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June 8, 2005

Honorable Magalie R. Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: California Independent System Operator Corporation,
Docket Nos. ER04-115-002, ER04-115-003, EL04-47-002 and EL04-47-003
&
Pacific Gas and Electric Company,
Docket Nos. ER04-242-001, EL04-50-001 and ER05-367-001

Dear Secretary Salas:

In accordance with the provisions of Rule 602 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("Commission"), 18 C.F.R. § 385.602, the California Independent System Operator Corporation ("ISO") and San Diego Gas & Electric Company ("SDG&E") submit an Offer of Settlement in connection with the above-referenced proceedings.

I. CONTENTS OF SUBMISSION

Enclosed are the original and fourteen (14) copies of:

- a draft Commission Order;
- an Explanatory Statement; and,
- a Offer of Settlement.

As indicated in the enclosed Explanatory Statement, this resolves all remaining issues that the Commission assigned for Settlement Discussions in its December 31, 2003 and April 27, 2005 orders in the above-referenced proceedings.

June 8, 2005

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In accordance with the provisions of Rule 602(c)(iii), the Parties submitting this Offer of Settlement state that this filing contains copies of, or references to, all documents relevant to this Offer of Settlement.

II. SERVICE OF SUBMISSION

A copy of this submission is being served on all participants in the referenced proceeding and on all other persons required to be served by operation of Rule 602(d) of the Commission's Rules of Practice and Procedure.

III. NOTICE REGARDING FILING COMMENTS ON OFFER OF PARTIAL SETTLEMENT

In accordance with the provisions of Rule 602(d)(2), the ISO and SDG&E hereby notify all participants in this proceeding as well as all other persons required by Rule 602(d)(1) that comments on the Offer of Settlement are to be filed on or before June 28, 2005, and Reply Comments are to be filed on or before July 8, 2005 unless other dates are provided by the Commission. The ISO and SDG&E request adherence to this comment period as provided in Rule 602(f)(2) in order to expedite the conclusion of this matter.

Two extra copies of this submission are provided to be date-stamped and returned to our messenger. Please contact the undersigned if you have any questions. Thank you for your assistance in this matter.

Sincerely,



Kenneth G. Jaffe
Michael E. Ward
Ronald E. Minsk
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W.
Washington, D.C. 20007

Counsel to California Independent
System Operator Corporation

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

[Date]

In Reply refer to:

Docket Nos. ER04-115-002
ER04-115-003
EL04-47-002
EL04-47-003
ER04-242-000
EL04-50-000

Swidler Berlin Shereff Friedman, LLP
ATTN: Michael E. Ward
Counsel for California Independent System Operator Corporation
3000 K Street, N.W.
Washington, D.C. 20007-5116

E. Gregory Barnes
Attorney for San Diego Gas & Electric Company
101 Ash Street
San Diego, California 92101

Dear Mr. Ward and Mr. Barnes:

On June 8, 2005, you filed in the above-referenced docket an Offer of Settlement sponsored by the California Independent System Operation Corporation ("ISO") and San Diego Gas & Electric Company ("SDG&E"). The Offer of Settlement resolves all outstanding issues in the dockets.

On [date], the settlement judge certified the settlement to the Commission.

The subject settlement is in the public interest and is hereby approved. The revised charges specified in the settlement shall take effect as of January 1, 2004 or as otherwise indicated in the Offer of Settlement, and the ISO and SDG&E shall revise charges and prepare refunds or surcharges as directed by the terms of the Offer of Settlement. The Commission's approval of this Offer of Settlement does not constitute approval of, or precedent regarding, any principle or issue in this proceeding. The Commission retains the right to investigate the rates, terms and conditions under the just and reasonable and not unduly discriminatory or preferential standard of Section 206 of the Federal Power Act, 16 U.S.C. § 824e.

By direction of the Commission.

Magalie R. Salas,
Secretary

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of this document upon all parties listed on the official service list compiled by the Secretary in the above-captioned proceedings, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010) and on all other persons required to be served by operation of Rule 602(d) of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.602). Dated this 8th day of June in the year 2005 at Folsom in the State of California.

Stephen A.S. Morrison /REM
Stephen A.S. Morrison
(916) 608-7143

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

| | | |
|----------------------------------|---|--------------------------|
| California Independent System |) | Docket Nos. ER04-115-002 |
| Operator Corporation |) | ER04-115-003 |
| |) | EL04-47-002 |
| |) | EL04-47-003 |
| |) | |
| Pacific Gas and Electric Company |) | Docket Nos. ER04-242-001 |
| |) | EL04-50-001 |
| |) | ER05-367-001 |

EXPLANATORY STATEMENT

As required by Rule 602(c) of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (“Commission”), 18 C.F.R. § 385.602(c) (2003), the California Independent System Operator Corporation (“ISO”) and San Diego Gas & Electric Company (“SDG&E”) submit this Explanatory Statement to describe the basis for and significance of the parties’ Offer of Settlement in this proceeding.

The Offer of Settlement is reflected entirely in the Offer of Settlement. This Explanatory Statement is not intended to alter any of the specific provisions of the Offer of Settlement, and is provided solely for purposes of explanation in accordance with the Commission’s Rules.

I. BACKGROUND

On October 31, 2003, the ISO submitted to the Commission revisions to its Grid Management Charge (“GMC”) (“October 31 GMC Submission”). The GMC is the rate through which the ISO recovers its administrative and operating costs, including the costs incurred in establishing the ISO prior to the commencement of operations. The ISO proposed to revise the

GMC rate to unbundle charges further, increasing the number of service categories from three to seven and adjusting the charges for the existing categories, and designed the rate to collect an annual revenue requirement of \$218.2 million, a decrease of \$19.6 million from the revenue requirement collected by the 2003 GMC. Notwithstanding the overall reduction in the 2004 revenue requirement, because of the overall revision of the GMC rate design, charges to some Scheduling Coordinators were projected to increase while others were projected to decrease.

On December 31, 2003, the Commission accepted and suspended the ISO's revised GMC subject to refund, directed the appointment of a settlement judge, directed the ISO GMC Parties to seek to reach a settlement, and directed the initiation of an administrative hearing in the event that the ISO GMC Parties could not resolve their differences in settlement. On January 9, 2004, the Chief Administrative Law Judge issued an order designating the Honorable Bruce L. Birchman as the Settlement Judge in this proceeding.

The parties to the proceeding negotiated with the assistance of Judge Birchman, resulting in the resolution of all issues that the Commission set for Settlement Discussions in its December 31, 2003 order, except for a single reserved issue, the application of the GMC charges on the Energy Schedules of the Arizona Public Service Company ("APS") and the Imperial Irrigation District ("IID") on their respective ownership shares of the Southwest Power Link ("SWPL"). It is that reserved issue that is the subject of this Offer of Settlement.

The ISO and Pacific Gas & Electric Co. submitted an Offer of Partial Settlement to the Commission on July 29, 2004. On February 2, 2005, the Commission approved the Offer of Partial Settlement, and terminated the docket. On March 3, 2005, SDG&E filed a Request for Rehearing, stating that termination of the dockets effectively deprived it of an opportunity to be heard on the issue reserved in the partial settlement.

On April 27, 2005, the Commission granted rehearing and reinstated the above-captioned dockets in order to ensure an appropriate process to resolve the reserved issue. On May 3, 2005, the Chief Judge designated Judge Herbert Grossman to convene a hearing to address the reserved issue, and scheduled a prehearing conference for May 12, 2005. Judge Grossman cancelled the prehearing conference when notified that the parties were nearing a settlement agreement.

On May 23, 2005, the ISO and SDG&E reached a settlement agreement (“the “Settlement Agreement”) (attached to the Offer of Settlement at Attachment A), which, among other issues, resolves the reserved issue, the application of the GMC charges on the Energy Schedules of APS and the IID on their respective shares of the SWPL (“APS/IID SWPL Transactions”).

II. EXPLANATION OF THE TERMS OF SETTLEMENT

The Offer of Settlement seeks Commission approval only of those portions of the May 23, 2005 Settlement Agreement that address the application of the GMC charges to APS/IID SWPL Transactions. This is the only issue that was left unresolved in the above-captioned dockets by the Offer of Partial Settlement that the Commission approved on February 2, 2005. Its approval by the Commission will constitute the final resolution of all issues in the instant dockets.

Outstanding issues involving the application of the GMC to the SDG&E SWPL shall be resolved as follows:

- 1) The ISO will refund to SDG&E GMC charges as billed by the ISO under the SDG&E SCID for APS/IID SWPL Transactions, from January 1, 2001 to June 1, 2005.
- 2) The ISO will not charge SDG&E any GMC for APS/IID SWPL Transactions.

- 3) The ISO will charge SDG&E a Line Operator Charge as specified in the Settlement Agreement.
- 4) SWPL Line Operator Charges paid by SDG&E to the ISO shall reduce the ISO's GMC Revenue Requirement by an amount equal to the Line Operator Charges.
- 5) The Commission's acceptance of this Offer of Settlement shall resolve SDG&E's pending request for rehearing and shall serve as the basis for the termination of Docket Nos. ER04-115, *et al.*

III. ADDITIONAL JUSTIFICATION FOR APPROVAL OF OFFER OF SETTLEMENT

Since 2000, SDG&E has taken action in several forums to challenge the ISO's authority to assess GMC and other charges on the APS/IID SWPL Transactions, claiming that the APS/IID SWPL Shares were not transferred to the ISO's Operational Control under the TCA, are not ISO Controlled Grid facilities subject to ISO Tariff charges, and that SDG&E is not a Scheduling Coordinator under the ISO Tariff for the APS/IID SWPL Transactions.¹ In each action the ISO defended its authority to assess charges to the APS/IID SWPL Transactions as being transmitted on the ISO Controlled Grid and to SDG&E as the Scheduling Coordinator for the transactions pursuant to the Scheduling Coordinator Agreement it executed with the ISO. This litigation has failed to resolve the SWPL issues. It has resulted in inconsistent language in a Commission decision and an arbitration Award as to whether the APS/IID SWPL Shares are part

¹ *California Indep. Sys. Operator Corp.*, Docket No. EL04-24-000 (ISO appeal of October 23, 2003 Award in an arbitration initiated by SDG&E under ISO Tariff Section 13.2.2, which held that the non-SDG&E owned portions of SWPL are not part of the ISO Controlled Grid and are not subject to ISO charges); *San Diego Gas & Elec., Co. v. FERC*, Case No. 04-1092 (D.C. Cir.) (SDG&E appeal of Commission Decisions in 2001 GMC case, at 103 FERC ¶ 61,144 (2003) and 106 FERC ¶ 61,032 (2004), which held that APS and IID Schedules transmit Energy on the ISO Controlled Grid and the ISO has authority to charge SDG&E the ISO's administrative costs for procuring Imbalance Energy to cover imbalances, including transmission losses on the APS and IID SWPL shares; and *California Indep. Sys. Operator Corp.*, Docket Nos. ER04-115, *et al.* (April 27, 2005 Commission decision in 2004 GMC case, at 111 FERC ¶ 61,125), which granted SDG&E's request for rehearing and instituted hearing procedures on the reserved issue concerning SDG&E's objection to the application of GMC charges to Energy Schedules for APS/IID SWPL Transactions. SDG&E has also protested the ISO's compliance report in Docket Nos. EL03-131-002, *et al.*, related to refunds for SDG&E's self-provision of Imbalance Energy for the APS/IID SWPL transactions in the 2001 GMC case. This protest is also pending.

of the ISO Controlled Grid.² The parties have appealed those decisions and the appeals remain pending.³

In order to settle this protracted litigation, the ISO and SDG&E have entered into companion agreements, the Settlement Agreement and the SWPL Operations Agreement, under which the ISO will treat the APS and IID owned portions of SWPL as beyond the scope of the ISO's existing Transmission Control Agreement and will refund to SDG&E the historic charges for transmission losses and uninstructed deviations, GMC, and other applicable charges for those portions of the SWPL. SDG&E will pay a new annual Line Operator Charge to the ISO to compensate the ISO for its capital costs and administrative expenses related to SWPL operation and transactions. SDG&E will also operate SWPL in accordance with specified operating requirements. The SWPL Operations Agreement was submitted to the Commission on May 24, 2005 and docketed No. ER05-1013-000.

