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June 25, 2002

FEDERAL ENERGY
REGULATORY COMMISSION

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

RE: *Duke Energy South Bay, LLC*, Docket No. ER98-496-000
Duke Energy Oakland, LLC, et al., Docket No. ER02-10-000

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), Duke Energy South Bay, LLC ("Duke"), the California Independent System Operator Corporation (the "ISO"), and San Diego Gas & Electric Company ("SDG&E") (collectively, the "Parties") hereby submit for filing in the above-referenced dockets an original and fourteen copies of an offer of Settlement and Stipulation and Agreement that resolves certain issues in these proceedings. The issues resolved in the above-referenced proceedings relate to the ISO's requirements for maintaining pre-existing fuel oil capability for the South Bay facility, and the extent to which costs associated with fuel oil storage, transportation, and barge-delivery facilities may be included in Duke's Annual Fixed Revenue Requirement ("AFRR") filings.

Contents of Submission

Enclosed with this filing are the following:

- (1) An Explanatory Statement (Attachment 1);
- (2) A Settlement Agreement, consisting of a Stipulation and Agreement with an appended revised RMR Schedule H (Attachment 2);
- (3) A draft Commission letter order approving the Settlement Agreement, with a diskette containing the draft order in MS Word format (Attachment 3).

As indicated in the enclosed Explanatory Statement, this Offer of Settlement is supported by all Parties to this proceeding. The Parties diligently have worked toward the settlement of these matters on an informal basis over a period of months, and thus request that the Commission give this Offer of Settlement expedited consideration to provide all Parties the ability to move forward with important economic decisions that currently depend on the resolution of these issues.

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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.

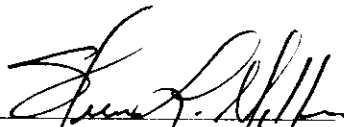
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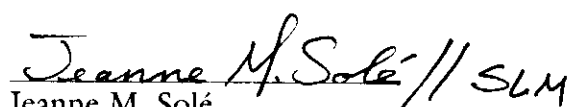
A copy of this submission is being served on all participants in the referenced proceeding and on all other persons required to be served pursuant to Rule 602(d) of the Commission's Rules of Practice and Procedure.

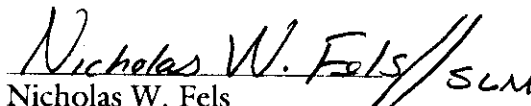
Notice Regarding Filing Comments to Offer of Settlement

In accordance with Rule 602(d), Duke hereby informs all participants in this proceeding that comments on the Offer of Settlement and Settlement Agreement are due by July 15, 2002, and reply comments are due by July 24, 2002. The Parties request adherence to this comment period as provided in Rule 602(f)(2) in order to expedite the conclusion of this matter.

Respectfully submitted,


Steven L. Miller
Attorney for
Duke Energy South Bay, LLC


Jeanne M. Solé // SLM
Attorney for
California Independent System
Operator Corporation


Nicholas W. Fels // SLM
Attorney for San Diego Gas &
Electric Company

Attachments

cc: Service List

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

Duke Energy South Bay, LLC)
Duke Energy Oakland, LLC, et al.)

Docket No. ER98-496-000
Docket No. ER02-10-000

**EXPLANATORY STATEMENT
IN SUPPORT OF OFFER OF SETTLEMENT**

Pursuant to Rule 602(c)(1)(ii) of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (“Commission”), 18 C.F.R. § 385.602(c)(1)(ii) (2001), Duke Energy South Bay, LLC (“Duke”), the California Independent System Operator Corporation (the “ISO”), and San Diego Gas & Electric Company (“SDG&E”) (collectively, the “Parties”), hereby submit this Explanatory Statement in support of the attached Offer of Settlement and Settlement Agreement (the “Settlement Agreement”), submitted to resolve certain issues in the above-captioned proceedings.¹ The attached Settlement consists of a Stipulation and Agreement and one appendix. This Explanatory Statement is not intended to alter any of the provisions of the Stipulation and Agreement or appendix, and is provided in accordance with the Commission’s rules.

I. BACKGROUND

Duke is the lessee and operator of the South Bay generating station (“South Bay”) at Chula Vista, California. The plant includes four steam units, as well as a combustion turbine. The four steam units normally operate on natural gas, but can also burn fuel oil.

