UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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

EXPLANATORY STATEMENT IN SUPPORT OF OFFER OF SETTLEMENT

To: The Commission

Pursuant to Rule 602(c)(ii) of the Federal Energy Regulatory Commission's (Commission) Rules of Practice and Procedure, 18 C.F.R. § 385.602(c)(ii) (1997), the California Independent System Operator Corporation (ISO), hereby submits this Explanatory Statement in support of the attached Offer of Settlement (Settlement).

INTRODUCTION

The ISO is filing an Offer of Settlement to extend for six months the current Grid Management Charge (GMC) formula and assessment provisions that are part of the settlement offer the ISO filed on April 7, 1998 (April 7, 1998 Settlement) and that were accepted by the Commission on June 1, 1998. As provided in the April 7, 1998 Settlement, the ISO has been facilitating an independent study to determine what, if any, of the ISO's services could be unbundled and separately priced. Based on the unbundling study analysis conducted to date, the unbundling study working group, which is made up of stakeholders, has determined that additional time is needed to gather additional operating data and to study further the unbundling methodology. The large majority of stakeholders either support or do not oppose this extension. As explained below, the ISO believes that an extension of the current GMC rate formula is in the interest of all stakeholders because it will provide an opportunity for the consultant to use an additional six months of operating data to refine the proposed cost assignment and allocation methodology. In addition, the extension will give stakeholders more opportunities to provide input in the unbundling process and increase the possibility that there will be a stakeholder consensus on the GMC unbundling issues.

BACKGROUND

Procedural Background

On October 17, 1997, the ISO filed with the Commission for approval of its GMC, pursuant to Section 205 of the Federal Power Act and Section 35.13 of the Commission's regulations, 18 C.F.R. § 35.13 (1998) (October 17 rate filing). The October 17, 1997 rate filing was designated by the Commission as Docket No. ER98-211-000. Also on October 17, 1998, the California Power Exchange Corporation (PX) filed for, among other things, approval of its PX Administration Charge. The PX Administration Charge proceeding was designated as Docket No. ER98-210-000. On December 17, 1997, the Commission set the ISO and PX rate filings for hearing. On January 30, 1998, the PX filed an amendment to its rate filing, which was designated as Docket No. ER98-1729-000. The Commission set the amendment for hearing on March 30, 1998 and consolidated it with the Docket No. ER98-210-000 proceeding.

On October 31, 1997, Southern California Edison Company (SoCal Edison) made a filing in Docket No. ER98-462-000 to pass through to its wholesale customers SoCal Edison's share of the ISO's GMC charge and the PX's full requirements volumetric Administrative Charge. Also on October 31, 1997, Pacific Gas & Electric (PG&E) filed a proposed formula rate in Docket No. ER98-556-000 to recover from certain existing customers a portion of the GMC. In Docket No. ER98-557-000, PG&E filed a proposed formula rate to recover a portion of the PX Administrative Charge from existing wholesale customers. On December 17, 1997, the Commission set both of these filings for hearing.

On April 7, 1998, the ISO filed a comprehensive settlement offer, which fully resolved issues in Docket Nos. ER98-211-000 and ER98-462-000 and partially resolved the issues in Docket Nos. ER98-210-000, ER98-1729-000, ER98-556-000 and ER98-557-000. No party objected to the April 7, 1998 Settlement Offer. On April 8, 1998, the Chief Judge consolidated the proceedings for purposes of settlement. The April 7, 1998 Settlement was approved by the Commission on June 1, 1998.

Summary of the April 7, 1998 Settlement

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

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

The parties also agreed to the reasonableness of three provisions in the GMC formula (a 25 percent debt coverage requirement, a 15 percent reserve requirement, and an initial debt financing with a maximum level of $310,000,000 to cover start-up and development costs, cash working capital and 1998 and 1999 budgeted capital expenditures).