With respect to GMC issues, Commission approval of the Offer of Settlement will end all litigation in the instant docket and the SDG&E appeal of the Commission's order in the 2001 GMC proceeding, which currently is pending before the D.C. Circuit.⁴ Moreover, the Offer of Partial Settlement previously approved by the Commission does not take effect until issuance of

² In its Order on Rehearing of the 2001 GMC case, the Commission held that: "The SWPL schedules are wheel through transactions. The generation which originates outside of the ISO control area, is *imported and transmitted over ISO grid facilities* and subsequently exported to serve APS and IID's load." 106 FERC ¶ 61,032, at ¶ 61, 117 (emphasis added). The October 23, 2003 Award of Arbitrator held that: "SDG&E could not and did not transfer to [the ISO] Operational Control over those portions of SWPL owned by APS and IID. Therefore *the APS and IID portions of SWPL are not part of the ISO Controlled Grid.*"

³ See footnotes 1 and 2.

⁴ *San Diego Gas & Electric Co. v. FERC*, No. 04-1092.

a Final Order by the Commission in this docket.⁵ Accordingly, approval of this Offer of Settlement and issuance by the Commission of a Final Order in this docket are necessary to make effective the July 29, 2004 Offer of Partial Settlement, which will enable the ISO to apply the agreed upon rates and make appropriate adjustments to its customers' accounts. Therefore, approval of the Offer of Settlement not only resolves all outstanding issues regarding the application of the GMC charges to Energy Schedules of the APS and the IID on their respective shares of the SWPL, and not only is just and reasonable, but also is in the interest of all other participants in the ISO market.

IV. INFORMATION TO BE PROVIDED WITH SETTLEMENT AGREEMENTS

Consistent with the requirements of a Notice to the Public dated October 23, 2004 from the Chief Administrative Law Judge regarding information that must be included in settlements filed with the Commission, the ISO and PG&E state that:

- 1) The issues underlying the agreement are explained above and in the text of the Offer of Settlement;
- 2) None of the issues addressed in the Offer of Settlement raise policy implications;
- 3) This Offer of Settlement affects no other cases pending at the Commission, beyond those cited above;
- 4) The Offer of Settlement does not involve issues of first impression and there are no previous reversals on the issues addressed in the agreement; and
- 5) The proceeding is subject to the just and reasonable standard.

⁵ For purposes of the Offer of Partial Settlement a Commission order shall be deemed a Final Order when the last date for filing an application for rehearing has expired and no application is filed by that date.

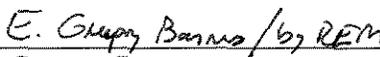
V. CONCLUSION

The ISO and SDG&E believe that the Offer of Settlement represents a fair and reasonable resolution of the outstanding issues in these proceedings. The Parties urge the Commission to rule on the Agreement expeditiously so that the rates provided for in the Offer of Partial Settlement may be placed into effect, and the other obligations imposed by the Offer of Partial Settlement and the Offer of Settlement may be undertaken.

Very Truly Yours,



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**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

| | | |
|----------------------------------|---|--------------------------|
| California Independent System |) | Docket Nos. ER04-115-002 |
| Operator Corporation |) | ER04-115-003 |
| |) | EL04-47-002 |
| |) | EL04-47-003 |
| |) | |
| Pacific Gas and Electric Company |) | Docket Nos. ER04-242-001 |
| |) | EL04-50-001 |
| |) | ER05-367-001 |

OFFER OF SETTLEMENT

This Offer of Settlement (“Settlement Offer”), dated June 8, 2005, is submitted by the California Independent System Operator Corporation (“ISO”) and San Diego Gas & Electric Company (“SDG&E”) with respect to the above-captioned dockets. This Offer of Settlement sets forth a basis to fully and finally resolve all issues in these proceedings.

**ARTICLE I
BASIC UNDERSTANDINGS**

1.1 On October 31, 2003, the ISO submitted to the Commission revisions to its Grid Management Charge (“GMC”) (“October 31 GMC Submission”). The GMC is the rate through which the ISO recovers its administrative and operating costs, including the costs incurred in establishing the ISO prior to the commencement of operations. The ISO proposed to revise the GMC rate to unbundle charges further, increasing the number of service categories from three to seven and adjusting the charges for the existing categories, and designed the rate to collect an annual revenue requirement of \$218.2 million, a decrease of \$19.6 million from the revenue requirement collected by the 2003 GMC. Notwithstanding the overall reduction in the 2004

revenue requirement, because of the overall revision of the GMC rate design, charges to some Scheduling Coordinators were projected to increase while charges to others are projected to decrease.

1.2 The Commission accepted and suspended the ISO's revised GMC subject to refund, directed the appointment of a settlement judge, directed the parties to the proceeding to attempt to reach a settlement, and directed the initiation of an administrative hearing in the event that the parties could not resolve their differences in settlement.

1.3 The Commission and the Chief Administrative Law Judge granted motions to intervene filed by the parties other than the ISO.

1.4 On January 9, 2004, the Chief Administrative Law Judge issued an order designating the Honorable Bruce L. Birchman as the Settlement Judge in this docket.

1.5 At settlement conferences convened by Judge Birchman, the parties and the ISO reached agreement on a mutually acceptable basis for resolving all outstanding issues regarding the ISO's *October 31 GMC Submission*, with the exception, at the request of San Diego Gas & Electric Co. ("SDG&E"), of a single reserved issue, the application of the GMC charges on the Energy Schedules of the Arizona Public Service Company ("APS") and the Imperial Irrigation District ("IID") on their respective ownership shares of the Southwest Power Link ("SWPL").

1.6 On July 29, 2004, the ISO, together with Pacific Gas & Electric Co. ("PG&E"), submitted to the Commission an Offer of Partial Settlement which resolved all issues in the proceeding, except for the reserved issue.

1.7 On February 2, 2005, the Commission issued an Order Approving Uncontested Partial Settlement and Terminating Related Dockets, which approved the uncontested Offer of

Partial Settlement filed by the ISO with respect to the GMC and terminating the dockets in which the agreement was filed.

1.8 On March 3, 2005, SDG&E filed a Request for Rehearing, stating that termination of the dockets effectively deprived it of an opportunity to be heard on the issue reserved in the partial settlement.

1.9 On April 27, 2005, the Commission granted rehearing and reinstated Docket Nos. ER04-115-003 and EL04-47-003, in order to ensure an appropriate process to resolve the reserved issue. On May 3, 2005, the Chief Judge designated Judge Herbert Grossman to convene a hearing to address the reserved issue, and scheduled a prehearing conference for May 12, 2005. Judge Grossman cancelled the prehearing conference when notified that the ISO and SDG&E were nearing a settlement agreement.

1.10 On May 23, 2005, the ISO and SDG&E reached a settlement (the “Settlement Agreement,” attached hereto at Attachment A) which, among other issues, resolves the reserved issue, the application of the GMC charges on the Energy Schedules of the APS and the IID on their respective ownership shares of the SWPL (“APS/IID SWPL Transactions”).

1.11 Capitalized terms used in this Offer of Settlement shall have the meanings set out in the Master Definitions Supplement in Appendix A to the ISO Tariff or in the Settlement Agreement, unless otherwise stated in this Offer of Settlement.

ARTICLE II SCOPE OF SETTLEMENT

2.1 The ISO files this Offer of Settlement with the Commission as an Offer of Settlement under Rule 602 of the Commission’s Rules of Practice and Procedure, 18 CFR § 385.602, as the full and final resolution of all issues in the above-captioned dockets.

2.2 Upon the Commission's acceptance of this Offer of Settlement, the replacement sheets of the ISO Tariff contained in Attachments B & C to this Offer of Settlement, which incorporate the modifications agreed upon in this Offer of Settlement, shall take effect as of January 1, 2004, in lieu of the tariff sheets filed by the ISO as part of the Offer of Partial Settlement, and approved by the Commission on February 3, 2005.

ARTICLE III RESOLUTION OF SDG&E SWPL ISSUES

3.1 Except as agreed to in this Offer of Settlement, all components of the GMC rate set forth in the Offer of Partial Settlement submitted by the ISO to the Commission on July 29, 2004, and approved by the Commission on February 2, 2005 (i.e., the "Current Rate") remain unchanged.

3.2 The ISO and SDG&E are seeking Commission approval, through this Offer of Settlement, only of those sections of the attached Settlement Agreement that address GMC, specifically the application of the GMC to the APS/IID SWPL Transactions. Outstanding issues involving the application of the GMC to the APS/IID SWPL Transactions shall be resolved as specified in the Settlement Agreement and are summarized as follows:

3.2.1 As specified in Sections 3.1.1, 5.1.1, 5.1.2, 5.1.5, 5.1.6 of the Settlement Agreement, the ISO will refund to SDG&E GMC charges as billed by the ISO under the SDG&E Scheduling Coordinator identifications (SCID) for APS/IID SWPL Transactions, from January 1, 2001 to June 1, 2005.

3.2.2 As specified in Section 3.2.2 of the Settlement Agreement, and the revised Tariff pages attached hereto at Attachments B and C, the ISO will not charge SDG&E any GMC for APS/IID SWPL Transactions.

3.2.3 As specified in Section 3.1.2. and 3.2.1 of the Settlement Agreement, the ISO will charge SDG&E a Line Operator Charge.¹

3.2.4 As specified in Section 5.3.2 of the Settlement Agreement, SWPL Line Operator Charges paid by SDG&E to the ISO shall reduce the ISO's GMC Revenue Requirement by an amount equal to the Line Operator Charges.

3.2.5 As specified in 5.1.5 and 5.1.6 of the Settlement Agreement, the ISO shall refund to SDG&E the GMC charges in past periods that the ISO had assessed to SDG&E as the Scheduling Coordinator for APS/IID SWPL Transactions.

3.2.6 The Commission's acceptance of this Offer of Settlement shall resolve the SWPL issue reserved for further proceedings by the Offer of Partial Settlement approved by the Commission in this proceeding, and shall serve as the basis for the termination of Docket Nos. ER04-115, *et al.*

ARTICLE IV EFFECTIVE DATE AND OTHER CONDITIONS

4.1 This Settlement Offer shall become effective upon issuance by the Commission of a Final Order approving this Settlement Offer, including its Attachments, without modifications or condition or, if modified or conditioned, upon its acceptance by adversely affected parties as provided below. For purposes of this Settlement Offer a Commission order shall be deemed a Final Order when the last date for filing an application for rehearing has expired and no application is filed by that date. If any application for rehearing is filed, a Commission order

¹ The basis for the ISO to charge SDG&E a Line Operator Charge is contained in the SWPL Operations Agreement, which has been submitted to the Commission in Docket No. ER05-1013-000, and which is a companion agreement to the SWPL Settlement Agreement.

shall be deemed a Final Order as of the date on which the right to seek rehearing expires, or if any request for rehearing is filed, as of the date on which rehearing is denied.

4.2 This Settlement Offer is made upon the express understanding that it constitutes a negotiated settlement and, except as otherwise expressly provided for herein, no settling party shall be deemed to have approved, accepted, agreed to, or consented to any principle or policy relating to rate design, rate calculation, or any other matter affecting or relating to any of the rates, charges, classifications, terms, conditions, principles, issues or tariff sheets associated with this Settlement Offer. This Settlement Offer shall not be deemed to be a “settled practice” as that term was interpreted and applied in *Public Service Commission of the State of New York v. FERC*, 642 F.2d 1335 (D.C. Cir. 1980), and shall not be the basis for any decision with regard to the burden of proof in any future litigation. This Settlement Offer shall not be cited as precedent, nor shall it be deemed to bind any settling party (except as otherwise expressly provided for herein) in any future proceeding, including, but not limited to, any FERC proceeding, except in any proceeding to enforce this Settlement Offer. This Settlement Offer, and any FERC order approving it, shall not be relied upon as evidence of the FERC’s or any party’s support for any particular methodology or to constrain any party’s position at the end of the Effective Term.

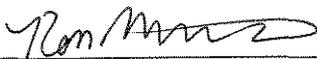
4.3 This Settlement Offer is an integrated whole and its provisions are not severable. Notwithstanding the foregoing, if the Commission’s approval of this Settlement is conditioned on the modification of this Settlement Offer or on any other condition, such modification or condition shall be considered to be accepted unless any party objecting to such condition or modification files written notice of objection to the Settlement, as modified or conditioned, with the Commission, and serves such notice on the other parties within a period of ten days from the date of such Final Order.