Since April 1, 1998, when the ISO began operations, some or all of the capacity of South Bay has been designated by the ISO as necessary for local reliability needs and

¹ While not Parties to the attached Settlement Agreement, the California Electricity Oversight Board (the “EOB”) and the California Public Utilities Commission (“CPUC”) have authorized the Parties to state that the EOB and CPUC do not oppose the Settlement Agreement.

thus has been subject to a “reliability must run” (“RMR”) contract between the ISO and the plant operator.² Broadly speaking, the RMR contract authorizes the ISO to call on South Bay units to provide specified levels of energy and ancillary services and requires the ISO to make specified fixed and variable-cost payments to Duke. Under Section 5.2.8 of the ISO tariff, costs payable by the ISO under the RMR contract for South Bay are passed through to SDG&E.³

By order issued December 17, 1997 in Docket Nos. ER98-441-000, *et al.*, the Commission placed the initial RMR contracts for South Bay and other RMR units in California into effect, subject to refund, as of the date the ISO began operations.⁴ The South Bay contract was in substantially the same form as other contracts covering other RMR units, with variations for unit-specific costs and operating characteristics. On April 2, 1999, the ISO, the owners of all of the RMR units in California, the three Responsible Utilities, and other parties to Docket Nos. ER98-441-000, *et al.*, (including the CPUC and EOB) filed an offer of settlement in those dockets (the “First Stipulation”) substantially revising the standard terms of the contract, but leaving a number of issues subject to litigation or further settlement efforts. The First Stipulation was approved by the

² SDG&E owned and operated the plant until April 22, 1999, at which time the plant was conveyed to the Unified Port District of San Diego, which leased the plant to Duke. For the period April 1, 1998 through December 31, 2001, the ISO designated all of the units at South Bay as RMR units. Effective January 1, 2002, Unit No. 4 ceased to be subject to such designation; however, this unit may be subject to such designation again in future years.

³ Section 5.2.8 provides that costs incurred by the ISO under an RMR contract for a generating plant are to be borne by the utility in whose service territory the generating plant is located (the “Responsible Utility”).

⁴ The docket for the contract covering South Bay, then owned by SDG&E, was Docket No. ER98-496-000.

Commission in May 1999, and the revised contract terms (the “South Bay RMR Contract”) took effect, as to South Bay, on June 1, 1999.⁵

Under the revised contract, the ISO pays Duke various charges, including a Monthly Option Payment that is based, in part, upon the Annual Fixed Revenue Requirement (“AFRR”) for the RMR units.⁶ The contract provides, however, that the AFRR is subject to adjustment on January 1 of each year, beginning January 1, 2002, to reflect actual costs for the 12-month period ending the previous June 30.⁷

On October 1, 2001, Duke filed in Docket No. ER02-10-000 a revised AFRR, with certain supporting information. The revised AFRR, \$42,611,000, represented an increase over the AFRR then in effect.⁸ On December 21, 2001, the ISO, SDG&E, the EOB and the CPUC protested Duke’s filing.

Among the issues not resolved by the First Stipulation was “[w]hether the ISO can require an RMR Owner to restore or maintain existing oil burning capability and, if so, under what conditions?”⁹ Pending resolution of that issue, the First Stipulation required that the owners maintain oil-burning capability at RMR units “in the condition that such capability exists as of the date the settlement is filed,” as set forth for each RMR unit in

⁵ California Independent System Operator Corp., 87 FERC ¶ 61,250 (1999). A subsequent settlement (the “Second Stipulation”), covering some of the issues not resolved in the First Stipulation, was filed on August 14, 2000 in Docket Nos. ER98-441-000, et al., and approved in California Independent System Operator Corp., 93 FERC ¶ 61,089 (2000).

⁶ See Schedule B of the RMR contract. The contract, which is voluminous, is Appendix A to the Second Stipulation.

⁷ See Schedule F of the RMR contract.

⁸ The same filing included a revised AFRR for Duke Energy Oakland, LLC. This Stipulation does not relate to that revision.

⁹ First Stipulation, Article X, Section C.8.

Schedule H of the applicable contract, “unless the ISO determines that it is unnecessary for the RMR owners to do so.”¹⁰

The Parties have conferred at length as to issues raised in Docket No. ER02-10-000. Additionally, they have discussed the extent to which fuel oil inventory at South Bay is necessary for local reliability purposes and should be reflected in the costs included in AFRR. Further, they have discussed whether the existing facilities for the delivery of fuel oil to South Bay by barge should be demolished and replaced by facilities to accommodate delivery by truck.

The attached Stipulation and Agreement is the product of those discussions. It resolves the extent to which the costs of storing fuel oil for South Bay and the costs associated with the barge-delivery facilities may be included in the AFRR for 2002 (an issue associated with Docket No. ER02-10-000) as well as for years thereafter.¹¹ In addition, this Stipulation resolves the issue in Docket No. ER98-496-000 as to maintaining pre-existing fuel oil capability for South Bay, which was left open by the First Stipulation.¹²

II. THE SETTLEMENT

The attached Settlement Agreement, comprised of the Stipulation and Agreement and one appendix, constitutes a definitive negotiated agreement between the Parties with respect to the outstanding fuel oil issues in Docket Nos. ER98-496-000 and ER02-10-000. It results in a just and reasonable settlement that addresses and balances all

¹⁰ First Stipulation, Article VIII.

¹¹ The Parties note that they are in the process of finalizing negotiations on all remaining issues in Docket No. ER02-10-000, and expect to file an offer of settlement with respect to those issues within the next few weeks.

¹² *Id.*, Article X, Section C.8.