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

The ISO agreed to make an informational filing to FERC on December 15 of each year, containing cost data on the ISO's operations and any additional information on which the ISO relies to set the GMC unit rate for the following year (April 7, 1998 Settlement, ¶ 16). The ISO agreed to prepare a preliminary annual budget forecast each fall for the following year and to hold a budget workshop open to all interested parties.

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

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

¶ 20). Thus, under the terms of the April 7, 1998 Settlement, the ISO is required to make a rate filing, whether or not the filing is for an unbundled rate pursuant to the unbundling study.

UNBUNDLING STUDY PROCESS

An unbundling working group made up of approximately 60 individuals from all stakeholder groups was formed to oversee the unbundling study process. The ISO prepared a Request for Proposals (RFP) for the selection of an independent consultant to undertake the unbundling study. A selection committee made up of volunteers from the working group reviewed and commented on the criteria outlined in the RFP. The selection committee contained a member from the commercial users group, an investor-owned utility, the marketers, and state and municipal stakeholder groups. The selection committee spent a great deal of time and put extraordinary effort into the selection of the consultant.

The RFP was sent to approximately 20 entities, which were chosen from working group recommendations and from a directory of consultants. The goal was to find a consultant that was sufficiently independent of California market participants, had experience with FERC ratemaking principles and had sufficient resources to undertake the project. The ISO received twelve responses to the RFP. After an extensive initial evaluation of the twelve responses, the selection committee narrowed the number of eligible entities to five. The selection committee interviewed, in person, each of the five eligible entities over a two-day period, after which the committee narrowed the field to two. After follow-up telephone interviews with the two entities, the selection committee unanimously chose R.J. Rudden Associates, Inc. (Rudden) to conduct the unbundling study.

Rudden’s assignment was to conduct an independent study to analyze whether the GMC can be unbundled and, if so, how it should be unbundled. If the GMC could be unbundled, users would be able to pay for only the services they use. As part of its study, Rudden attempted to define the specific services the ISO provides and analyze the detailed costs within the ISO's budget to provide those services. Rudden also analyzed methods for allocating costs among services and/or user groups.

During the study process, Rudden received input from many stakeholder groups and attempted to develop pricing structures that responded to the stakeholders' concerns. Rudden conducted interviews with each stakeholder group, including investor-owned utilities, municipal agencies, the California Power Exchange, energy service providers, marketers, brokers, aggregators, and commercial and industrial end users.

Because the ISO did not begin operating until April 1, 1998, Rudden had limited data on which to base its recommendations. Rudden was faced with a lack of documentation on cost causation and customer usage patterns. It also had to contend with an evolving operating environment and a lack of experience with allocating the specific costs incurred by the ISO. In its preliminary unbundling report, issued on June 19, 1998, Rudden recommended that the ISO unbundle its control area function and its market function. Rudden recommended that the portion of the ISO revenue requirement related to market facilitation activities, such as ancillary services auctions, settlements, and billing and metering be recovered on a per transaction basis. The remaining costs for managing the grid dispatch and assuring reliability should be collected on a volumetric (per MWh) basis of scheduled energy including wheeling through and wheeling out volumes, according to Rudden. Rudden's preliminary report was the focus of a daylong meeting of all interested parties held on July 9, 1998. Based on the concerns raised at that meeting, and on Rudden's further investigation and discussions with ISO staff and other stakeholders, Rudden submitted a revised unbundling report on August

17, 1998. In addition to some adjustments to its preliminary cost allocation proposal, the revised report also modified the proposal to recover market-related costs on a MWh basis, finding that the proposal was too complex and would lead to an unacceptable level of revenue instability at this time.