4.4 The discussions among the parties that have produced this Settlement Offer 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.

4.5 Headings in this Settlement Offer are included for convenience only and are not intended to have any significance in interpretation of this Settlement Offer.

4.6 Signatures may occur by counterparts. Such signatures shall have the same effect as if all signatures were on the same document.

Very Truly Yours,



Kenneth G. Jaffe
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Ronald E. Minsk
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**Attachment A
To Offer of Settlement**

SWPL SETTLEMENT AGREEMENT

Between

**CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION**

and

**SAN DIEGO GAS & ELECTRIC
COMPANY**

**CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION**

AND

**SAN DIEGO GAS & ELECTRIC
COMPANY**

SWPL SETTLEMENT AGREEMENT

SWPL SETTLEMENT AGREEMENT

THIS SWPL SETTLEMENT AGREEMENT is made this _____ day of May, 2005 and is entered into, by and between **San Diego Gas & Electric Company**, having its registered and principal place of business located at 8330 Century Park Court, San Diego, California ("SDG&E"), and the **California Independent System Operator Corporation**, a California nonprofit public benefit corporation having a principal executive office located at such place in the State of California as the ISO Governing Board may from time to time designate ("ISO")

Hereinafter collectively referred to as "Parties", and individually as "Party".

WHEREAS:

- A. SDG&E shares joint ownership of the Southwest Powerlink ("SWPL") with Arizona Public Service Company ("APS") and the Imperial Irrigation District ("IID"), in percentages defined by the SWPL Agreements.
- B. SDG&E has executed a TCA with the ISO, transferring SDG&E's transmission ownership and rights, including those in SWPL, to the ISO's Operational Control, making the SDG&E SWPL Share part of the ISO Controlled Grid.
- C. SDG&E, as the Scheduling Agent under the SWPL Agreements, submits energy schedules to the ISO for the APS/IID SWPL Transactions, and the ISO assesses charges to SDG&E, as the Scheduling Coordinator under the ISO Tariff for the APS/IID SWPL Transactions, but SDG&E does not recover certain of such ISO charges from APS and IID pursuant to the terms of the SWPL Agreements.
- D. The SWPL is currently within the ISO Control Area and the inclusion of SDG&E's joint ownership of SWPL provides substantial benefits to ISO customers, such as curtailment sharing and non-firm access to additional transfer capability, and also causes the ISO to incur costs in connection with the operation of the ISO Controlled Grid, including SDG&E's joint ownership of SWPL.
- E. SDG&E has filed disputes and commenced litigation in several forums challenging the ISO's charges on the APS/IID SWPL Transactions, and the ISO has appealed an arbitration decision regarding such charges to FERC, which matters are currently pending.
- F. In order to 1) ensure that SWPL remains in the ISO Control Area and is operated and scheduled in a reliable manner, and 2) resolve the pending litigation and disputes related to ISO charges on APS/IID SWPL Transactions, the Parties enter into this Settlement Agreement and the

companion SWPL Operations Agreement, which treat APS/IID SWPL Shares as non-ISO Controlled Grid, eliminate all ISO charges to SDG&E for APS/IID SWPL Transactions, except as otherwise provided in the SWPL Operations Agreement, and provide for SDG&E to pay a Line Operator Charge to compensate the ISO for its operating expenses and capital costs related to the administration of SDG&E's joint ownership of SWPL.

- G. The Parties agree that this Settlement Agreement resolves the issues and amounts in controversy, as set forth in the spreadsheet identified as Attachment A, which is attached to this Settlement Agreement and incorporated herein by reference.
- H. The Parties agree to compromise based on the risks to both Parties of continuing litigation and the benefits of the certainty afforded by the resolution of the disputes reflected in this Settlement Agreement.

NOW, THEREFORE, in consideration of the mutual covenants set forth herein,
THE PARTIES AGREE as follows:

1. DEFINITIONS AND INTERPRETATION

1.1 Master Definitions Supplement. Except as otherwise defined in Section 1.3 of this Settlement Agreement, all terms and expressions used in this Settlement Agreement with initial capitalization shall have the same meaning as those contained in the Master Definitions Supplement to the ISO FERC Electric Tariff ("ISO Tariff").

1.2 Rules of Interpretation. The following rules of interpretation and conventions shall apply to this Settlement Agreement:

- (a) if and to the extent a matter is specifically addressed by a provision of this Settlement Agreement, the provision of this Settlement Agreement shall govern notwithstanding any inconsistent provisions of the ISO Tariff,
- (b) if and to the extent this Settlement Agreement provides that a matter shall be determined in accordance with the applicable provisions of the ISO Tariff, the applicable provisions of the ISO Tariff shall govern;
- (c) the singular shall include the plural and vice versa;
- (d) the masculine shall include the feminine and neutral and vice versa;
- (e) "includes" or "including" shall mean "including without limitation";
- (f) references to a Section shall mean a Section of this Settlement Agreement, as the case may be, unless the context otherwise requires;

- (g) a reference to a given agreement or instrument shall be a reference to that agreement or instrument as modified, amended, supplemented or restated through the date as of which such reference is made;
- (h) unless the context otherwise requires, references to any law shall be deemed references to such law as it may be amended, replaced or restated from time to time;
- (i) unless the context otherwise requires, any reference to a "person" includes any individual, partnership, firm, company, corporation, joint venture, trust, association, organization or other entity, in each case whether or not having separate legal personality;
- (j) unless the context otherwise requires, any reference to a Party includes a reference to its permitted successors and assigns;
- (k) any reference to a day, week, month or year is to a calendar day, week, month or year; and
- (l) the captions and headings in this Settlement Agreement are inserted solely to facilitate reference and shall have no bearing upon the interpretation of any of the terms and conditions of this Settlement Agreement.

1.3 Special Agreement Definitions. In addition to terms defined in the beginning of this Settlement Agreement and in Section 1.1, for purposes of this Settlement Agreement the following terms shall have the meanings set forth below.

Arizona Agreement means the APS - SDG&E Arizona Transmission System Participation Agreement between APS, IID and SDG&E providing for the joint ownership of SWPL from the Palo Verde/Hassayampa 500 kV substations outside Phoenix, Arizona to the North Gila 500 kV substation outside Yuma, Arizona and operation of SWPL from the Palo Verde/Hassayampa 500 kV substations to the Arizona/California border outside Yuma, Arizona.

APS/IID SWPL Shares means the respective percentage of joint ownership and attendant rights that APS and IID have in SWPL, as defined in the SWPL Agreements.

APS/IID SWPL Transactions means transactions by APS and/or IID on the APS/IID SWPL Shares.

California Agreement means the IID - SDG&E California Transmission System Participation Agreement between IID and SDG&E providing for the joint ownership of SWPL from the North Gila 500 kV substation outside

Yuma, Arizona to the Imperial Valley Switchyard in Imperial Valley, California and the operation of SWPL from the Arizona/California border outside Yuma, Arizona to the Imperial Valley Switchyard.

FERC Rate means the interest rate and calculation determined in accordance with 18 C.F.R. § 35.19a of the regulations of the FERC, as in effect from time to time.

Grid Management Charge or “GMC” means the monthly administrative charge assessed by the ISO, as defined in the ISO Tariff as it may be amended from time-to-time.

Other Charges means the ISO charges for the Summer Reliability Assessment, Emissions and Start Up costs, Minimum Load Cost Compensation, and FERC Fees.

Pay-When-Paid Basis means that, in accordance with ISO Tariff Section 11, the ISO’s payment of all or any portion of a refund payable under this Settlement Agreement, including interest thereon, will be made after and to the extent that, the ISO collects such funds from Scheduling Coordinators.

SDG3 SCID means the ISO Scheduling Coordinator identification code assigned to SDG&E for transactions other than APS/IID SWPL Transactions, or any successor to such code.

SDGE SCID means the ISO Scheduling Coordinator identification code assigned to the APS/IID SWPL Transactions, or any successor to such code.

SDG&E SWPL Share means the percentage of joint ownership and attendant rights that SDG&E has in SWPL, as defined in the SWPL Agreements, which SDG&E has made subject to the ISO’s Operational Control pursuant to the TCA.

SWPL means the Southwest Powerlink, a 500 kV transmission line and associated transmission facilities that run from the Palo Verde/Hassayampa Substation adjacent to the Palo Verde Nuclear Generation Station substations outside Phoenix, Arizona to the Miguel Substation in San Diego County, California.

SWPL Agreements means collectively the Arizona Agreement and the California Agreement.

SWPL Operations Agreement means the agreement described in Section 5.2, as attached hereto for reference as Attachment B.

SWPL Participants means collectively SDG&E, APS and IID.

2. TRANSMISSION LOSSES

- 2.1 Historic:** Subject to Section 5.1.2, the ISO will refund amounts paid to the ISO by SDG&E for Imbalance Energy relating to APS/IID SWPL Transactions under the SDGE SCID from April 1998 to the Effective Date of the SWPL Operations Agreement (see Attachment A, line 5). SDG&E waives all claims for reimbursement for its costs to self-supply losses assigned by the ISO to APS/IID SWPL Transactions not reimbursed by APS/IID (see Attachment A, line 2). Except as provided in Section 5.1.8, the ISO waives all claims to revenues associated with the sale of Energy supplied by APS and IID to offset losses on the APS/IID SWPL Shares from 1998 through 2001 (see Attachment A, line 3).
- 2.2 Going forward:** In accordance with the SWPL Operations Agreement, the ISO will assign to APS/IID SWPL Transactions a fixed percentage for losses of 0.5% for a period of 43 months, from June 1, 2005 through December 31, 2008. Beginning January 1, 2009, the ISO will annually establish a fixed loss percentage for APS/IID SWPL Transactions based on the actual percentage losses for the prior calendar year, as determined pursuant to the SWPL Operations Agreement. During the term of the SWPL Operations Agreement, the ISO will not charge SDG&E for transmission losses attributable to the APS/ IID SWPL Transactions to the extent that SDG&E self-provides the ISO designated amount of such losses. To the extent that SDG&E does not self provide all or any portion of the ISO designated amount of such losses, SDG&E will be assessed applicable ISO charges as provided in Section 6.3 of the SWPL Operations Agreement.

3. ADMINISTRATIVE CHARGES

3.1. Historic:

- 3.1.1** Subject to Section 5.1.2, the ISO will refund to SDG&E all GMC paid by SDG&E, as billed by the ISO under the SDGE SCID for APS/IID SWPL Transactions, from January 1, 2001 to the Effective Date of the SWPL Operations Agreement (see Attachment A, line 11).
- 3.1.2** The ISO will implement a new charge called the "Line Operator Charge", as described in Schedule 2 of the SWPL Operations Agreement, to be assessed to the SDG3 SCID for the period 2001-2004. The Line Operator Charge will be \$250,000 per year for each year 2001 through 2004, for a total amount of \$1 million for the four-year period. SDG&E will pay these Line Operator Charge amounts to the ISO when invoiced, in accordance with the SWPL Operations Agreement.

3.2 Going forward:

- 3.2.1** The ISO will assess the new Line Operator Charge, as described in Schedule 2 of the SWPL Operations Agreement, of \$1.577 million per year to the SDG3 SCID for the period January 1, 2005 through December 31, 2010. Beginning with the year 2011, the Line Operator Charge will be recalculated annually and will remain in effect for one year, or for a longer period as the Parties may mutually agree, as provided in Section 6.3 and Schedule 2 of the SWPL Operations Agreement.
- 3.2.2** During the term of the SWPL Operations Agreement, the ISO will not charge any GMC to the APS/IID SWPL Transactions.
- 3.2.3** Nothing in this Settlement Agreement affects SDG&E's obligation to pay GMC in accordance with the ISO Tariff with respect to all Loads served, market transactions, transmission usage, transactions on the SDG&E SWPL Share, and all other bases of GMC liability in accordance with the ISO Tariff, other than with respect to the APS/IID SWPL Shares and Transactions.

4. OTHER CHARGES

- 4.1 Historic:** Subject to Section 5.1.2, the ISO will refund to SDG&E all Other Charges paid by SDG&E under SDGE SCID for APS/IID SWPL Transactions, for the specified periods (see Attachment A, line 21).
- 4.2 Going forward:** During the term of the SWPL Operations Agreement, the ISO will not assign any Other Charges to the APS/IID SWPL Transactions, nor will the ISO assess any other charge types to such transactions except as provided in the SWPL Operations Agreement.