Parties' interests. The principal terms of the Settlement Agreement are briefly summarized as follows:

- Duke, at its expense, can demolish the barge-unloading fuel-oil facilities for South Bay located at the National City Marine Terminal ("NCMT"). Duke will not be able to include costs of the NCMT in its AFRR calculations after 2003, and its 2002 and 2003 NCMT costs will be limited to its lease payments for the facility, up to \$162,000 per year.
- Duke agrees to maintain a minimum useable¹³ fuel-oil inventory for South Bay of 50,000 barrels, beyond "heel"¹⁴ inventory levels, unless the ISO requests or directs Duke to acquire additional volumes.¹⁵ If Duke must remove the entire useable and "heel" inventory from a tank, Duke may recover 30% of the costs associated with replacing the "heel" inventory.
- As between Duke and the ISO, Duke shall be liable for all costs associated with the clean-up and/or mitigation of any release into the environment of the fuel oil maintained by Duke and for environmental liability insurance covering such release, naming the ISO as an additional insured. Duke can include costs for this insurance (pro-rated, if applicable, to the amount necessary to insure 100,000 barrels of useable fuel oil) in any AFRR effective after December 31, 2002.
- Duke may consume, sell, or retain current fuel oil volumes exceeding 100,000 barrels of useable fuel oil, but cannot recover from any Party costs incurred in selling such excess volumes. Duke is not obligated to share any proceeds from these sales. Provided there are no additional costs to the ISO, Duke also may use fuel oil purchased in the future for Market Transactions and in non-RMR units for Market Transactions, and may retain all profits therefrom.
- Duke will revise the AFRR filed in Docket No. ER02-10-000 to reflect a useable fuel oil volume of 100,000 barrels, thus reducing the value for Fuel Stocks (Schedule F, line 4(F)(1)) by \$2,540,000; the ad valorem taxes by \$29,000 (2C1), and return on investment by \$311,000 (3); and the total 2002 AFRR by \$340,000.
- Duke shall not, in future South Bay Schedule F filings, be entitled to recover from any of the Parties a return on an oil inventory of more than 100,000 barrels

¹³ "Useable" oil is that oil that is readily available for use in power generation (i.e., oil that is liquid, above tank suction points, and otherwise capable of being used.).

¹⁴ "Heel" inventory is the oil at the tank bottom that may contain sediment and water and/or is beyond the reach of the suction pipe(s).

¹⁵ See Dual Fuel Capability Requirements Report to the ISO Governing Board dated August 19, 1999, Attachment C, Attachment 7, "Value to Customers of Increased Reliability".

of useable fuel oil (based on the quantity of useable fuel oil at South Bay on the June 30 immediately preceding the annual filing) unless the ISO requests or directs Duke to acquire additional volumes. The fuel oil transportation cost included in Duke's fuel oil inventory AFRR calculations cannot exceed \$1.50 per barrel.

- In accordance with Section 8 of Schedule C of the South Bay RMR Contract, actual costs of transportation may be included in the replacement cost of fuel consumed or the last-in-first-out inventory price of the fuel consumed, as applicable, but no additional transportation cost shall be recovered through a Transportation Rate. After January 1, 2002, however, transportation cost shall not exceed \$1.50 per barrel. Duke shall refund to the ISO all transportation amounts above that amount collected from January 1, 2002 to the effective date of the Stipulation.
- No Party is entitled to additional compensation or rate adjustment related to fuel oil for the South Bay facility prior to January 1, 2002.
- Within 30 days after the Effective Date of the Stipulation, Duke will file with the Commission an amended Schedule H of the South Bay RMR Contract in substantially the form of Appendix A to the Stipulation
- The Stipulation resolves the issue stated in Article X, Section C.8 of the First Stipulation as that issue relates to South Bay.
- Agreement to or acquiescence in the Settlement shall not be deemed in any respect to constitute an admission by any Party hereto that any allegation or contention made by any other Party in these proceedings is true or valid. The Settlement represents a negotiated agreement for the sole purpose of settling certain issues, as described herein in the captioned dockets, and no signatory, participant or affiliate of any of the Parties shall be deemed to have approved, accepted, agreed to, or consented to any fact, concept, theory, rate methodology, principle or method relating to jurisdiction, prudence, reasonable cost of service, cost classification, cost allocation, rate design, tariff provisions, or other matters underlying or purported to underlie any resolution of the issues provided therein. The Commission's approval of the Stipulation shall not constitute approval of, or precedent regarding, any principle or issue in this proceeding.
- Resolution of any matter in the Stipulation 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 1334 (D.C. Cir. 1980).
- The discussions among the Parties that have produced the Stipulation have been conducted on the explicit understanding that they were undertaken subject to Rule 602(e) of the Commission's Rules of Practice and Procedure.
- As between Duke and SDG&E regarding environmental mitigation at the NCMT site, no provision of the Stipulation will supersede any provision in (i)

the Asset Sale Agreement (“ASA”) dated December 11, 1998, among the San Diego Port District and SDG&E, including “Related Agreements” as that term is defined in the ASA; (ii) the Three-Party Agreement dated December 11, 1998, between the San Diego Port District, SDG&E, and Duke; or (iii) the Lease Agreement, dated April 1, 1999, between the San Diego Port District and Duke.

