UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	)))	Docket No. ER98-211-000
California Power Exchange Corporation	)))	Docket Nos. ER98-210-000 and ER98-1729-000
Southern California Edison Company	))	Docket No. ER98-462-000
Pacific Gas and Electric Company	))	Docket Nos. ER98-556-000 and ER98-557-000

CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION'S OFFER OF SETTLEMENT TO EXTEND THE TERMS OF THE EXISTING GMC SETTLEMENT

To: The Commission

Pursuant to Rule 602 of the Federal Energy Regulatory Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.602 (1998), the California Independent System Operator Corporation (ISO), hereby submits its Offer of Settlement to Extend the Terms of the Existing GMC Settlement (Offer of Settlement). The existing GMC settlement was filed on April 7, 1998 and approved by the Commission on June 1, 1998 (April 7, 1998 Settlement). A copy of the April 7, 1998 Settlement is included in Attachment 1 hereto. With the present filing, the ISO, in accordance with the consensus of the unbundling working group, proposes to extend the terms of the April 7, 1998 Settlement for six months to allow the ISO to further study the unbundling of the Grid Management Charge (GMC). In support of this Offer of Settlement, the ISO states as follows:

BACKGROUND

Procedural History

1. On October 17, 1997, the ISO filed with FERC for approval of the GMC, pursuant to Section 205 of the Federal Power Act and Section 35.13 of the Commission's

regulations, 18 C.F.R. § 35.13 (1998). The October 17, 1997 rate filing was designated by the Commission as Docket No. ER98-211-000. On December 17, 1997, the Commission set the ISO's October 17, 1997 rate filing for hearing. *California Independent System Operator Corporation*, 81 FERC ¶ 61,321 (1997).

2. On October 31, 1997, Southern California Edison Company (SoCal Edison) made a filing in Docket No. ER98-462-000 to pass through to its wholesale customers SoCal Edison's share of the ISO's GMC charge and the PX's full requirements volumetric Administrative Charge. On October 31, 1997, Pacific Gas and Electric Company (PG&E) filed a proposed formula rate in Docket No. ER98-556-000 to recover from certain existing customers a portion of the GMC. In Docket No. ER98-557-000, PG&E filed a proposed formula rate to recover a portion of the PX Administrative Charge from existing wholesale customers. The SoCal Edison and PG&E filings were also set for hearing on December 17, 1997. 81 FERC ¶ 61,321. The California Power Exchange's (PX's) Administration Charge proceeding (Docket No. ER98-210-000) was filed on October 17, 1997 and set for hearing on December 17, 1997. 81 FERC ¶ 61,321. The PX filing was amended on January 31, 1998, designated as Docket No. ER98-1729-000, and consolidated with the Docket No. ER98-210-000 proceedings.

3. On April 7, 1998, after extensive negotiations with stakeholders, the ISO filed a comprehensive settlement offer, which fully resolved the issues in Docket Nos. ER98-211-000 and ER98-462-000 and partially resolved the issues in Docket Nos. ER98-210-000, ER98-1729-000, ER98-556-000 and ER98-557-000. The April 7, 1998 Settlement offer was not opposed by any party. On April 8, 1998, the Chief Judge consolidated the proceedings for

purposes of settlement. The Commission approved the Settlement on June 1, 1998. A copy of the letter order approving the settlement is included in Attachment 2.

Summary of the April 7, 1998 Settlement

4. In the April 7, 1998 Settlement, the parties agreed that for 1998 the GMC would be calculated as follows:

$$\text{GMC} = \frac{\text{Revenue Requirement of \$152,710,000}}{\text{Total Transmission Volume of 195,000,000 MWh}} = \$0.7831/\text{MWh}$$

The parties also agreed to the reasonableness of three provisions in the GMC formula and consented to their inclusion so long as these provisions are required by the ISO financing covenants and their duration does not extend beyond the tenth anniversary of the ISO's initial debt financing (April 7, 1998 Settlement, ¶ 7). The three provisions include a 25 percent debt coverage requirement; a 15 percent reserve requirement; and an initial debt financing (to cover start up and development costs, cash working capital, and 1998 and 1999 budgeted capital expenditures) set at a maximum level of $310,000,000.