5. IMPLEMENTATION

5.1 Refunds and Payment Obligations

- 5.1.1** The refund amounts identified in Attachment A shall be updated by calculating the actual ISO charges assessed to APS/IID SWPL Transactions from the end date of Attachment A through the Effective Date of the SWPL Operations Agreement. The updated amounts will be refunded in accordance with this Section
- 5.1.2** The ISO shall refund to SDG&E the amounts owing under this Agreement for Transmission Losses, GMC, and Other Charges subject to any necessary regulatory approvals and on a Pay-When-Paid Basis. Such refunds are also subject to the conditions and contingencies set forth in Sections 5.2.2, 5.3.4. and 6. In the event the ISO is unable to pay the full amount contemplated herein as a result of any Bankruptcy of any third party, the Parties agree that

SDG&E will absorb the first \$500,000 of under collections that would otherwise be paid to SDG&E. Should the amount of under collections exceed \$500,000, the Parties agree to enter into negotiations to address allocation of Bankruptcy risk.

5.1.3 The ISO will refund the amounts owing for Transmission Losses and Other Charges under this Agreement in four distinct settlement periods, which take into account bankruptcy dates (pre-petition and post-petition), the timing of reruns under FERC refund case in Docket No. EL00-95 *et al.*, the preparatory re-runs and "wall-off" approved by FERC in Docket No. ER03-746, and ISO settlement software limitations. The four periods consist of:

- P1 - April 1, 1998 through June 20, 2001
- P2 - June 21, 2001 through December 31, 2001
- P3 - January 1, 2002 through June 30, 2004
- P4 - July 1, 2004 to the Effective Date of the SWPL Operations Agreement

5.1.4 Subject to the conditions set forth in Section 5.1.2, the ISO shall refund to SDG&E the amounts owing for Transmission Losses and Other Charges under this Agreement, as follows:

- a. For period P1, the ISO shall make payment in the first quarter of 2006.
- b. For period P2, the ISO shall make payment in the first quarter of 2006.
- c. For period P3, the ISO shall make payment in the third quarter of 2005.
- d. For period P4, the ISO shall make payment in the third quarter of 2006.
- e. The ISO will endeavor to make payments as soon as possible with the objective of the payment being made not later than the quarters identified in this Section 5.1.4.a – d.

5.1.5 The ISO will refund the amounts owing for GMC under this Agreement in two distinct settlement periods, which take into account the 2004 GMC proceeding, FERC Docket Nos. ER04-115, *et al.*, and ISO settlement software limitations. The two periods consist of:

- GMC P1 - January 1, 2001 through December 31, 2004
- GMC P2 - January 1, 2005 to Effective Date of the SWPL Operations Agreement

5.1.6 Subject to Section 5.1.2, the ISO shall refund to SDG&E the amounts owing for GMC under this Agreement, as follows:

- a. For period GMC P1, the ISO shall make payment in the first quarter of 2006.
- b. For period GMC P2, the ISO shall make payment within 60 days of regulatory approval of the settlement pursuant to Section 5.3.1.

- 5.1.7** The ISO will submit invoices to SDG&E for the 2001 through 2004 Line Operator Charges and SDG&E's payment of those Line Operator Charges will be due simultaneously with the ISO's payment of refunds under Section 5.1.6.a. The ISO will submit an invoice for the 2005 Line Operator Charge before the end of calendar year 2005, and SDG&E shall pay such invoices in accordance with the SWPL Operations Agreement. Beginning in 2006, the ISO will invoice the annual Line Operator Charge in 12 monthly installments. SDG&E will pay these Line Operator Charge amounts to the ISO when invoiced, in accordance with the SWPL Operations Agreement.
- 5.1.8** To the extent SDG&E receives refunds from third parties as a result of FERC's market mitigation litigation in FERC Docket Nos. EL00-95-000 and EL00-98-000, SDG&E will refund to the ISO amounts found by the CPUC to be allocable to the SDGE SCID as an offset to refunds tendered pursuant to Section 5.1.2.
- 5.1.9** All refund and payment amounts owing under this Settlement Agreement, including any refund or payment amounts to be returned in the event this Settlement Agreement is terminated, shall be paid with interest at the FERC Rate.

5.2 SWPL Operations Agreement:

- 5.2.1** The Parties have simultaneously executed and are submitting for FERC acceptance or approval a SWPL Operations Agreement appended as Attachment B hereto, in order to ensure certainty that the SWPL is operated and scheduled in a reliable manner and to implement the calculation of transmission loss costs identified in Section 2.2 and the Line Operator Charge described in Section 3.2.1.
- 5.2.2** If FERC rejects, or modifies, in whole or in part, the SWPL Operations Agreement in a manner not acceptable to either Party, either Party may elect to terminate this Settlement Agreement by notice to the other Party. In the event of such election, each Party will return any and all refunds and payments made pursuant to this Agreement, within 30 days of the date of a final, non-appealable FERC order rejecting or modifying the SWPL Operations Agreement.

5.3 Offer of Partial Settlement in GMC Proceeding:

- 5.3.1.** The Parties will submit an Offer of Partial Settlement in FERC Docket Nos. ER04-115, *et al.*, which will include this Settlement Agreement as an Attachment, and will seek FERC acceptance or approval of the portions of this Settlement Agreement relating to:

- a. The refund of historic GMC charges paid by SDG&E with respect to the APS/IID SWPL Transactions in accordance with Section 3.1.1; and
 - b. The exemption of APS/IID SWPL Transactions from future liability for GMC in accordance with Section 3.2.2.
- 5.3.2.** The Offer of Partial Settlement shall also seek FERC acceptance or approval of:
- a. The crediting of SWPL Line Operator Charges paid by SDG&E to GMC charges.
 - b. The timing of refunds of GMC charges paid to SDG&E with respect to past periods in accordance with Sections 5.1.5 and 5.1.6, net of SWPL Line Operator Charges paid by SDG&E with respect to past periods, in accordance with this Settlement Agreement for recognition as costs for inclusion in GMC charges commencing as of January 1, 2006.
 - c. Revisions to the sheets of the ISO Tariff containing the GMC to implement all changes required by this Settlement Agreement
- 5.3.3** The Offer of Partial Settlement shall also provide that FERC's acceptance of the Offer of Partial Settlement shall resolve SDG&E's pending request for rehearing and shall serve as the basis for the termination of Docket Nos. ER04-115, *et al.*
- 5.3.4** If FERC rejects or modifies, in whole or in part, the Offer of Partial Settlement in a manner not acceptable to either Party, either Party may elect to terminate this Settlement Agreement by notice to the other Party. In the event of such election, each Party will return any and all refunds and payments made pursuant to this Settlement Agreement, within 30 days of the date of a final, non-appealable FERC order rejecting or modifying the Offer of Partial Settlement.
- 5.4** **Termination of Related Litigation:** Upon FERC approval of the SWPL Operations Agreement and the Offer of Partial Settlement in FERC Docket Nos. ER04-115, *et al.*, both Parties will cooperate to timely file and advocate early approval of any FERC filings necessary to implement this settlement. Such filings are to include:
- 5.4.1** A motion to withdraw the ISO's appeal of the Arbitration Award in Docket No. EL04-24-000, in which motion SDG&E will withdraw all allegations made in that case and its July 6, 2001 Statement of Claim in AAA Case No. 71 Y 198 00420 and;
 - 5.4.2** A motion to dismiss SDG&E's petition for review in Case Nos. 04-1090, *et al.* (D.C. Cir.) (2001 GMC appeal).

- 5.4.3 A motion to withdraw SDG&E's protest of the ISO's compliance refund report in FERC Docket Nos. EL03-131-002, *et al.*
- 5.4.4 The Parties will make best efforts to secure any other regulatory approvals required to implement this Settlement Agreement.
- 5.5 **TO Tariff appeal:** SDG&E shall maintain its petition for review of FERC Opinion Nos. 458 and 458-A (Nos. 02-1374, *et al.*, D.C. Cir.). If SDG&E prevails and is permitted to include all ISO charges to SDGE SCID for APS/IID SWPL Transactions in its TO Tariff rates, this Settlement Agreement will terminate and each Party will return any and all refunds and payments made pursuant to this Settlement Agreement, within 30 days of the date of a final, non-appealable FERC order accepting SDG&E's implementing pass-through report.

6. TERM

- 6.1 **Term:** This Settlement Agreement shall become effective immediately upon execution ("Effective Date"), and shall terminate when any of the following events take place:
- 6.1.1 Upon receipt of all refunds and payments to be returned by the Parties in the event the court grants SDG&E's petition for review as described in Section 5.5;
- 6.1.2 In the event either party elects to terminate this Settlement Agreement under Section 5.2.2, 5.3.4, or 6.1.3; or
- 6.1.4 The SWPL Operating Agreement is terminated according to its terms.

7. DISPUTE RESOLUTION

- 7.1 **Dispute Resolution.** The Parties shall make reasonable efforts to settle all disputes arising out of or in connection with this Settlement Agreement. In the event any dispute is not settled, the Parties shall adhere to the ISO ADR Procedures set forth in Section 13 of the ISO Tariff, which is incorporated by reference, except that any reference in Section 13 of the ISO Tariff to the ISO Tariff shall be read as a reference to this Settlement Agreement.

8. LIABILITY

- 8.1 **Liability.** The provisions of Section 14 of the ISO Tariff will apply to liability arising under this Settlement Agreement, except that all references in Section 14 of the ISO Tariff to Market Participants shall be read as references to SDG&E as the Scheduling Coordinator for APS/IID'SWPL Transactions and references to the ISO Tariff shall be read as references to this Settlement Agreement.

9. UNCONTROLLABLE FORCES

- 9.1 **Uncontrollable Forces.** Section 15 of the ISO Tariff shall be incorporated by reference into this Settlement Agreement except that all references in Section 15 of the ISO Tariff to the ISO Tariff shall be read as references to this Settlement Agreement.

10. MISCELLANEOUS

- 10.1 **Assignments.** Either Party may assign or transfer any or all of its rights and/or obligations under this Settlement Agreement with the other Party's prior written consent in accordance with Section 17 of the ISO Tariff. Such consent shall not be unreasonably withheld. Any such transfer or assignment shall be conditioned upon the successor in interest accepting the rights and/or obligations under this Settlement Agreement as if said successor in interest was an original Party to this Settlement Agreement.
- 10.2 **Notices.** Any notice, demand or request which may be given to or made upon either Party regarding this Settlement Agreement shall be made in accordance with Section 20.1 of the ISO Tariff. A Party must update the information in Schedule 1 of this Settlement Agreement as information changes. Such changes shall not constitute an amendment to this Settlement Agreement.
- 10.3 **Waivers.** Any waivers at any time by either Party of its rights with respect to any default under this Settlement Agreement, or with respect to any other matter arising in connection with this Settlement Agreement, shall not constitute or be deemed a waiver with respect to any subsequent default or other matter arising in connection with this Settlement Agreement. Any delay, short of the statutory period of limitations, in asserting or enforcing any right under this Settlement Agreement shall not constitute or be deemed a waiver of such right.
- 10.4 **Governing Law and Forum.** This Settlement Agreement shall be deemed to be a contract made under, and for all purposes shall be governed by and construed in accordance with, the laws of the State of California, except its conflict of law provisions. The Parties irrevocably consent that any legal action or proceeding arising under or relating to this Settlement Agreement to which the ISO ADR Procedures do not apply, shall be brought in any of the following forums, as appropriate: any court of the State of California, any federal court of the United States of America located in the State of California, or, where subject to its jurisdiction, before the Federal Energy Regulatory Commission.
- 10.5 **Consistency with Federal Laws and Regulations.** This Settlement Agreement shall incorporate by reference Section 20.8 of the ISO Tariff as if the references to the ISO Tariff were referring to this Settlement Agreement.