- Nothing in the Settlement is intended to limit or affect the rights and remedies of the Parties with respect to any particular dispute not discussed in the Settlement, including the issues in Docket No. EL02-15-000.

III. CONCLUSION

The Parties to the Settlement Agreement believe that it represents a fair and reasonable negotiated resolution of the issues set for hearing in this proceeding. Therefore, the Parties respectfully request that the Commission expeditiously approve the Settlement Agreement without condition or modification.

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

Duke Energy South Bay, LLC)	Docket No. ER98-496-000
Duke Energy Oakland, LLC, <u>et al.</u>)	Docket No. ER02-10-000

STIPULATION AND AGREEMENT

Pursuant to 18 C.F.R. § 385.602, Duke Energy South Bay, LLC (“Duke”), the California Independent System Operator Corporation (the “ISO”), and San Diego Gas & Electric Company (“SDG&E”) (collectively, the “Parties”) hereby submit this Stipulation and Agreement (the “Stipulation”) to resolve certain issues in the above-numbered dockets.¹

I. BACKGROUND

Duke is the lessee and operator of the South Bay generating station (“South Bay”) at Chula Vista, California. The plant includes four steam units, as well as a combustion turbine. The four steam units normally operate on natural gas, but can also burn fuel-oil.

Since April 1, 1998, when the ISO began operations, some or all of the capacity of South Bay has been designated by the ISO as necessary for local reliability needs and thus has been subject to a “reliability must run” (“RMR”) contract between the ISO and the plant operator.² Broadly speaking, the RMR contract authorizes the ISO to call on South Bay units to provide specified levels of energy and ancillary services and requires the ISO to make specified

¹ While not signatories to this Stipulation and Agreement, the California Electricity Oversight Board (the “EOB”) and the California Public Utilities Commission (“CPUC”) have authorized the Parties to state that the EOB and CPUC do not oppose this Stipulation and Agreement.

² SDG&E owned and operated the plant until April 22, 1999, at which time the plant was conveyed to the Unified Port District of San Diego, which leased the plant to Duke. For the period April 1, 1998 through December 31, 2001, the ISO designated all of the units at South Bay as RMR units. Effective January 1, 2002, Unit No. 4 ceased to be subject to such designation; however, this unit may be subject to such designation again in future years.

fixed and variable-cost payments to Duke. Under Section 5.2.8 of the ISO tariff, costs payable by the ISO under the RMR contract for South Bay are passed through to SDG&E.³

By order issued December 17, 1997 in Docket Nos. ER98-441-000, *et al.*, the Commission placed the initial RMR contracts for South Bay and other RMR units in California into effect, subject to refund, as of the date the ISO began operations.⁴ The South Bay contract was in substantially the same form as other contracts covering other RMR units, with variations for unit-specific costs and operating characteristics. On April 2, 1999, the ISO, the owners of all of the RMR units in California, the three Responsible Utilities, and other parties to Docket Nos. ER98-441-000, *et al.*, (including the CPUC and EOB) filed an offer of settlement in those dockets (the “First Stipulation”) substantially revising the standard terms of the contract, but leaving a number of issues subject to litigation or further settlement efforts. The First Stipulation was approved by the Commission in May 1999, and the revised contract terms (the “South Bay RMR Contract”) took effect, as to South Bay, on June 1, 1999.⁵

Under the revised contract, the ISO pays Duke various charges, including a Monthly Option Payment that is based, in part, upon the Annual Fixed Revenue Requirement (“AFRR”) for the RMR units.⁶ The contract provides, however, that the AFRR is subject to

³ Section 5.2.8 provides that costs incurred by the ISO under an RMR contract for a generating plant are to be borne by the utility in whose service territory the generating plant is located (the “Responsible Utility”).

⁴ The docket for the contract covering South Bay, then owned by SDG&E, was Docket No. ER98-496-000.

⁵ California Independent System Operator Corp., 87 FERC ¶ 61,250 (1999). A subsequent settlement (the “Second Stipulation”), covering some of the issues not resolved in the First Stipulation, was filed on August 14, 2000 in Docket Nos. ER98-441-000, *et al.*, and approved in California Independent System Operator Corp., 93 FERC ¶ 61,089 (2000).

⁶ *See Schedule B of the RMR contract.* The contract, which is voluminous, is Appendix A to the Second Stipulation.

adjustment on January 1 of each year, beginning January 1, 2002, to reflect actual costs for the 12-month period ending the previous June 30.⁷

On October 1, 2001, Duke filed in Docket No. ER02-10-000 a revised AFRR, with certain supporting information. The revised AFRR, \$42,611,000, represented an increase over the AFRR then in effect.⁸ On December 21, 2001, the ISO, SDG&E, the EOB and the CPUC protested Duke's filing.