5. The April 7, 1998 Settlement also provides that entities receiving energy under "Existing Contract" rights will be assessed the GMC rate on 50 percent of their metered consumption for 1998 (April 7, 1998 Settlement, ¶ 22). During 1998, the ISO will bill the GMC for entities receiving energy under Existing Contracts and for certain QFs serving on a "net" basis (April 7, 1998 Settlement, ¶ 23). The ISO also agreed that in 1998, the ISO will not assess any "Specified Charges," including a Grid Operations Charge, charges for Black Start, Voltage Support, or Unaccounted For Energy, or a GMC for any transmission service that does not use any part of the ISO Controlled Grid (April 7, 1998 Settlement, ¶ 24).

6. The ISO agreed to make an informational filing at FERC on December 15 of each year, containing cost data on the ISO's operations and any additional information relied

upon to set the GMC unit rate for the following year (April 7, 1998 Settlement, ¶ 16). The ISO agreed to prepare a preliminary annual budget forecast each fall for the following year and to hold a budget workshop open to all interested parties.

7. The ISO agreed to act as a facilitator for the performance of an unbundling study to identify what, if any, of the ISO's functions should be separately priced (April 7, 1998 Settlement, ¶ 19). A stakeholder steering committee was created to (1) assist in the selection of a consultant to conduct the study; (2) receive periodic progress reports from the consultant; and (3) review the study and provide advice on what should be presented to the ISO Board (April 7, 1998 Settlement, ¶ 19).

8. According to the April 7, 1998 Settlement, if approved by the ISO Governing Board, the ISO will file with FERC under Section 205 to implement new GMC rates (proposed to be effective January 1, 1999) based on the results of the unbundling study (April 7, 1998 Settlement, ¶ 20). The parties reserved the right to challenge any rate based on an unbundling study (except to the extent that certain provisions of the ISO formula rate as indicated in Paragraph 7 of the April 7, 1998 Settlement are not subject to future challenge). The Settlement further provides that if the ISO Board does not approve an unbundled rate, the ISO will nevertheless make a new rate filing to be effective January 1, 1999 (April 7, 1998 Settlement, ¶ 20).

The Unbundling Study Stakeholder Process

9. After a competitive bidding process, the ISO retained R.J. Rudden Associates, Inc. (Rudden) to conduct an independent study to analyze whether the GMC can be unbundled and, if so, how it should be unbundled. As part of its study, Rudden attempted to define the specific services the ISO provides and analyze the detailed costs within the ISO's

budget to provide those services. Rudden also analyzed methods for allocating costs among services and/or user groups. During the study process, Rudden received input from many stakeholder groups and attempted to develop pricing structures that responded to the stakeholders' concerns. Rudden issued its preliminary unbundling report on June 19, 1998. Following an open meeting of interested parties in July 9, 1998 to discuss the preliminary report, Rudden conducted further inquiries and issued a revised unbundling report on August 17, 1998.

10. Because the ISO did not begin operating until April 1, 1998, Rudden had limited data on which to base its recommendations. Rudden was faced with a lack of documentation on cost causation and customer usage patterns, an evolving operating environment, and a lack of experience with allocating the specific costs incurred by the ISO. The GMC unbundling working group met on several occasions and conducted several teleconferences to discuss the unbundling issues. The unbundling working group reached a consensus that the unbundling process needed more time and that the GMC filing (to be effective January 1, 1999) as required by the April 7, 1998 Settlement should be postponed.

11. On August 31, 1998, the ISO sent a letter to stakeholders, inquiring whether they would support an extension of the April 7, 1998 Settlement, so that the GMC filing required by the April 7, 1998 Settlement, could be postponed until more data could be collected and the unbundling issues studied further. As stated in the letter, the extension would advance two objectives previously identified by the stakeholder groups. The extension will 1) allow the consultant to analyze actual operations data over an additional six-month period and modify or refine the proposed cost assignment and allocation methodology, and 2) provide the opportunity for additional stakeholder input to increase the possibility for

developing a consensus approach to the unbundling. The large majority of stakeholders indicated that they either support or do not oppose the extension of the GMC Settlement for six months to allow further study of the unbundling issues. To continue stakeholder participation in the unbundling process, the ISO sent a memorandum (dated September 11, 1998) to all parties outlining a proposed schedule for obtaining stakeholder input on the outstanding unbundling issues during the GMC extension period.