- 10.6 Merger.** This Settlement Agreement constitutes the complete and final agreement of the Parties with respect to the subject matter hereto and supersedes all prior agreements, whether written or oral, with respect to such subject matter, except with respect to the Operations Agreement.
- 10.7 Amendment.** This Settlement Agreement and the Attachments hereto may be amended from time to time by the mutual agreement of the Parties in writing. Amendments that require FERC approval shall not take effect until FERC has accepted such amendments for filing and made them effective. Nothing contained herein shall be construed as affecting in any way the right of a Party furnishing services in accordance with this Agreement to unilaterally make application to FERC for a change in the rates, terms and conditions of this Operating Agreement under Section 205 of the Federal Power Act and pursuant to the Commission's Rules and Regulations promulgated thereunder, nor shall it affect the right of any Party taking service under this Agreement to file a complaint under Section 206 of the Federal Power Act.
- 10.8 Severability.** If any term, covenant, or condition of this Settlement Agreement or the application or effect of any such term, covenant, or condition is held invalid as to any person, entity, or circumstance, or is determined to be unjust, unreasonable, unlawful, imprudent, or otherwise not in the public interest by any court or government agency of competent jurisdiction, and the Parties elect not to terminate this Settlement Agreement, then such term, covenant, or condition shall remain in force and effect to the maximum extent permitted by law, and all other terms, covenants, and conditions of this Settlement Agreement and their application shall not be affected thereby, but shall remain in force and effect and the Parties shall be relieved of their obligations only to the extent necessary to eliminate such regulatory or other determination unless a court or governmental agency of competent jurisdiction holds that such provisions are not separable from all other provisions of this Settlement Agreement. Nothing in this Section 10.8 shall limit the rights of any Party under Section 10.7.
- 10.9 Effect on SWPL Agreements.** Nothing in this Settlement Agreement shall affect the rights and obligations among the SWPL Participants under the SWPL Agreements and nothing contained herein shall assign any rates or charges to the APS/IID SWPL Shares under the SWPL Agreements, except as provided in Section 6.3 of the Operations Agreement. In addition, nothing in this Settlement Agreement is intended to confer any rights on the ISO with respect to losses supplied to SDG&E by APS and IID under the SWPL Agreements.
- 10.10 Non-Precedential Effect of Settlement Agreement.**
- 10.10.1** This Settlement Agreement is non-precedential with respect to any pending or future proceeding, and its terms may not be referred to in any pending or

future proceeding before FERC or any court or other forum for the purpose of supporting or opposing any specific approach to any issue. Notwithstanding the foregoing, either Party may refer to and introduce this Settlement Agreement in the pending matters, as identified and to the extent provided herein, and in any future case or other proceeding for the sole purpose of enforcing the rights and obligations established by this Settlement Agreement.

10.10.2 Agreement to or acquiescence in this Settlement Agreement shall not be deemed in any respect to constitute an admission by any Party that any allegation or contention made by any other Party in the disputes and proceedings identified herein is true or valid. In negotiating the Settlement Agreement, the Parties specifically agreed that the Settlement Agreement represents a negotiated agreement for the sole purpose of settling the issues discussed herein, and no other issues or disputed matters. No Party shall be deemed to have approved, accepted, agreed to, or consented to any fact, concept, theory, rate methodology, rate calculation, 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 resolutions of the issues provided herein. The FERC's approval of the filings necessary to implement this Settlement Agreement shall not constitute approval of, or precedent regarding, any principle or issue addressed in this Settlement Agreement. The resolution of any matter in this Settlement Agreement shall not be deemed to be a "settled practice" as that term was interpreted and applied in *Public Service Commission of the State of New York v. FERC*, 642 F.2d 1335 (D.C. Cir. 1980).

10.11. Settlement Discussions are Privileged. The discussions between the Parties that have produced this Settlement Agreement have been conducted on the explicit understanding, pursuant to Rule 602 of FERC'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.

10.12. Counterparts. This Settlement Agreement may be executed in one or more counterparts at different times, each of which shall be regarded as an original and all of which, taken together, shall constitute one and the same Agreement.

IN WITNESS WHEREOF, the Parties have caused this Settlement Agreement to be executed by their respective authorized officials.

California Independent System Operator Corporation:

By: Y. Mansour
Name: Yakout Mansour
Title: President and Chief Executive Officer
Date: May 23, 2005

San Diego Gas & Electric Company:

By: _____
Name: _____
Title: _____
Date: _____

**SCHEDULE 1
NOTICES**

SDG&E

Name of Primary

Representative: Scott Peterson

Title: Director, Electric Grid Operations

Address: San Diego Gas & Electric Company

P.O. Box 129831, SD1160

City/State/Zip Code: San Diego, California 92112-9831

Email Address: speterson@semprautilities.com

Phone: 619-725-8639

Fax No: 619-683-3291

Name of Alternative

Representative: S. Ali Yari

Title: Director, Electric Transmission & Distribution Engineering

Address: San Diego Gas & Electric Company

8330 Century Park Court

City/State/Zip Code: San Diego, California 92123

Email Address: AYari@semprautilities.com

Phone: 858-654-8200

Fax No: 619-654-1692

ISO:

Name of Primary

Representative:

Thomas Doughty

Title:

Director of Client Relations

Address:

151 Blue Ravine Road

City/State/Zip Code:

Folsom, CA 95630

Email Address:

tdoughty@caiso.com

Phone:

(916) 608-7373

Fax No:

(916) 351-2487

Name of Alternative

Representative:

Deborah Le Vine

Title:

Director of Contracts

Address:

151 Blue Ravine Road

City/State/Zip Code:

Folsom, CA 95630

Email Address:

dlevine@caiso.com

Phone:

(916) 351-2144

Fax No:

(916) 351-2487

ATTACHMENT A
SDG&E/CAISO SWPL Settlement Summary Sheet

| Issue Category | Time Frame | Period 1 ^(a) (Millions) | Period 2 ^(a) (Millions) | Period 3 ^(a) (Millions) | Period 4 ^(b) (Millions) | Total (Millions) |
|-------------------------------------|--------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|---------------------|
| Losses/Imbalance Energy | 4/98 to 12/31/04 | \$15.556 | (\$0.160) | \$3.921 | \$2.102 | \$21.419 |
| SDGE Procure ^(c) | 2001 forward (\$9.625) | - | - | - | - | - |
| APS/IID Credits ^(c) | 5/98 to 12/2000 (-\$2.459) | - | - | - | - | - |
| | <i>Imbalance Subtotal:</i> | \$15.556 | (\$0.160) | \$3.921 | \$2.102 | \$21.419 |
| GMC | 1/2004 to 12/31/2005 | \$0.392 | \$0.789 | \$5.119 | \$0.632 | \$6.932 |
| | <i>GMC Subtotal:</i> | \$0.392 | \$0.789 | \$5.119 | \$1.234 | \$7.534 |
| Other Charges ^(d) | 1/2001 to 12/2003 | \$0.009 | 0.161 | \$0.571 | (\$0.096) | \$0.644 |
| SRA | 1/2001 to 12/31/2004 | - | 0.021 | \$0.045 | \$0.010 | \$0.076 |
| Emissions/Start-up | 1/2001 to 12/31/2004 | - | 0.000 | \$1.134 | \$0.951 | \$2.085 |
| MLCC | 2000 to 12/31/2004 | - | 0.000 | \$1.162 | \$1.032 | \$2.194 |
| RT Redispatch | 2001 to 12/31/2004 | \$0.007 | 0.029 | \$0.160 | \$0.024 | \$0.219 |
| FERC Fee | | | | | | |
| | <i>Other Charges Subtotal:</i> | \$0.015 | \$0.210 | \$3.072 | \$1.920 | \$5.218 |
| Interest | | \$4.356 | \$0.060 | \$0.779 | \$0.070 | \$5.265 |
| | <i>Interest Subtotal:</i> | \$4.356 | \$0.060 | \$0.779 | \$0.070 | \$5.265 |
| Total Charges: | | \$20.319 | \$0.899 | \$12.891 | \$5.326 | \$39.436 |

(a) Total represents APS/IID-related costs incurred for the period May 1998 through December 2004 Final activity.

(b) Costs will be updated to reflect timing of settlement.

(c) Settlement excludes SDG&E's self procurement and APS/IID credits.

(d) Congestion, Ancillary Service, and Wheeling Charges have been removed.

**Attachment B
To SWPL Settlement Agreement**

SWPL Operations Agreement

**CALIFORNIA INDEPENDENT SYSTEM
OPERATOR**

AND

**SAN DIEGO GAS & ELECTRIC
COMPANY**

SWPL OPERATIONS AGREEMENT

SWPL Operations Agreement

THIS SWPL OPERATIONS AGREEMENT is made this _____ day of May, 2005, and is entered into, by and between:

(1) **San Diego Gas & Electric Company** having its registered and principal place of business located at 8330 Century Park Court, San Diego, California 92123 ("SDG&E");

and

(2) **California Independent System Operator Corporation**, a California nonprofit public benefit corporation having a principal executive office located at such place in the State of California as the ISO Governing Board may from time to time designate ("ISO").

Hereinafter collectively referred to as "Parties", and individually as "Party".

Whereas:

- A. SDG&E shares joint ownership of the Southwest Powerlink ("SWPL") with Arizona Public Service Company ("APS") and the Imperial Irrigation District ("IID"), in percentages defined by the SWPL Agreements.
- B. SDG&E has executed a TCA with the ISO, transferring SDG&E's transmission ownership and rights, including those in SWPL, to the ISO's Operational Control, making the SDG&E SWPL Share part of the ISO Controlled Grid.
- C. SDG&E, as the Scheduling Agent under the SWPL Agreements, submits energy schedules to the ISO for the APS/IID SWPL Transactions, and the ISO assesses charges to SDG&E, as the Scheduling Coordinator under the ISO Tariff for the APS/IID SWPL Transactions, but SDG&E does not recover certain of such ISO charges from APS and IID pursuant to the terms of the SWPL Agreements.
- D. The SWPL is currently within the ISO Control Area and the inclusion of SDG&E's joint ownership of SWPL provides substantial benefits to ISO customers, such as curtailment sharing and non-firm access to additional transfer capability, and also causes the ISO to incur costs in connection with the operation of the ISO Controlled Grid, including SDG&E's joint ownership of SWPL.
- E. SDG&E has filed disputes and commenced litigation in several forums challenging the ISO's charges on the APS/IID SWPL Transactions, and the ISO has appealed an arbitration decision regarding such charges to FERC, which matters are currently pending.

- F.** In order to 1) ensure that SWPL remains in the ISO Control Area and is operated and scheduled in a reliable manner, and 2) resolve the pending litigation and disputes related to ISO charges on APS/IID SWPL Transactions, the Parties enter into this SWPL Operations Agreement (“Operations Agreement”) and the companion SWPL Settlement Agreement, which treat APS/IID SWPL Shares as non-ISO Controlled Grid, eliminate all ISO charges to SDG&E for APS/IID SWPL Transactions, except as otherwise provided herein, and provide for SDG&E to pay a Line Operator Charge to compensate the ISO for its operating expenses and capital costs related to the administration of SDG&E’s joint ownership of SWPL.
- G.** The Parties desire certainty to ensure that the SWPL is operated and scheduled in a reliable manner, and charges herein are settled with the ISO.

NOW, THEREFORE, in consideration of the mutual covenants set forth herein, **THE PARTIES AGREE as follows:**

1. DEFINITIONS AND INTERPRETATION

1.1 Master Definitions Supplement. Except as otherwise defined in Section 1.3 of this Operations Agreement, all terms and expressions used in this Operations Agreement with initial capitalization shall have the same meaning as those contained in the Master Definitions Supplement to the ISO Tariff.

1.2 Rules of Interpretation. The following rules of interpretation and conventions shall apply to this Operations Agreement:

- (a) if and to the extent a matter is specifically addressed by a provision of this Operations Agreement, the provision of this Operations Agreement shall govern notwithstanding any inconsistent provisions of the ISO Tariff,
- (b) if and to the extent this Operations Agreement provides that a matter shall be determined in accordance with the applicable provisions of the ISO Tariff, the applicable provisions of the ISO Tariff shall govern;
- (c) the singular shall include the plural and vice versa;
- (d) the masculine shall include the feminine and neutral and vice versa;
- (e) “includes” or “including” shall mean “including without limitation”;
- (f) references to a Section or Schedule shall mean a Section or a Schedule of this Operations Agreement, as the case may be, unless the context otherwise requires;

- (g) a reference to a given agreement or instrument shall be a reference to that agreement or instrument as modified, amended, supplemented or restated through the date as of which such reference is made;
- (h) unless the context otherwise requires, references to any law shall be deemed references to such law as it may be amended, replaced or restated from time to time;
- (i) unless the context otherwise requires, any reference to a "person" includes any individual, partnership, firm, company, corporation, joint venture, trust, association, organization or other entity, in each case whether or not having separate legal personality;
- (j) unless the context otherwise requires, any reference to a Party includes a reference to its permitted successors and assigns;
- (k) any reference to a day, week, month or year is to a calendar day, week, month or year; and
- (l) the captions and headings in this Operations Agreement are inserted solely to facilitate reference and shall have no bearing upon the interpretation of any of the terms and conditions of this Operations Agreement.