Among the issues not resolved by the First Stipulation was "[w]hether the ISO can require an RMR Owner to restore or maintain existing oil burning capability and, if so, under what conditions?"⁹ Pending resolution of that issue, the First Stipulation required that the owners maintain oil-burning capability at RMR units "in the condition that such capability exists as of the date the settlement is filed," as set forth for each RMR unit in Schedule H of the applicable contract, "unless the ISO determines that it is unnecessary for the RMR owners to do so."¹⁰

The Parties have conferred at length as to issues raised in Docket No. ER02-10-000. Additionally, they have discussed the extent to which fuel-oil inventory at South Bay is necessary for local reliability purposes and should be reflected in the costs included in AFRR. Further, they have discussed whether the existing facilities for the delivery of fuel-oil to South Bay by barge should be demolished and replaced by facilities to accommodate delivery by truck.

⁷ See Schedule F of the RMR contract.

⁸ The same filing included a revised AFRR for Duke Energy Oakland, LLC. This Stipulation does not relate to that revision.

⁹ First Stipulation, Article X, Section C.8.

¹⁰ First Stipulation, Article VIII.

The instant Stipulation is the product of those discussions. It resolves the extent to which the costs of storing fuel-oil for South Bay and the costs associated with the barge-delivery facilities may be included in the AFRR for 2002 (an issue associated with Docket No. ER02-10-000) as well as for years thereafter.¹¹ In addition, this Stipulation resolves the issue in Docket No. ER98-496-000 as to maintaining pre-existing fuel-oil capability for South Bay, which was left open by the First Stipulation.¹²

II. TERMS

A. Fuel-Oil Capability

1. The Parties agree that, subject to the other terms of this Stipulation, Duke is not required to maintain the existing barge-unloading fuel-oil facilities for South Bay located at 24th Street in National City, California (the "National City Marine Terminal" or "NCMT") for local reliability purposes. The costs associated with any demolition or other disposition of the facilities shall not be charged to any of the Parties other than Duke.

2. No costs of the NCMT, other than \$162,000 (representing 12 lease payments of \$13,510 per month) shall be included in the AFRR for 2002. For 2003, the only costs relating to NCMT that may be included in AFRR shall be the amount of lease payments, not to exceed \$162,000, actually paid by Duke during the period July 1, 2001, through June 30, 2002. No lease payments related to NCMT shall be included for years after 2003.

¹¹ The Parties note that they are in the process of finalizing negotiations on all remaining issues in Docket No. ER02-10-000, and expect to file an offer of settlement with respect to those issues within the next few weeks.

¹² Id., Article X, Section C.8.

3. Duke shall use best efforts to maintain at all times a minimum useable¹³ fuel-oil inventory for South Bay of 50,000 barrels, beyond “heel”¹⁴ inventory levels, for local reliability purposes unless the ISO requests or directs Duke to acquire additional volumes. At a minimum, Duke shall not reduce the useable fuel-oil inventory for South Bay below 50,000 barrels, except in response to a Dispatch Notice by the ISO during a period of natural gas curtailment by the Owner's natural gas supplier. Moreover, as soon as Duke becomes aware that the useable fuel-oil inventory for South Bay will be reduced below 50,000 barrels, Duke shall immediately notify the ISO and use best efforts to promptly replenish its fuel-oil inventory to restore the useable fuel-oil inventory for South Bay to no less than 50,000 barrels. Duke shall promptly notify the ISO upon replenishment. The minimum useable fuel-oil inventory for South Bay of 50,000 barrels represents approximately five days’ fuel requirement for the RMR units at South Bay,¹⁵ and shall be maintained in such a manner as to be readily available for use in the boilers. If in the future, the entire fuel-oil inventory (useable and “heel”) must be removed from a tank, Duke may include 30% of the costs associated with replacing the "heel" inventory in the ISO invoice for the month during which the replacement occurred in accordance with Section 3 of Schedule H of the South Bay RMR Contract, attached hereto.

4. As between Duke and the ISO: Duke shall be liable for all costs associated with the clean-up and/or mitigation of any release into the environment of the fuel-oil maintained by

¹³ “Useable” oil is that oil that is readily available for use in power generation (i.e., oil that is liquid, above tank suction points, and otherwise capable of being used.).

¹⁴ “Heel” inventory is the oil at the tank bottom that may contain sediment and water and/or is beyond the reach of the suction pipe(s).

¹⁵ *See Dual Fuel Capability Requirements Report to the ISO Governing Board dated August 19, 1999, Attachment C, Attachment 7, "Value to Customers of Increased Reliability".*

Duke pursuant to the terms of the RMR Agreement, including but not limited to all penalties assessed by regulatory agencies as a result of any such release, and all amounts paid to compensate third parties for damages resulting from any such release. In addition to insurance obtained in accordance with section 12.1 and Schedule I of the RMR Agreement, Duke will secure and maintain in effect environmental liability insurance to indemnify it in the event of any such release so long as this Agreement requires Duke to maintain residual fuel-oil burning capability, residual fuel-oil inventories, and permits to burn residual fuel-oil. Duke shall name the ISO as an additional insured on such insurance. The coverage will be no less than the coverage required pursuant to Title 14, California Code of Regulations, Section 791.7(e)(2)(B). The reasonable costs to Duke of such environmental liability insurance will be a fixed operating expense that Duke is entitled to include in its Schedule F filings for any AFRR effective after December 31, 2001. Should Duke ever obtain environmental liability insurance that is incrementally priced based on the amount of fuel-oil in its tanks, Duke shall pro-rate the cost of such insurance and include in its annual AFRR filing only those insurance costs corresponding to the amounts necessary to insure 100,000 barrels of useable fuel-oil.