TERMS OF THE PRESENT OFFER OF SETTLEMENT

The ISO files this Offer of Settlement for the purpose of extending the terms of the April 7, 1998 Settlement, as follows:

12. The GMC calculation provisions of the April 7, 1998 Settlement will be extended for six months to allow time to further study the unbundling of the GMC. Specifically, the GMC formula and assessment provisions from the April 7, 1998 Settlement will be carried forward until July 1, 1999. The ISO will make an informational filing on December 15, 1998, to incorporate the ISO's 1999 revenue requirement and transmission volumes in the GMC formula to be effective on January 1, 1999. The 1999 revenue requirement and transmission volume calculation will be made in accordance with Paragraphs 12 through 17 of the April 7, 1998 Settlement.

13. The ISO agrees to make a new GMC filing with rates to be effective on July 1, 1999. The filing will be consistent with the GMC rate methodology that will be adopted by the ISO Board of Governors. The new GMC filing will contain the same formulary provisions adopted in Paragraph 7 of the April 7, 1998 Settlement (the 25% debt coverage, 15% reserve requirement and $310,000,000 initial debt amount).

14. This Offer of Settlement does not change the provisions in Paragraph 25 of the April 7, 1998 Settlement regarding the ongoing proceedings in Docket Nos. ER98-556-000, ER98-557-000, ER98-210-000 and ER98-1729-000.

15. The provisions in Paragraphs 27 through 31 of the April 7, 1998 Settlement will also remain unchanged, except to the extent that beginning on January 1, 1999, the rate level referenced in Paragraph 29 will be determined based on the ISO's 1999 revenue requirement and transmission volumes as approved by the ISO Board of Governors.

General Conditions

16. Agreeing to this Offer of Settlement shall not be deemed in any respect to constitute an admission by any party hereto that any allegation or contention made by any other party in these proceedings is true or valid. No signatory, participant or affiliate of any of the settling parties shall be deemed to have approved, accepted, agreed to, or consented to any fact, concept, theory, rate methodology, principle or method relating to jurisdiction, prudence, reasonable cost of service, cost classification, cost allocation, rate design, tariff provisions, or other matters underlying or purported to underlie any of the resolution of the issues provided herein. The Commission's approval of the Settlement shall not constitute approval of, or precedent regarding, any principle or issue in this proceeding and shall not relieve the Commission or any signatory, participant, or affiliate thereof, of the burden, under Sections 205 or 206 of the Federal Power Act, to establish the justness and reasonableness of any aspect of any superseding rate. Nothing herein shall affect any party's rights under existing contracts.

17. This Offer of Settlement is submitted on the further condition that, in the event the Commission does not by order accept it in its entirety, this Offer of Settlement shall be

deemed withdrawn and, upon such withdrawal, it shall not constitute any part of the record in this proceeding or be used for any other purpose. If, however, the ISO and one or more of the Parties specifically agree, in writing, to all modifications ordered by the Commission, then the Settlement shall become effective as to those parties accepting such modifications.

18. The discussions among the Parties that have produced this Offer of Settlement have been conducted on the explicit understanding, pursuant to Rule 602(e) of the Commission's Rules of Practice and Procedures, that all offers of settlement and any comments on these offers are privileged and not admissible as evidence against any participant who objects to their admission and that any discussion of the parties with respect to offers of settlement is not subject to discovery or admissible in evidence. No signatory, participant, or affiliate thereof shall cite, summarize, utilize, or rely upon this Settlement, or the terms thereof, in any case, proceeding or rulemaking before this Commission or any other commission, regulatory authority, court, arbitrator, or alternative resolution dispute officer, to assert or infer that this Settlement, or the terms thereof, has any precedential effect on the issues resolved herein or any other substantive matter.

19. This Offer of Settlement shall become effective when an order of the Commission approving the settlement, without modification, or with modifications that are agreed to as provided in Paragraph 28, becomes final and nonappealable under the terms of the Federal Power Act.

20. If any date specified in this agreement falls on a weekend or holiday, the next business day will be the applicable date.

Respectfully submitted,

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Dated: October 28, 1998