OFFER OF SETTLEMENT

Guiding Principles

I. Protection of Consumers from the Exercise of Market Power

There is evidence that at times of supply insufficiency, California's electricity markets are not workably competitive. As a consequence, load-serving entities, and in one case its consumers, have been subjected to unacceptably high prices. To provide consumers with protection from the exercise of market power, while providing supply with the incentive both to enter California's markets and to forward contract with load-serving entities on terms that are fair to both, it is proposed that:

(a) the payment price cap that applies in the markets administered by the ISO be reduced to $100/Mwhr;

(b) that resources bidding into those markets be paid the market clearing price ("MCP"), but not in excess of $100/Mwhr. Bids submitted in excess of the $100/Mwhr payment cap would be rejected, unless they were submitted by an "exempt" entity, in which case the bidder would be paid the MCP not in excess of any prevailing damage-control cap (currently set at $250/Mwhr);

(c) the Owner of a supply resource or supply portfolio (including commitments for demand reductions) could receive partial or complete exemption from the $100/Mwhr payment price limitation:

(1) if it demonstrates that the $100/Mwhr price is insufficient to recover a unit's avoided operating costs (the costs that would not be incurred if the unit did not operate) and make a contribution to fixed cost recovery. In that event, the unit would be paid a price sufficient to recover those costs and to make that contribution, but that price will neither establish the MCP paid to the Owner for other resources within its portfolio nor the MCP paid to others;

(2) for generation that is powered by renewable resources (e.g., wind, solar);

(3) for a generation resource of 50 MW or less, providing that the Owner or operator of such resource neither owns nor operates a generating unit with a nameplate capacity in excess of 50 MW;

(4) for incremental supply resources, either additions to existing units or the development of new units, located within the State of California;

(5) for the remainder of a supply portfolio, if it is demonstrated that at least 70% of the portfolio is contractually committed to load-serving entities within California for a term extending at least through October 15, 2002; and

(6) for imports from out-of-State resources but only to the extent that the imports exceed exports made by the Owner of the supply or by any directly- or indirectly-affiliated entity.

(d) demand-side programs would not be subject to any payment cap, but could be compensated at a price that is acceptable to the Governing Board.

II. Forward Contracting by Load

It is a common attribute of commodity markets that those who must have access to supply – and therefore have requirements that are relatively inelastic – will hedge against exposure to spot price volatility by forward contracting for a significant portion of their requirements. The load-serving entities in California must be empowered to achieve this customary level of price protection and they must in fact exercise that authority. Therefore, it is proposed:

(a) that load-serving entities commit to forward contracting for no less than 85% of their anticipated requirements, at least through October 15, 2002. In calculating satisfaction of this commitment, load-serving entities would include capacity that they currently own; and

(b) that the California Public Utilities Commission empower the Utility Distribution Companies to forward contract at least to that extent.

III. Forward Scheduling For Load

It is intolerable for the imbalance energy market to be the vehicle for the satisfaction of load that could and should have been anticipated and met in the forward markets. Forward contracting should help alleviate this problem and enable Scheduling Coordinators to adhere to a requirement to submit balanced schedules covering at least 90% of load in the Day-Ahead market, and 95% of load in the Hour-Ahead market. To ensure compliance with this requirement, it is proposed that:

(a) a real-time charge (Large Uninstructed Deviation Charge) be assessed against load and generation that appears in real-time and exceeds 1.10 and 1.05 times the balanced schedules submitted, respectively, in the Day-Ahead and Hour-Ahead markets; and

(b) the ISO also proposes that a Real-time Trading Charge, initially set at zero, apply to all instructed deviations (both generation and load) that occur in real time. The purpose of this charge is to create a financial preference for all parties to trade in the forward markets; and

(c) Out-of-Market costs will be charged to underscheduled load and to generation appearing in real-time in excess of balanced schedules.

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