5. Duke may consume, sell, or retain current fuel-oil volumes exceeding 100,000 barrels of useable fuel-oil, but shall not seek to recover from the ISO, SDG&E, or any other party to this Stipulation, any costs it incurs in selling such excess volumes, nor shall Duke be obligated to share any proceeds of any sales. Subject to Section II. A. 3 above, Duke may use any fuel-oil purchased in the future for 1) purposes of Market Transactions and may retain all profits from those Market Transactions as allowed in Section 9.1 of the South Bay RMR Contract, and 2) non-RMR units for Market Transactions, provided that there are no additional costs to the ISO associated with such usage.

6. The AFRR filed in Docket No. ER02-10-000 reflected a fuel-oil volume of 213,612 barrels, which was comprised of 182,209 useable barrels of fuel-oil and 31,403 barrels of "heel". The AFRR for South Bay, effective January 1, 2002, shall be revised to reflect a useable fuel-oil volume of 100,000 barrels. Duke is not entitled to include "heel" inventory in the 2002 AFRR calculation. This revision shall reduce the value for Fuel Stocks (Schedule F, line 4(F)(1)) as originally filed in Docket No. ER02-10-000, by \$2,540,000. The reduced fuel inventory also will reduce the Schedule F ad valorem taxes by \$29,000 (2C1), and return on investment by \$311,000 (3). As a result, the total 2002 AFRR will be reduced by \$340,000.

7. Duke shall not, in future annual filings pursuant to Schedule F of the South Bay RMR Contract or otherwise, be entitled to recover from any of the parties to this Stipulation a return on an oil inventory of more than 100,000 barrels of useable fuel-oil at South Bay unless the ISO requests or directs Duke to acquire such additional volumes. In any future annual filing pursuant to Schedule F, the inventory cost of the fuel-oil chargeable to the ISO shall be based on the quantity of useable fuel-oil at South Bay on the June 30 immediately preceding the annual filing. If the inventory of fuel-oil at South Bay does exceed 100,000 useable barrels, for purposes of calculating the fuel-oil inventory component of AFRR, the costs of such inventory shall be multiplied by a fraction, the numerator of which is 100,000, and the denominator of which is the total number of barrels of useable fuel-oil. The fuel-oil transportation cost included in the fuel-oil inventory shall not exceed \$1.50 per barrel for AFRR purposes.

8. Section 8 of Schedule C of the South Bay RMR Contract provides, as to the Commodity Price for No. 6 Residual Fuel-Oil, that the "fuel price shall be the prudent actual replacement cost of the fuel consumed, or, if the fuel is consumed and not replaced, then the fuel price will be 'last-in-first-out' (LIFO) inventory price of the fuel consumed." Section 8 of

Schedule C also provides that there shall be no Transportation Rate for No. 6 Residual Fuel-Oil. The actual cost of transportation may be included in the prudent actual replacement cost of the fuel consumed or the LIFO inventory price of the fuel consumed (whichever is applicable), except that, effective January 1, 2002, and so long as the South Bay RMR Contract remains in effect, such cost of transportation shall not exceed \$1.50 per barrel. Any amounts above \$1.50 per barrel of fuel-oil for the cost of transportation collected by Duke under the South Bay RMR Contract for residual fuel-oil transportation during the period from January 1, 2002 to the date on which this Stipulation goes into effect shall be refunded to the ISO within 30 days of the effective date of a Commission order approving this Stipulation without material condition (the "Effective Date.").

9. None of the Parties shall be entitled to any additional compensation or rate adjustment related to fuel-oil for the South Bay facility for the period prior to January 1, 2002. Within 30 days after the Effective Date, Duke shall file with the Commission under Section 205 of the Federal Power Act an amended Schedule H of the South Bay RMR Contract in substantially the form of Appendix A hereto. None of the Parties shall oppose such filing.

10. This Stipulation resolves the issue stated in Article X, Section C.8 of the First Stipulation as that issue relates to South Bay.

B. Reservations

1. Agreement to or acquiescence in this Stipulation shall not be deemed in any respect to constitute an admission by any Party hereto that any allegation or contention made by any other Party in these proceedings is true or valid. In reaching the Stipulation, the Parties specifically agreed that the Settlement represents a negotiated agreement for the sole purpose of

settling certain issues, as described herein, in the captioned dockets. No signatory, participant or affiliate of any of the Parties shall be deemed to have approved, accepted, agreed to, or consented to any fact, concept, theory, rate methodology, principle or method relating to jurisdiction, prudence, reasonable cost of service, cost classification, cost allocation, rate design, tariff provisions, or other matters underlying or purported to underlie any of the resolution of the issues provided herein. The Commission's approval of the Stipulation shall not constitute approval of, or precedent regarding, any principle or issue in this proceeding.

