest amounts.

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

As to this issue, the ISO stands on the arguments presented in its initial brief.

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

As to this issue, the ISO stands on the arguments presented in its initial brief.

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?

As to this issue, the ISO stands on the arguments presented in its initial brief.

B. Automated Power Exchange, Inc.

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

As to this issue, the ISO stands on the arguments presented in its initial brief.

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?

As to this issue, the ISO stands on the arguments presented in its initial brief.

D. Dynegy

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

As to this issue, the ISO stands on the arguments presented in its initial brief.

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, megawatt hours?

As to this issue, the ISO stands on the arguments presented in its initial brief.

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?

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?

As to this issue, the ISO stands on the arguments presented in its initial brief.

2. What are the correct amounts owed to SRP?

As to this issue, the ISO stands on the arguments presented in its initial brief.

I. [Removed]

J. Southern California Edison Company

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

As to this issue, the ISO stands on the arguments presented in its initial brief.

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?

As to this issue, the ISO stands on the arguments presented in its initial brief.

L. Western Area Power Administration

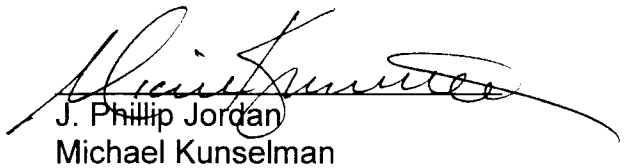
1. Did the ISO fail to properly account for a settlement between the ISO and the Western Area Power Administration (for SCID WAMP) of an error in CT 401 on Western's (WAMP) December 2000 invoice?

As to this issue, the ISO stands on the arguments presented in its initial brief.

V. CONCLUSION

For the reasons set forth above, the ISO respectfully requests that the Presiding Judge issue proposed findings of fact consistent with the positions set forth herein and in the ISO's initial brief.

Respectfully submitted,



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Dated: October 25, 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 25th day of October, 2002.

Michael Kunselman
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