In addition to the July 9, 1998 conference, the GMC unbundling working group met on several occasions and conducted several teleconferences to discuss the unbundling issues and to review the preliminary and final study results. Members of the unbundling working group had three concerns about the Rudden study results: 1) some members were concerned that the study did not go far enough in terms of unbundling ISO services; 2) some members felt that the use of a transaction-based billing determinant for the market functions needed further definition; and 3) some members objected to the large financial impact that the Rudden recommendation would have on smaller Scheduling Coordinators. As a result, the unbundling working group reached a consensus that the unbundling process needed more time and that the GMC filing (to be effective January 1, 1999) required by the April 7, 1998 Settlement should be postponed. The extension of the April 7, 1998 Settlement will advance two important objectives identified by the stakeholder groups. First, the extension will provide the opportunity for the consultant to analyze operational data over an additional six-month period and modify or refine the proposed cost assignment and allocation methodology. Second, the extension will provide more opportunity for stakeholder input and increase the possibility for developing a consensus approach to the unbundling process.

On August 31, 1998, the ISO sent a letter to all stakeholders, inquiring whether they would support an extension of the April 7, 1998 Settlement, so that the required GMC filing (to be effective on January 1, 1999) could be postponed until more data could be collected and the unbundling issues studied further. The large majority of stakeholders indicated that they either support or do not oppose the extension of the April 7, 1998 Settlement for six months. To continue stakeholder participation in the unbundling process, the ISO sent a memorandum (dated September 11, 1998) to all parties outlining a proposed schedule for obtaining stakeholder input on the outstanding unbundling issues during the GMC extension period.

PROPOSED EXTENSION OF THE APRIL 7, 1998 SETTLEMENT GMC FORMULA

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

The preliminary 1999 revenue requirement, transmission volumes, and resulting GMC are now posted on the ISO's website. While the 1999 revenue requirement is slightly higher than the 1998 revenue requirement (the numerator of the GMC calculation), there are higher annual transmission volumes in the denominator of the GMC calculation. As a result, based on the current 1999 revenue requirement figures, the 1999 GMC will decrease by approximately $.005/MWh. The ISO has completed a GMC workshop, which was open to all interested parties, and parties had the opportunity to discuss and comment on the ISO proposed revenue requirement, transmission volumes and resulting GMC.

In the Offer of Settlement, the ISO agrees to make a new GMC filing with rates to be effective on July 1, 1999. The filing will be consistent with the GMC rate methodology that will be adopted by the ISO Board of Governors at that time. The new GMC filing will contain the agreed-to formulary provisions adopted in Paragraph 7 of the April 7, 1998 Settlement (the 25% debt coverage, 15% reserve requirement, and $310,000,000 initial debt amount). The Offer of Settlement does not affect the provisions in Paragraph 25 of the April 7, 1998 Settlement regarding the ongoing proceedings in Docket Nos. ER98-556-000, ER98-557-000, ER98-210-000 and ER98-1729-000.

MOTION FOR AUTHORIZATION TO COLLECT SETTLEMENT RATES ON AN INTERIM BASIS AND REQUEST FOR WAIVERS

The current GMC rate on file with the Commission will expire on January 1, 1999, by the terms of the April 7, 1998 Settlement. Consequently, the ISO is filing a Motion for Authorization to Collect Settlement Rates on an Interim Basis to enable the ISO to continue charging the April 7, 1998 GMC rate (updated with 1999 operating costs and volumes) in the event the Commission does not act on attached Offer of Settlement to extend the GMC by January 1, 1999. In the alternative, the ISO requests a waiver of all requirements necessary to keep the April 7, 1998 Settlement rates in effect past January 1, 1999 until the Commission approves the Offer of Settlement extending the GMC or until 30 days after the Commission rejects it. The ISO must have a rate on file and it would not be in the best interest of stakeholders, nor would it facilitate the largely successful stakeholder process that has been nearing a consensus on the unbundling rate issues, if the originally filed rate (from the October 17, 1997 filing) goes into effect by default. Moreover, the April 7, 1998 Settlement

GMC rate was reached through a consensus of stakeholders and was approved by the Commission – the October 17, 1997 rate was not.

If the Commission does not approve the Offer of Settlement extending the GMC, the ISO will make a Section 205 GMC rate filing within 30 days of that order.

WHEREFORE, the ISO respectfully requests that the ISO approve the attached Offer of Settlement.

Respectfully submitted,

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