2. The Parties agree that the resolution of any matter in the Stipulation 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 1334 (D.C. Cir. 1980).

3. The discussions among the Parties that have produced the Stipulation have been conducted on the explicit understanding that they were undertaken subject to Rule 602(e) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.602(e) (2002), and the rights of the parties with respect thereto shall not be impaired by the Stipulation.

4. Notwithstanding any provision of the Stipulation, nothing herein is intended to limit or affect the rights and remedies of the Parties with respect to any claim that the amounts invoiced under an RMR contract do not comply with that contract.

5. As between Duke and SDG&E regarding environmental mitigation at the NCMT site, no provision of this Agreement shall supersede any provision in (i) the Asset Sale Agreement ("ASA") dated December 11, 1998, between the San Diego Port District and SDG&E, including "Related Agreements" as that term is defined in the ASA; (ii) the Three-Party Agreement dated December 11, 1998, between the San Diego Port District, SDG&E, and

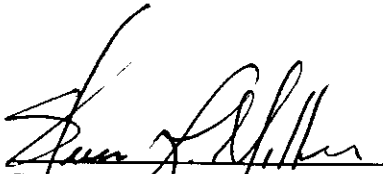
Duke; or (iii) the Lease Agreement, dated April 1, 1999, among the San Diego Port District and Duke.

6. In Docket No. EL02-15-000, the ISO, the CPUC, the EOB, and SDG&E (among others) have filed a complaint alleging that the currently effective method of determining the Fixed Option Payment Factor for purposes of Schedule B of the RMR contracts for the South Bay units and other units is unjust and unreasonable, and, should be calculated on the basis of a different methodology. Duke has urged that the complaint be dismissed. The instant Stipulation is not intended to affect in any way the outcome of that proceeding, and the Parties specifically reserve their positions therein.

C. Execution in Counterparts

This Stipulation may be executed in counterparts by each Party, each of which shall be deemed to be an original, but together shall constitute one and the same instrument.

Signed and dated this 24th day
of June, 2002


Steven L. Miller
Attorney for
Duke Energy South Bay, LLC

Jeanne M. Solé
Attorney for
California Independent System
Operator Corporation

Nicholas W. Fels
Attorney for San Diego Gas &
Electric Company

Duke; or (iii) the Lease Agreement, dated April 1, 1999, among the San Diego Port District and Duke.

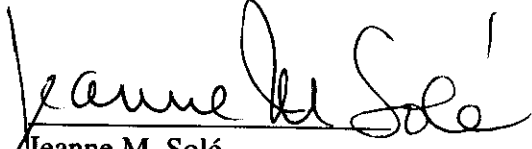
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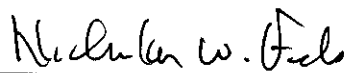
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Signed and dated this ²⁴th day
of June, 2002

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Attorney for
Duke Energy South Bay, LLC

Jeanne M. Solé
Attorney for
California Independent System
Operator Corporation



Nicholas W. Fels
Attorney for San Diego Gas &
Electric Company

Schedule H

Fuel-Oil Service

1. Owner's Obligations: With respect to South Bay Units 1, 2, 3, and 4, Owner is required to (1) maintain, in accordance with Good Industry Practice, residual fuel-oil¹ burning capability, residual fuel-oil inventories, and permits to burn residual fuel-oil and (2) burn residual fuel-oil in response to a Dispatch Notice during periods of natural gas curtailment by the Owner's natural gas supplier.

(a) Environmental Liability Obligation - As between Owner and the ISO: Owner shall be liable for all costs associated with the clean-up and/or mitigation of any release into the environment of the fuel-oil maintained by Owner pursuant to the terms of this Agreement, including but not limited to all penalties assessed by regulatory agencies as a result of any such release, and all amounts paid to compensate third parties for damages resulting from any such release. In addition to insurance obtained in accordance with section 12.1 and Schedule I of this Agreement, Owner will secure and maintain in effect environmental liability insurance to indemnify it in the event of any such release so long as this Agreement requires Owner to maintain residual fuel-oil burning capability, residual fuel-oil inventories, and permits to burn residual fuel-

oil. Owner shall name ISO as an additional insured on such insurance. The coverage will be no less than the coverage required pursuant to Title 14, California Code of Regulations, Section 791.7(e)(2)(B). The reasonable costs to Owner of such environmental liability insurance will be a fixed operating expense that Owner is entitled to include in its Schedule F filings for any AFRR effective after December 31, 2002. Should Owner ever obtain environmental liability insurance that is incrementally priced based on the amount of fuel-oil in its tanks, Owner shall pro-rate the cost of such insurance and include in its annual AFRR filing only those insurance costs corresponding to the amounts necessary to insure 100,000 barrels of useable fuel-oil.

