

# SWIDLER BERLIN SHEREFF FRIEDMAN, LLP

THE WASHINGTON HARBOUR  
3000 K STREET, NW, SUITE 300  
WASHINGTON, DC 20007-5116  
TELEPHONE (202) 424-7500  
FACSIMILE  
WWW.SWIDLAW.COM

J. PHILLIP JORDAN  
DIRECT DIAL: (202) 424-7757  
FAX: (202) 424-7643  
JPJORDAN@SWIDLAW.COM

NEW YORK OFFICE  
THE CHRYSLER BUILDING  
405 LEXINGTON AVENUE  
NEW YORK, NY 10174  
TEL.(212) 973-0111  
FAX (212) 891-9598

October 17, 2002

The Honorable Magalie R. Salas  
Secretary  
Federal Energy Regulatory Commission  
888 First Street, NE  
Washington, DC 20426

Re: *California Independent System Operator Corporation*, Docket Nos. ER02-250-000 and ER02-527-000; *Pacific Gas and Electric Company*, Docket No. ER02 479-000

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 (2002), the California Independent System Operator Corporation (“ISO”), on behalf of itself, Pacific Gas and Electric Company (“PG&E”), and Southern California Edison Company (collectively, the “Sponsoring Parties”), submits the enclosed Offer of Settlement and Settlement Agreement in connection with the above-captioned consolidated proceedings (“Settlement Agreement”) together with a Motion to Shorten Comment Period. The ISO is authorized to state that the Settlement Agreement is sponsored by, supported by, or unopposed by all of the active parties in the above captioned dockets, which include the Staff of the California Public Utilities Commission.<sup>1</sup> This Settlement Agreement is not opposed by Commission Staff.

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<sup>1</sup> The active parties are: The California Department of Water Resources, the California Electricity Oversight Board, the California Independent System Operator Corporation, the California Public Utilities Commission, the City of Redding, the City and County of San Francisco, the City of Santa Clara, The Metropolitan Water District of Southern California, Modesto Irrigation District, Northern California Power Agency, Pacific Gas and Electric Company, Sacramento Municipal Utility District, San Diego Gas and Electric Company, San Francisco Bay Area Rapid Transit District, Southern California Edison

The Settlement Agreement constitutes the full and final resolution of all issues in the above captioned dockets, except for one issue of interest only to SDG&E, and terminates the above-captioned proceedings. The Settlement Agreement, which determines the ISO's Grid Management Charge ("GMC") rates for calendar year 2002, and provides a mechanism for the ISO to make changes to GMC in 2003 without a Section 205 filing, is in the public interest. This settlement is particularly important because it will allow the parties to avoid protracted and repeated litigation, and to devote their efforts to the important tasks facing the ISO and its stakeholders in the remainder of this year and 2003. Foremost among these tasks is the implementation of the ISO's market redesign pursuant to the ISO's proposals and the Commission's orders. As the Commission is well aware, the new initiatives that have been approved require extensive education and modification of software and practices. Moreover, the shape of the long term projects envisioned in the redesign must be formulated with the full participation of stakeholders.

In addition, the ISO and its ratepayers are committed to a complete and thorough reevaluation of the ISO's GMC structure during 2003, as mandated by Judge Bobbie J. McCartney in her Initial Decision in Docket Nos. ER01-313-000, *et al.*<sup>2</sup> The parameters of that reevaluation are set forth in Appendix B of the Settlement Agreement. This process is intended to publicly consider and address the structure of the ISO's GMC. The Settlement Agreement will allow the parties to devote their attention to the further refinement of the GMC, rather than to litigating.

The Settlement Agreement has been the subject of intense negotiations over more than four months. It provides significant reductions by the ISO in its requested revenue requirement and in the rates for two of the three service categories in response to concerns by intervenors, as well as important compromises that ensure that the ISO recovers the revenue requirement necessary to continue the reliable operation of the ISO Controlled Grid and to implement the market and structural improvements that are necessary to provide reliable and nondiscriminatory service in the future. All of the active parties respectfully request the Presiding Judge to certify the Settlement Agreement as filed to the Commission, and respectfully urge that the Commission approve the Settlement Agreement without condition or modification.

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Company, Trinity Public Utility District, the Transmission Agency of Northern California, and Turlock Irrigation District.

<sup>2</sup> *California Independent System Operator Corporation*, 99 FERC ¶ 63,020 (2002).

### CONTENTS OF THIS SUBMISSION

This filing includes the following documents:

- Transmittal letter
- Motion to Shorten Comment Period
- Explanatory Statement
- Settlement Agreement
- Appendix A – Provisions relating to the ISO's 2003 budget process
- Appendix B – Provisions relating to the 2003 GMC re-evaluation process
- Blackline and Clean Tariff Sheets incorporating amendments to the ISO Tariff
- Blackline and Clean Tariff Sheets incorporating amendments to PG&E's Pass-Through Tariff
- Draft Letter Order Approving Settlement Agreement – Hardcopy and Diskette
- Draft Notice – Hardcopy and Diskette
- Snapshot of Fines and Penalties as of September 30, 2002
- Confidentiality Agreement for the 2003 ISO Budget and Rate Development Process
- Certificate of Service

### SETTLEMENT RATES

The following Settlement Rates are to be effective January 1, 2002, for the Control Area Services Charge ("CAS"), the Congestion Management Charge ("CM"), and the Ancillary Services and Real Time Energy Operations Charge ("ASREO"):