1.3 Special Agreement Definitions. In addition to terms defined in the beginning of this Operations Agreement and in Section 1.1 of this Agreement, for purposes of this Operations Agreement the following terms shall have the meanings set forth below.

APS/IID SWPL Shares means the respective percentage of joint ownership and attendant rights that APS and IID have in SWPL, including the use of the other joint owners' unused SWPL capacity, as defined in the SWPL Agreements.

APS/IID SWPL Transactions means transactions by APS and/or IID, or their scheduling agent, on the APS/IID SWPL Shares.

Arizona Agreement means the APS - SDG&E Arizona Transmission System Participation Agreement between APS, IID and SDG&E providing for the joint ownership of SWPL from the Palo Verde/Hassayampa 500 kV substations outside Phoenix, Arizona to the North Gila 500 kV substation outside Yuma, Arizona and the operation of SWPL from the Palo Verde/Hassayampa 500 kV substations to the Arizona/California border outside Yuma, Arizona.

Electric System means all physically connected properties and other assets, now or hereafter existing, owned or controlled by a single entity, and used for, or pertaining to, the generation, transmission, transformation, distribution, or sale of electric power and energy, including all additions, extensions, expansions, and improvements, but excluding subsidiaries and their properties and assets. To the extent that an entity is not the sole owner of an asset or property, only that entity's ownership interest in such asset or property shall be considered to be part of its Electric System.

California Agreement means the IID - SDG&E California Transmission System Participation Agreement between IID and SDG&E providing for joint ownership of SWPL from the North Gila 500 kV substation outside Yuma, Arizona to the Imperial Valley Switchyard in Imperial Valley, California and the operation of SWPL from the Arizona/California border outside Yuma, Arizona to the Imperial Valley Switchyard.

Interconnected Control Area Operating Agreement ("APS ICAOA") means the agreement dated November 26, 1997 between APS and the ISO, as may be amended from time to time.

Reliability Management System ("RMS") means the contractual reliability management program implemented through the WECC Reliability Criteria Agreement, the WECC RMS Agreement, this Operations Agreement, and any similar contractual arrangement.

Settlement Agreement means the SWPL Settlement Agreement entered into on May 23, 2005 between SDG&E and the ISO to resolve the litigation and disputes referenced in Recital E to this Operations Agreement.

SDG3 means the ISO Scheduling Coordinator identification code assigned to SDG&E, or any successor identification code.

SDG&E SWPL Share means the percentage of joint ownership and attendant rights that SDG&E has in SWPL, as defined in the SWPL Agreements, which SDG&E has made subject to the ISO's Operational Control pursuant to the TCA.

SWPL means the Southwest Powerlink, a 500 kV transmission line and associated transmission facilities that run from the Palo Verde/Hassayampa Substation adjacent to the Palo Verde Nuclear Generation Station substations outside Phoenix, Arizona, to the Miguel Substation in San Diego County, California, including any future upgrades to this line or to its associated transmission facilities.

SWPL Agreements means collectively the Arizona Agreement and the California Agreement.

SWPL Participants means collectively SDG&E, APS and IID.

WECC RMS Agreement means the Reliability Management System Agreement between the WECC and the ISO requiring the ISO to comply with the reliability criteria contained in the WECC Reliability Criteria Agreement, as such may be amended from time to time.

2. TERM AND TERMINATION

2.1 Term. This Operations Agreement shall be effective as of the later of i) June 1, 2005, or ii) the date this Operations Agreement is accepted for filing and made effective by FERC and shall continue in effect until terminated.

2.2 Termination.

2.2.1 Termination by Default. Either Party (the terminating Party) may terminate this Operations Agreement by giving written notice in the event that the other Party (the defaulting Party) commits any default under this Operations Agreement and/or the ISO Tariff as it relates to this Operations Agreement which, if capable of being remedied, is not remedied within 30 days after the terminating Party has given the defaulting Party written notice of the default, unless excused by reason of Uncontrollable Forces under Article X of this Operations Agreement.

2.2.3 Termination for TCA. This Operations Agreement shall terminate if both APS and IID execute the TCA. If only one party executes the TCA then this Operations Agreement shall no longer be applicable to SWPL transactions involving that party, but will remain in effect for the party that has not executed the TCA.

2.2.4 Termination for Control Area Change. This Operations Agreement shall terminate if the portion of SWPL from Palo Verde/Hassayampa through the Imperial Valley substation facilities is no longer within the ISO Control Area. SDG&E shall provide no less than six months advance written notice to the ISO if the SWPL Participants elect to remove such portion of SWPL from the ISO Control Area. Such notice of termination may not occur until January 1, 2010 at the earliest.

2.2.5 Termination for D.C. Circuit Case. This Operations Agreement shall terminate if SDG&E prevails in SDG&E, et al. v. FERC, Case Nos. 02-1374, et al. (D.C. Cir.) with respect to FERC Opinion Nos. 458 and 458-A and is permitted to include in its Transmission Revenue Requirement all ISO charges applicable to

APS and IID SWPL transactions in excess of the compensation owed to SDG&E by APS and IID under the SWPL Agreements.

- 2.2.6 Termination of the SWPL Agreements.** This Operations Agreement shall terminate if the California Agreement and the Arizona Agreement terminate. If only one agreement terminates then this Operations Agreement shall no longer be applicable for that party but will remain in effect for SWPL transactions involving the party that has not terminated its agreement.
- 2.2.7 Other Termination:** This Operations Agreement may be terminated upon 120 days advance written notice from either Party. Such notice of termination may not occur until January 1, 2010 at the earliest.
- 2.2.9 Filing.** With respect to any notice of termination given pursuant to this Section, the ISO must file a timely notice of termination with FERC or must otherwise comply with the requirements of FERC Order No. 2001 and related FERC orders. The filing of the notice of termination by the ISO will be considered timely if (1) the filing of the notice of termination is made after the preconditions for termination as set forth in this Operations Agreement have been met, and (2) the ISO files the notice of termination within sixty (60) days after issuance of the notice of default. This Operations Agreement shall terminate upon acceptance by FERC of such a notice of termination, if filed with FERC, or thirty (30) days after the date of the ISO's notice of default, if terminated in accordance with the requirements of FERC Order No. 2001 and related FERC orders.
- 3. OPERATING REQUIREMENTS.** This Operations Agreement shall be implemented in accordance with the applicable provisions of the ISO Tariff, the TCA, and the SWPL Agreements.
- 3.1 Outages.** SDG&E shall coordinate planned and the restoration of forced Outages on SWPL, including removal from, and restoration to, any facilities within the ISO Control Area, with the ISO in accordance with the ISO Tariff.
- 3.2 Removal From and Restoration To Service.** SDG&E acting in coordination with the ISO, which acts in accordance with the Outage Coordination Protocol of the ISO Tariff, may remove from service, and following an outage shall restore to service, all or parts of the SWPL facilities in California.
- 3.3 Emergency Response.** The ISO shall initiate requests for, or implement as appropriate, emergency response procedures to isolate inoperable components of SWPL and to restore the available SWPL facilities to service without undue delay.

3.4 Voltage Control and Reactive Support. SDG&E shall make available the necessary status and telemetry information to the ISO and shall operate under the direction of the ISO the associated voltage control and reactive facilities on the portion of the SWPL within California to meet voltage control standards under Applicable Requirements and the ISO Tariff. For the portion of SWPL in Arizona, APS shall operate such voltage control and reactive facilities in accordance with the APS ICAOA.

4. RELIABILITY MANAGEMENT SYSTEM

4.1 Purpose. In order to maintain the reliable operation of the transmission grid, the WECC Reliability Criteria Agreement sets forth reliability criteria adopted by the WECC to which the ISO shall be required to comply.

4.2 Compliance. Section III.K to Annex A of the WECC Reliability Criteria Agreement provides for Qualified Path Unscheduled Flow Relief and SWPL is part of a qualified path for Unscheduled Flow. If the ISO is sanctioned on behalf of SWPL Participants, pursuant to the WECC Reliability Criteria Agreement, SDG&E on behalf of the SWPL Participants agrees to reimburse the ISO for their proportionate share of such sanction.

4.3 Publication. SDG&E hereby consents to the release by the WECC of information related to compliance with this Operations Agreement only in accordance with the WECC Reliability Criteria Agreement, including release of information as necessary to the North American Electric Reliability Council.

4.4 Reserved Rights. Nothing in the RMS or the WECC Reliability Criteria Agreement shall affect the right of the ISO, subject to any necessary regulatory approval, to take such other measures to maintain reliability, which the ISO may otherwise be entitled to take.

5. TRANSMISSION LOSSES

5.1 Calculation of Losses. The ISO shall calculate Transmission Losses for the APS/IID SWPL Transactions to be assessed to SDG&E (or to any successor Scheduling Coordinator for such transactions) based on a fixed percentage in accordance with Schedule 1. The Scheduling Coordinator for the APS/IID SWPL Transactions may self-supply or procure from the ISO the Transmission Losses so calculated. SDG&E shall calculate Transmission Losses for the APS/IID SWPL Transactions to be assessed to APS and IID pursuant to the SWPL Agreements.

5.2 SWPL Agreements Losses. Nothing in this Operations Agreement is intended to confer any rights on the ISO with respect to losses supplied to SDG&E by

APS and IID under the SWPL Agreements. Similarly, nothing in this Operations Agreement is intended to modify the rights and obligations of the SWPL Participants with respect to losses supplied to SDG&E by APS and IID under the SWPL Agreements.

5.3 SDG&E's Losses Not Affected. The SDG&E SWPL Share is an ISO Controlled Grid facility in accordance with the TCA. The ISO shall calculate the losses for all transactions using the SDG&E SWPL Share in accordance with the ISO Tariff. Nothing in this Operations Agreement is intended to affect the loss calculation for transmission service customers of the ISO for use of the ISO Controlled Grid.

6. COSTS, CHARGES AND PAYMENT

6.1 Operating and Maintenance Costs. SDG&E is responsible for all of the costs it incurs in connection with operating and maintaining its Electric System including its ownership interests in the SWPL.

6.2 Charges Not Generally Affected. Nothing in this Operations Agreement is intended to affect the rates and charges paid by transmission service customers of the ISO for use of the ISO Controlled Grid including the SDG&E SWPL Share. Transmission service customers of the ISO using the ISO's markets or the ISO Controlled Grid shall pay rates and charges in accordance with the ISO Tariff.

6.3 Charges for Non-ISO Controlled Grid Facilities. If the Scheduling Coordinator for APS/IID SWPL Transactions submits schedules using only the APS/IID SWPL Share, that Scheduling Coordinator shall be responsible for procuring or self-providing: (1) Ancillary Services consistent with the requirements of the Control Area in which the Load is served; (2) Imbalance Energy which occurs during the period after a curtailment has occurred and the associated Schedules are changed; and (3) Transmission Losses determined in accordance with Section 5 of this Operations Agreement. To the extent that the Scheduling Coordinator for the APS/IID SWPL Transactions does not self-provide the required amounts for the transactions scheduled under this Operations Agreement and procures all or a portion of the required amounts from the ISO, the ISO shall impose charges or credits for such amounts. In addition the ISO will charge the Line Operator Charge in accordance with Schedule 2. The ISO shall not charge nor credit the Scheduling Coordinator for the APS/IID SWPL Transactions for any other charge types outside of this Section 6.3, if such transactions do not use the ISO Controlled Grid.

6.4 Line Operator Charge Billing. The ISO shall bill SDG&E after the fact for the Line Operator Charge incurred to provide services under this Operations

Agreement each month by the 15th day of the following month as specified in Schedule 2.

6.4.1 Payment. Payment of bills shall be made in full, either directly to the ISO (for undisputed amounts) via Fed wire or, at the election of SDG&E, to an escrow account via Fed wire in accordance with Section 6.5 (for disputed amounts). Payment of any bill must be received by the ISO or deposited into the escrow account no later than 20 calendar days after delivery (such date, for purposes of this Section 6.4, is the "Payment Due Date").