2. Minimum Oil Inventory for non Market Transactions: Owner shall use best efforts to maintain at all times a minimum useable² fuel-oil inventory for South Bay of 50,000 barrels, beyond “heel”³ inventory levels, for local reliability purposes unless the ISO requests or directs Owner to acquire additional volumes. Owner shall not reduce the useable fuel-oil inventory for South Bay below 50,000 barrels except in response to a Dispatch Notice by the ISO during a period of natural gas curtailment by the Owner's natural gas supplier. Moreover, as soon as Owner becomes aware that the useable fuel-oil inventory for South Bay will be reduced below 50,000 barrels, Owner shall immediately notify the ISO and use best

¹ Residual Fuel-Oil, for the purpose of this document shall be considered the fuel-oil product capable of 6.258 MMBtu output per barrel.

² “Useable” oil is that oil that is readily available for use in power generation (i.e., oil that is liquid, above tank suction points, and otherwise capable of being used.).

³ “Heel” inventory is the oil at the tank bottom that may contain sediment and water and/or is beyond the reach of the suction pipe(s).

efforts to promptly replenish its fuel-oil inventory to restore the useable fuel-oil inventory for South Bay to no less than 50,000 barrels. Owner shall promptly notify the ISO upon replenishment. The minimum useable fuel-oil inventory for South Bay of 50,000 barrels represents approximately five days' fuel requirement for the RMR units at South Bay,⁴ and shall be maintained in such a manner as to be readily available for use in the boilers.

3. Cost Recovery:

(a) Variable Cost: Recovery of commodity and transportation costs for fuel-oil shall be in accordance with Equation C1-8 of Schedule C. Section 8 of Schedule C provides as to the Commodity Price for No. 6 Residual Fuel-Oil that the "fuel price shall be the prudent actual replacement cost of the fuel consumed, or, if the fuel is consumed and not replaced, then the fuel price will be 'last-in-first-out' (LIFO) inventory price of the fuel consumed." Section 8 of Schedule C provides also that there shall be no Transportation Rate for No. 6 Residual Fuel-Oil. The actual cost of transportation may be included in the prudent actual replacement cost of the fuel consumed or the LIFO inventory price of the fuel consumed (whichever is applicable), except that such cost of transportation shall not exceed \$1.50 per barrel.

(b) AFRR: Owner shall not, in filings to take effect after December 31, 2002, pursuant to Schedule F of the Agreement or otherwise, include the costs relating to an inventory of more than 100,000 barrels of usable fuel-oil at South Bay unless the ISO requests or directs Owner to acquire

⁴ See Dual Fuel Capability Requirements Report to the ISO Governing Board dated August 19, 1999, Attachment C, Attachment 7, "Value to Customers of Increased Reliability".

such additional volumes. In any filing to take effect after December 31, 2002, pursuant to Schedule F or otherwise, the inventory cost of the fuel-oil chargeable to the ISO shall be based on the quantity of useable fuel-oil at South Bay on the June 30 immediately preceding the annual filing. If the inventory of fuel-oil at South Bay does exceed 100,000 useable barrels, for purposes of calculating the fuel-oil inventory component of AFRR, the costs of such inventory shall be multiplied by a fraction the numerator of which is 100,000 and the denominator of which is the total number of barrels of useable fuel-oil. The fuel-oil transportation cost included in the fuel-oil inventory shall not exceed \$1.50 per barrel for AFRR.

(c) Cost of "heel" inventory: If the entire fuel-oil inventory (usable and "heel") must be removed from a tank, Owner may include 30% of the costs associated with replacing the "heel" inventory in the ISO invoice for the month during which the replacement occurred.

4. Owner's Utilization of the Fuel-Oil: Subject to Section 2 above, Owner may use residual fuel-oil for: 1) purposes of Market Transactions and may retain all profits from those Market Transactions as allowed in Section 9.1 of the Agreement, and 2) non-RMR units for Market Transactions, provided that there are no additional costs to the ISO associated with such usage.

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

In Reply Refer To:
Docket Nos. ER98-496-000 and
ER02-10-000

_____, 2002

Dickstein Shapiro Morin & Oshinsky LLP
ATT: Steven L. Miller
Attorney for Duke Energy South Bay, LLC
2101 L Street, N.W.
Washington, D.C. 20037-1526

Dear Mr. Miller:

1. On June _____, 2002, you filed a settlement agreement among Duke Energy South Bay, LLC ("Duke"), the California Independent System Operator Corporation (the "ISO"), and San Diego Gas & Electric Company ("SDG&E") (collectively, the "Parties").
2. The subject settlement is in the public interest and is hereby approved. The Commission's approval of this 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.
3. Any amounts collected in excess of the settlement rates shall be refunded together with interest computed under Section 35.19a of the Commission's Regulations, 18 C.F.R. § 35.19a, in accordance with the terms of the settlement. Within thirty (30) days after making such refunds, Duke shall file with this Commission a compliance report documenting such refunds. Duke shall furnish copies of the report to all parties herein.

By direction of the Commission.

Magalie R. Salas
Secretary

cc: All Parties