CAS:           \$0.553/MWh

CM:             \$0.312/MWh

ASREO:        \$0.957/MWh

For ASREO, the following rate is effective September 1, 2002, through October 31, 2002:

ASREO: \$1.048/MWh

For ASREO, the following rate is effective November 1, 2002, through December 31, 2002:

ASREO: \$1.158/MWh<sup>3</sup>

The Settlement Agreement would allow the ISO, under limited circumstances, to adjust the 2003 GMC rates to ensure recovery of the ISO's revenue requirement for 2003 without a filing under Section 205 of the Federal Power Act. The ISO may make such an adjustment, under the terms of its tariff, for changes in billing determinant volumes. Under the Settlement Agreement, the ISO could also make an adjustment without a Section 205 filing if, and only if (1) the ISO does not change the service categories (*i.e.*, CAS, CM, and ASREO), (2) neither the ISO revenue requirement *in toto* (referred to in the Settlement Agreement as the "gross revenue requirement") nor the revenue requirement for any individual service category exceeds the amounts set forth in the Settlement Agreement, and (3) the ISO's revenue requirement calculated before consideration of the Operating and Capital Reserves Account does not exceed the amount set forth in the Settlement Agreement. As discussed above, this provision will allow the parties to avoid unnecessary litigation in 2003 and instead devote their attention to the major tasks facing the ISO. In addition, the reevaluation of the ISO GMC structure that is being undertaken in 2003 for calendar year 2004 will provide the parties with an extensive opportunity to address their concerns about the GMC and to offer alternative structures, including those rejected by Judge McCartney in her Initial Decision in Docket Nos. ER01-313-000, *et al.*. The avoidance of litigation in 2003 was a significant factor motivating the ISO and many of the active parties to enter into this Settlement Agreement.

#### SETTLEMENT TARIFF CHANGES

Sections 8.3 and 8.4 as well as Appendix F, Schedule 1, Part D of the Tariff have been revised to clarify that except as specified by the Settlement Agreement, changes to the ISO's revenue requirement must be filed with the Commission.

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<sup>3</sup> On September 12, 2002, the Commission issued a letter order granting the Joint Motion for Interim Rates, submitted by the ISO on behalf of the active parties in the proceeding. The Commission's order placed the settlement rates into effect on an interim basis, effective September 1, 2002. On October 11, 2002, the ISO submitted an additional motion to place the \$1.158/MWh rate for ASREO into effect on November 1, 2002 on an interim basis so that settlement rates going forward would be in effect while the Commission considers this submission.

Section 8.3.3, the description of “Ancillary Services and Real-Time Energy Operations Charge”, and Appendix F, Schedule 1, Part A have been revised to reflect that the ISO will not be assessing fifty percent of the ASREO charge on self-provided Ancillary Services.

Section 8.5 has been revised to make the application of surplus funds from the Operating and Capital Reserves Account to offset the next fiscal year’s revenue requirement mandatory instead of discretionary.

Appendix F, Schedule 1, Part B has made the quarterly adjustment due to volume changes automatic to clarify that no additional Section 205 filing is involved to adjust rates to recover a FERC approved revenue requirement. The language allowing the revenue requirement to be adjusted to reflect cost savings or unanticipated collections of fines and penalties has been struck.

Appendix F, Schedule 1, Part B and Part D have been revised to clarify that the ISO may make a Section 205 filing at any time during a year and not just on an annual basis.

In its November 2, 2002 filing in ER02-250-000, the ISO submitted a change to Appendix F, Schedule 1, Part C to add the word “and” to the Operating Expenses formula. The blackline sheets used to track changes to the Tariff reflected this change, but the clean sheets did not. The clean sheets submitted with today’s filing include the change.

PG&E’s Tariff has been revised to reflect the rates set forth in the Settlement Agreement.

#### SERVICE OF SUBMISSION

In accordance with Rule 602(d), 18 C.F.R. § 385.602(d), the Settlement Agreement is being served on the Public Utilities Commission of California, the California Energy Commission, the California Electricity Oversight Board, all entities with effective Scheduling Coordinator Service Agreements under the ISO Tariff and on all parties on the Commission’s official service list for the above captioned proceedings. In addition, a copy of the Settlement Agreement is being electronically sent to all Market Participants via ISO market notice. Under Rule 602(e)(3), 18 C.F.R. § 385.602(e)(3), those entities will have an opportunity to comment on the Settlement Agreement.

The parties to the Settlement Agreement specifically direct the attention of persons served with this Settlement Agreement to Section 602(f)(3) of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.602(f)(3), which provides that, “Any failure to file a comment constitutes a waiver of all objections to the offer of settlement.”

NOTICE RESPECTING COMMENTS REGARDING OFFER OF SETTLEMENT

In accordance with the provisions of Rule 602(d)(2), 18 C.F.R. § 385.602(d)(2), the parties making this filing hereby notify all participants in these proceedings as well as other persons required by Rule 602(d)(1) that Comments on the Offer of Settlement are due to be filed by November 5, 2002, and Reply Comments are due to be filed by November 15, 2002, unless other dates are provided by the Commission. The parties making this filing are requesting a shortened comment period, as explained in the enclosed Motion to Shorten Comment Period. Under that shortened comment period, if ordered by the Commission, Comments will be due by October 28, 2002, and Reply Comments by November 4, 2002.

Respectfully submitted,

J. Phillip Jordan

Counsel for the  
California Independent System Operator  
Corporation

On behalf of the Sponsoring Parties