6.4.2 Full Payment. Payments shall not be subject to any reduction, whether by offset or otherwise. No Party shall take any action that would disable itself from meeting, or jeopardize its ability to meet, its obligations under this Operations Agreement including any obligation to pay money.

6.4.3 Late Payments. Bills that are not paid in full by the Payment Due Date shall accrue interest in accordance with Section 35.19a(a)(2) of FERC Regulations, 18 C.F.R. § 35.19a(a)(2), as they may be amended or superseded (for purposes of this Section 6.4, "Interest"). Interest shall accrue daily on the unpaid amount from the Payment Due Date until the date that full payment, including accrued Interest, is received by the Party owed (it may be a credit).

6.5 Disputed Line Operator Charge Bills.

6.5.1 Notice of Dispute: If a Party owing payment disputes all or a portion of a bill, it shall either pay the full amount of the bill directly to the Party owed or, at its election, pay the full undisputed amount, without offset or reduction, directly to the Party owed and, on or before the Payment Due Date (a) notify the Party owed in writing of the amount in dispute and the basis for the dispute and (b) pay the full disputed amount into an escrow account in accordance with Section 6.5.2. The Party owed and such owing Party shall endeavor to resolve informally any dispute prior to the Payment Due Date of the disputed bill. When the owing Party has paid to the Party owed amounts billed to it but contested at the time paid, any amount determined to be due and owing to the owing Party upon resolution of the dispute shall be refunded by the Party owed with Interest.

6.5.2 Escrow Account: The escrow account established pursuant to Section 6.5.1 shall be with an escrow agent selected by the paying owing Party and approved in advance by the Party owed in a form acceptable to the Party owed. The instructions given to the escrow agent shall include an express obligation on the escrow agent's part to release sufficient funds from the account, including Interest that has accrued on the account, to pay in full to the Party owed one of the following amounts (plus accumulated Interest on that amount), as applicable: (1) the amount originally billed; (2) an alternative amount agreed upon by the

disputing Parties; or (3) the amount determined by FERC or other tribunal of competent jurisdiction to be due to the Party owed but unpaid by the disputing Party. The disputing Party shall pay all costs and penalties that may be associated with withdrawing funds to pay the Party owed. Any funds remaining in the escrow account after payment to the Party owed, including accumulated interest on those remaining funds, shall be returned to the owing Party.

- 6.6 Market Payments.** All payments for market charges to the ISO will be made in accordance with the Settlement and Billing Protocol and the ISO Tariff. Any payment that is late will incur interest in accordance with the ISO Tariff, and the payment may receive a credit for distribution of interest or penalties received from other Scheduling Coordinators in accordance with the ISO Tariff.

7. SCHEDULING AND UNUSED CAPACITY

- 7.1 Scheduling.** Except as provided herein, scheduling of all APS/IID SWPL Transactions shall be in accordance with the scheduling provisions of the ISO Tariff, the ISO scheduling protocols, operating procedures and time lines. SDG&E, or its designee, shall act as the Scheduling Coordinator for the APS/IID SWPL Transactions. The ISO shall provide SDG&E with a separate Scheduling Coordinator identification for these transactions to ensure proper scheduling and settlement in accordance with this Operations Agreement.

- 7.2 Unused Capacity.** If the Schedules submitted by the Scheduling Coordinator for APS/IID SWPL Transactions do not fully utilize the transmission capacity of the APS/IID SWPL Shares, the ISO shall have the right to use all or any portion of unused capacity on the SWPL in real-time in accordance with the SWPL Agreements. APS and IID have reciprocal rights to use unused transmission capacity on the SDG&E SWPL Share in accordance with the SWPL Agreements.

8. DISPUTE RESOLUTION

- 8.1 Dispute Resolution.** The Parties shall make reasonable efforts to settle all disputes arising out of or in connection with this Operations Agreement. In the event any dispute is not settled, the Parties shall adhere to the ISO ADR Procedures set forth in Section 13 of the ISO Tariff, which is incorporated by reference, except that any reference in Section 13 of the ISO Tariff to Market Participants shall be read as a reference to SDG&E as the Scheduling Coordinator for the APS/IID SWPL Transactions and references to the ISO Tariff shall be read as references to this Operations Agreement.

9. LIABILITY

9.1 Liability. The provisions of Section 14 of the ISO Tariff will apply to liability arising under this Operations Agreement, except that all references in Section 14 of the ISO Tariff to Market Participants shall be read as references to SDG&E as the Scheduling Coordinator for the APS/IID SWPL Transactions and references to the ISO Tariff shall be read as references to this Operations Agreement.

10. UNCONTROLLABLE FORCES

10.1 Uncontrollable Forces. Section 15 of the ISO Tariff shall be incorporated by reference into this Agreement except that all references in Section 15 of the ISO Tariff to Market Participants shall be read as references to SDG&E as the Scheduling Coordinator for the APS/IID SWPL Transactions and references to the ISO Tariff shall be read as references to this Agreement.

11. NO DEDICATION OF FACILITIES

11.1 No Dedication of Facilities. Any undertaking by a Party under any provision of this Operations Agreement is rendered strictly as an accommodation and shall not constitute the dedication of the SWPL or any portion thereof by the undertaking Party to the public, to any other Party or to any third party, and any such undertaking by a Party shall cease upon the termination of such Party's obligations under this Operations Agreement.

12. MISCELLANEOUS

12.1 Assignments. Any Party may assign or transfer any or all of its rights and/or obligations under this Operations Agreement with the other Party's prior written consent in accordance with Section 17 of the ISO Tariff. Such consent shall not be unreasonably withheld. Any such transfer or assignment shall be conditioned upon the successor in interest accepting the rights and/or obligations under this Operations Agreement as if said successor in interest was an original Party to this Operations Agreement.

12.2 Notices. Any notice, demand or request which may be given to or made upon any Party regarding this Operations Agreement shall be made in accordance with Section 20.1 of the ISO Tariff. A Party must update the information in Schedule 3 of this Operations Agreement as information changes. Such changes shall not constitute an amendment to this Operations Agreement.

12.3 Waivers. Any waivers at any time by any Party of its rights with respect to any default under this Operations Agreement, or with respect to any other matter arising in connection with this Operations Agreement, shall not constitute or be

deemed a waiver with respect to any subsequent default or other matter arising in connection with this Operations Agreement. Any delay, short of the statutory period of limitations, in asserting or enforcing any right under this Operations Agreement shall not constitute or be deemed a waiver of such right.

- 12.4 Governing Law and Forum.** This Operations Agreement shall be deemed to be a contract made under, and for all purposes shall be governed by and construed in accordance with, the laws of the State of California, except its conflict of law provisions. The Parties irrevocably consent that any legal action or proceeding arising under or relating to this Operations Agreement to which the ISO ADR Procedures do not apply, shall be brought in any of the following forums, as appropriate: any court of the State of California, any federal court of the United States of America located in the State of California, or, where subject to its jurisdiction, before the Federal Energy Regulatory Commission.
- 12.5 Consistency with Federal Laws and Regulations.** This Operations Agreement shall incorporate by reference Section 20.8 of the ISO Tariff as if the references to the ISO Tariff were referring to this Operations Agreement.
- 12.6 Merger.** This Operations Agreement constitutes the complete and final agreement of the Parties with respect to the subject matter hereto and supersedes all prior agreements, whether written or oral, with respect to such subject matter, except with respect to the Settlement Agreement.
- 12.7 Amendment.** This Operations Agreement and the Schedules attached hereto may be amended from time to time by the mutual agreement of the Parties in writing. Amendments that require FERC approval shall not take effect until FERC has accepted such amendments for filing and made them effective. If the amendment does not require FERC approval, the amendment will be filed with FERC for information. Nothing contained herein shall be construed as affecting in any way the right of a Party furnishing services in accordance with this Operations Agreement to unilaterally make application to FERC for a change in the rates, terms and conditions of this Operations Agreement under Section 205 of the Federal Power Act and pursuant to FERC's Rules and Regulations promulgated thereunder, nor shall it affect the right of any Party taking service under this Operations Agreement to file a complaint under Section 206 of the Federal Power Act.
- 12.8 Severability.** If any term, covenant, or condition of this Operations Agreement or the application or effect of any such term, covenant, or condition is held invalid as to any person, entity, or circumstance, or is determined to be unjust, unreasonable, unlawful, imprudent, or otherwise not in the public interest by any court or government agency of competent jurisdiction, and the Parties elect not to terminate this Operations Agreement, then such term, covenant, or condition

shall remain in force and effect to the maximum extent permitted by law, and all other terms, covenants, and conditions of this Operations Agreement and their application shall not be affected thereby, but shall remain in force and effect and the Parties shall be relieved of their obligations only to the extent necessary to eliminate such regulatory or other determination unless a court or governmental agency of competent jurisdiction holds that such provisions are not separable from all other provisions of this Operations Agreement. Nothing in this Section 12.8 shall limit the rights of any Party under Section 12.7.

- 12.9 Effect on SWPL Agreements.** Nothing in this Operations Agreement shall affect the rights and obligations among the SWPL Participants under the SWPL Agreements and nothing contained herein shall assign any rates or charges to the APS/IID SWPL Shares under the SWPL Agreements except as provided under Section 6.3 of this Operations Agreement.
- 12.10 Counterparts.** This Operations Agreement may be executed in one or more counterparts at different times, each of which shall be regarded as an original and all of which, taken together, shall constitute one and the same Agreement.

IN WITNESS WHEREOF, the Parties have caused this Operations Agreement to be executed by their respective authorized officials.

California Independent System Operator Corporation:

By Y. Mansour
Name: Yakout Mansour
Title: President and Chief Executive Officer
Date: May 23, 2005

San Diego Gas & Electric Company:

By: _____
Name: _____
Title: _____
Date: _____

SCHEDULE 1 LOSS CALCULATION

- 1) For calendar years 2005 through 2008, the ISO will apply a fixed percentage for Transmission Losses of 0.5% to all APS/IID SWPL Transactions.
- 2) The Parties will develop a procedure to implement the annual fixed loss calculation percentage. Beginning in calendar year 2009, the Parties shall determine an annual fixed loss percentage to be applied to all APS/IID SWPL Transactions, based on the following:
 - a) Actual Transmission Losses will be determined for a 12-month period from January 1 through December 31 of the previous year.
 - b) Transmission Losses shall be calculated using actual meter data at the ISO Control Area boundary for Palo Verde/Hassayampa, North Gila and Imperial Valley.
 - c) Transmission Losses shall be changed effective on March 1, of each year and reported to the ISO by January 15.
 - d) If SDG&E disputes the loss factor calculation, SDG&E shall invoke Section 8 of this Operations Agreement to resolve the dispute.
 - e) If the dispute is not resolved by January 15, the ISO may apply the fixed loss percentage for the previous year until the dispute is resolved.

SCHEDULE 2 Line Operator Charge

For the period from 2005 through 2010, the ISO shall charge SDG&E an annual Line Operator Charge ("LOC") of \$1,577,000 to compensate the ISO for its capital costs and operating expenses associated with the administration of the joint ownership of SWPL for the benefit of all ISO customers. The LOC will be assessed on a monthly basis at a rate of \$131,416.67 per month to the SDG&E Scheduling Coordinator identification "SDG3." The ISO will submit all invoices for such charges incurred in 2005 before the end of calendar year 2005.

Effective January 1, 2011, the amount of the Line Operator Charge will be evaluated and adjusted to reimburse the ISO for the forecasted costs associated with such joint ownership. The Line Operator Charge shall be determined as follows:

- a) The ISO shall forecast its annual capital costs and operating expenses attendant to administration of the joint ownership aspects of SWPL. The calculation shall be provided to SDG&E no later than July 1.
- b) If SDG&E disputes the Line Operator Charge calculation, SDG&E shall invoke Section 8 of this Agreement to resolve the dispute.
- c) If the dispute is not resolved by December 15, the ISO shall assess the Line Operator Charge it calculated under paragraph (a) until the dispute is resolved

The Parties may mutually agree to a multi-year calculation of the Line Operator Charge.

Any revenue received by the ISO for the Line Operator Charge addressed in this Agreement shall be considered Other Revenue and used to reduce the ISO's capital costs and operating expenses.

Billing:

- 1) The ISO will bill SDG&E by the 15th day of each month for the previous month's service. The bills shall be sent via electronic mail with a copy sent via first-class United States Mail.
- 2) SDG&E shall pay monthly 1/12th of the Line Operator Charge.
- 3) SDG&E shall provide the ISO the following billing information and notify the ISO of any changes to its information at least one billing cycle prior to the change:
Contact name
Billing address
Billing telephone number
Billing electronic mail address

**SCHEDULE 3
NOTICES**

SDG&E

Name of Primary Representative: Scott Peterson
Title: Director, Electric Grid Operations
Address: P.O. Box 129831, SD1160
City/State/Zip Code: San Diego, California 92112-9831
Email Address: speterson@semprautilities.com
Phone: 619-725-8639
Fax No: 619-683-3291

Name of Alternative Representative: S. Ali Yari
Title: Director, Electric Transmission & Distribution Engineering
Address: 8330 Century Park Court
City/State/Zip Code: San Diego, California 92123
Email Address: AYari@semprautilities.com
Phone: 858-654-8200
Fax No: 619-654-1692

ISO:

Name of Primary Representative: Thomas Doughty
Title: Director of Client Relations
Address: 151 Blue Ravine Road
City/State/Zip Code: Folsom, CA 95630
Email Address: tdoughty@caiso.com
Phone: (916) 608-7373
Fax No: (916) 351-2487

Name of Alternative Representative: Deborah Le Vine
Title: Director of Contracts
Address: 151 Blue Ravine Road
City/State/Zip Code: Folsom, CA 95630
Email Address: dlevine@caiso.com
Phone: (916) 351-2144
Fax No: (916) 351-2487

Attachment B
To Offer of Settlement

Revised ISO Tariff Sheets

- **O&M Expenses** = Transmission O&M Expenses (Accounts 560-574) plus Customer Accounting Expenses (Accounts 901-905) plus Customer Service and Informational Expenses (Accounts 906-910) plus Sales Expenses (Accounts 911-917) plus Administrative & General Expenses (Accounts 920-935)
- **Taxes Other Than Income Taxes** = those taxes other than income taxes which relate to ISO operating income (Account 408.1)
- **Penalties** = payments by the ISO for penalties or fines incurred for violation of WECC reliability criteria (Account 426.3)
- **Debt Service** = for any fiscal year, scheduled principal and interest payments, sinking fund payments related to balloon maturities, repayment of commercial paper notes, net payments required pursuant to a payment obligation, or payments due on any ISO notes. This amount includes the current year accrued principal and interest payments due in April of the following year.
- **Coverage Requirement** = 25% of the Senior Lien Debt Service.
- **Senior Lien Debt Service** = all Debt Service that has a first lien on ISO Net Operating Revenues (Account 128 subaccounts).
- **Cash Funded Capital Expenditures** = Post current fiscal year capital additions (Accounts 301-399) funded on a pay-as-you-go basis.
- **Interest Earnings** = Interest earnings on Operating and Capital Reserve balances (Account 419). Interest on bond or note proceeds specifically designated for capital projects or capitalized interest is excluded.
- **Other Revenues** = Amounts booked to Account 456 subaccounts. Such amounts include but are not limited to application fees, WECC reliability coordinator reimbursements, Line Operator Charges, and fines assessed and collected by the ISO.
- **Reserve Transfer** = the projected reserve balance for December 31 of the prior year less the Reserve Requirement as adopted by the ISO Governing Board and FERC. If such amount is negative, the amount may be divided by two, so that the reserve is replenished within a two-year period. (Account 128 subaccounts)
- **Reserve Requirement** = 15% of Annual Operating Expenses.

A separate revenue requirement shall be established for each component of the Grid Management Charge by developing the revenue requirement for the ISO as a whole and then assigning such costs to the seven service categories using the allocation factors provided in Appendix F, Schedule 1, Part E of this Tariff.

Part D – Information Requirements

Budget Schedule

The ISO will convene, prior to the commencement of the Annual Budget process, an initial meeting with stakeholders to: (a) receive ideas to control ISO costs; (b) receive ideas for projects to be considered in the capital budget development process; and, (c) receive suggestions for reordering ISO priorities in the coming year.

Within 2 weeks of the initial meeting, the ideas presented by the stakeholders shall be communicated in writing to the ISO's officers, directors and managers as part of the budget development process, and a copy of this communication shall be made available to stakeholders.

Subsequent to the initial submission of the draft budget to the finance committee of the ISO Governing Board, the ISO will provide stakeholders with the following information: (a) proposed capital budget with indicative projects for the next subsequent calendar year, a budget-to-actual

under SCID PGAB, the ISO will not charge any additional GMC at the tariffed GMC rate, but rather will attribute such schedules and load to the fixed \$75,000.00 per month payment set forth above, provided that MID schedules such load under a new and separate SCID and the ISO shall not assess GMC charges to such SCID.

4. San Diego Gas & Electric is the Scheduling Coordinator for transactions on those portions of the Southwest Power Link ("SWPL") which are owned by the Arizona Public Service Company ("APS") and the Imperial Irrigation District ("IID"), and are scheduled by SDG&E under a designated SCID. Schedules submitted to the ISO under that designated SCID shall not be subject to GMC charges. In lieu of GMC charges, SDG&E will pay the ISO a Line Operator Charge, as agreed to in the SWPL Operations Agreement, entered into by the ISO and SDG&E on May 23, 2005, and submitted to the Commission as a rate schedule pursuant to the Federal Power Act.

Attachment C
To Offer of Settlement

Blacklined Revised ISO Tariff Sheets

ISO TARIFF APPENDIX F

Rate Schedules

Schedule 1

Grid Management Charge

* * *

Part C – Costs Recovered through the GMC

As provided in Section 8 of the ISO Tariff, the Grid Management Charge includes the following costs, as projected in the ISO's budget for the year to which the Grid Management Charge applies:

- Operating costs (as defined in Section 8.2.2)
- Financing costs (as defined in Section 8.2.3), including Start-Up and Development costs and
- Operating and Capital Reserve costs (as defined in Section 8.2.4)

Such costs, for the ISO as a whole, are allocated to the eight service charges that comprise the Grid Management Charge: (1) Core Reliability Services - Demand Charge, (2) Core Reliability Services – Energy Export Charge, (3) Energy Transmission Services Net Energy Charge, (4) Energy Transmission Services Uninstructed Deviations Charge, (5) Forward Scheduling Charge, (6) Congestion Management Charge, (7) Market Usage Charge, and (8) Settlements, Metering, and Client Relations Charge, according to the factors listed in Part E of this Schedule 1, and

adjusted annually for:

- any surplus revenues from the previous year as deposited in the Operating and Capital Reserve Account, as defined under Section 8.5, or deficiency of revenues, as recorded in a memorandum account;

divided by:

- forecasted annual billing determinant volumes;

adjusted quarterly for:

- a change in the volume estimate used to calculate the individual Grid Management Charge components, if, on an annual basis, the change is 5% or more.

The Grid Management Charge revenue requirement formula is as follows:

Grid Management Charge revenue requirement =

- Operating Expenses + Debt Service + [(Coverage Requirement x Senior Lien Debt Service) and/or (Cash Funded Capital Expenditures)] - Interest Earnings - Other Revenues - Reserve Transfer

Where,

- **Operating Expenses** = O&M Expenses plus Taxes Other Than Income Taxes and Penalties
- **O&M Expenses** = Transmission O&M Expenses (Accounts 560-574) plus Customer Accounting Expenses (Accounts 901-905) plus Customer Service and Informational Expenses (Accounts 906-910) plus Sales Expenses (Accounts 911-917) plus Administrative & General Expenses (Accounts 920-935)

- **Taxes Other Than Income Taxes** = those taxes other than income taxes which relate to ISO operating income (Account 408.1)
- **Penalties** = payments by the ISO for penalties or fines incurred for violation of WECC reliability criteria (Account 426.3)
- **Debt Service** = for any fiscal year, scheduled principal and interest payments, sinking fund payments related to balloon maturities, repayment of commercial paper notes, net payments required pursuant to a payment obligation, or payments due on any ISO notes. This amount includes the current year accrued principal and interest payments due in April of the following year.
- **Coverage Requirement** = 25% of the Senior Lien Debt Service.
- **Senior Lien Debt Service** = all Debt Service that has a first lien on ISO Net Operating Revenues (Account 128 subaccounts).
- **Cash Funded Capital Expenditures** = Post current fiscal year capital additions (Accounts 301-399) funded on a pay-as-you-go basis.
- **Interest Earnings** = Interest earnings on Operating and Capital Reserve balances (Account 419). Interest on bond or note proceeds specifically designated for capital projects or capitalized interest is excluded.
- **Other Revenues** = Amounts booked to Account 456 subaccounts. Such amounts include but are not limited to application fees, WECC reliability coordinator reimbursements, [Line Operator Charges](#), and fines assessed and collected by the ISO.
- **Reserve Transfer** = the projected reserve balance for December 31 of the prior year less the Reserve Requirement as adopted by the ISO Governing Board and FERC. If such amount is negative, the amount may be divided by two, so that the reserve is replenished within a two-year period. (Account 128 subaccounts)
- **Reserve Requirement** = 15% of Annual Operating Expenses.

A separate revenue requirement shall be established for each component of the Grid Management Charge by developing the revenue requirement for the ISO as a whole and then assigning such costs to the seven service categories using the allocation factors provided in Appendix F, Schedule 1, Part E of this Tariff.

* * *

Part F – Other Modifications to the Rates

Consistent with a Settlement Agreement accepted by the FERC in Docket Nos. ER04-115-000, et al., GMC rates and charges shall be calculated consistent with the following additional requirements during the period that the GMC rates and charges specified in that Settlement Agreement remain in effect:

1. The GMC chargeable to a Scheduling Coordinator for transactions representing transfers from the Mohave generation facility to the Loads of the Mohave co-owners located outside of the ISO Control Area, will be reduced by excluding 65 percent of those Loads from the Energy Transmission Services Net Energy Charge and the Core Reliability Services – Energy Exports Charge. Such excluded Load shall not be included in the denominators used to calculate

the rates for the Energy Transmission Services – Net Energy Charge and the Core Reliability Services – Energy Export Charge.

2. The Forward Scheduling Charge assessed against Schedules submitted by PG&E solely in its role as Path 15 facilitator will be reduced by excluding 65 percent of the number of such Schedules from the Forward Scheduling Charge. Such excluded Schedules shall not be included in the denominator upon which the Forward Scheduling Charge is calculated.

3. Modesto Irrigation District (MID) is a Scheduling Coordinator and also is responsible for a portion of the GMC charges payable by another Scheduling Coordinator, Pacific Gas and Electric Company (PG&E) pursuant to a contract between them. MID and PG&E have agreed that MID shall pay the ISO directly \$75,000 each month, in lieu of any payments to PG&E for its share of the GMC charges payable by PG&E and the ISO shall credit a portion of the amount received from MID to PG&E as an offset to PG&E's obligation for GMC charges. Any difference, positive or negative, between the amount credited to PG&E and the amount paid by MID to the ISO under this provision shall be reflected in the Operating and Capital Reserves Account. The payment arrangement described in this paragraph is subject to the conditions, and will be implemented pursuant to the procedures, set forth in the Offer of Partial Settlement accepted by the FERC in Docket Nos. ER04-115-000, et al. This arrangement shall not apply to MID's obligation for GMC charges as a Scheduling Coordinator, which shall be governed by the provisions of this Schedule 1 and the other applicable provisions of the ISO Tariff, except that in the event that MID accepts responsibility for scheduling any load currently scheduled by PG&E under SCID PGAB, the ISO will not charge any additional GMC at the tariffed GMC rate, but rather will attribute such schedules and load to the fixed \$75,000.00 per month payment set forth above, provided that MID schedules such load under a new and separate SCID and the ISO shall not assess GMC charges to such SCID.

4. San Diego Gas & Electric is the Scheduling Coordinator for transactions on those portions of the Southwest Power Link ("SWPL") which are owned by the Arizona Public Service Company ("APS") and the Imperial Irrigation District ("IID"), and are scheduled by SDG&E under a designated SCID. Schedules submitted to the ISO under that designated SCID shall not be subject to GMC charges. In lieu of GMC charges, SDG&E will pay the ISO a Line Operator Charge, as agreed to in the SWPL Operations Agreement, entered into by the ISO and SDG&E on May 23, 2005, and submitted to the Commission as a rate schedule pursuant to the Federal Power Act.