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

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

# EXPLANATORY STATEMENT IN SUPPORT OF OFFER OF SETTLEMENT

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

## INTRODUCTION

This Settlement is a full resolution of the issues raised in Docket Nos. ER98-211-000 and ER98-462-000, and a partial resolution of the issues in Docket Nos. ER-98-210-000, ER98-1729-000, ER98-556-000, and ER98-557-000. This Offer of Settlement follows extensive negotiations between the ISO, Commission Trial Staff (Staff) and active intervenors. The Settlement reflects many of the comments that were received. The ISO has filed herewith a motion to shorten the time for filing comments to 10 days for initial comments and 5 days for reply comments.[1] For reasons outlined in the Motion, the ISO urges the Chief Judge, after the requested comment period, to certify the Settlement to the

[1] The motion also requests that if there are no adverse comments the Chief Judge certify the Settlement without waiting for reply comments.

Commission, and for the Commission to accept the Settlement without condition or modification.

**BACKGROUND**

On October 17, 1997, the ISO filed with the Federal Energy Regulatory Commission (Commission) for approval of its Grid Management Charge, pursuant to Section 205 of the Federal Power Act and Section 35.13 of the Commissions regulations, 18 C.F.R. § 35.13 (1997) (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 ER98-210-000. On December 17, 1997, the Commission set the ISO and PX rate filings for hearing. The Chief Administrative Law Judge held a prehearing conference and set a procedural schedule on January 10, 1998. 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 ER98-210-000 proceeding. On January 26, 1998, the Chief Judge designated Administrative Law Judge Warren H. Albrecht as the Presiding Judge in these proceedings.

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. SoCal Edison also filed a separate scheduling and dispatch charge. The Commission set SoCal Edison's filing for hearing on December 17, 1997. On January 9, 1998, the Chief Judge designated Administrative Law Judge Herbert Grossman as the Presiding Judge in that proceeding.

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 January 13, 1998, the Chief Judge designated Administrative Law Judge Lawrence Brenner as the Presiding Judge in these proceedings.

A hearing in this matter is currently scheduled for October 20, 1998. The parties and Staff have participated in settlement discussions, including two technical conferences held on January 28, 1998 and February 26, 1998. This Settlement reflects the resolution of the issues set for hearing in Docket no. ER98-211-000 and ER98-462-000.

If accepted by the Commission, the Offer of Settlement would resolve the following issues:

- all issues in Phase II in Docket No. ER98-211-000 (Judge Albrecht);
- the joint allocation of start up and development costs between the ISO and PX issue in Phase I of Docket No. ER98-210-000 and ER98-1729 (Judge Albrecht);
- all issues in Docket No. ER98-462-000 (Judge H. Grossman); and
- all issues in Docket Nos. ER98-556-000 and ER98-557-000 until 1999 (Judge Brenner).

With respect to Docket Nos. ER98-556-000 and ER98-557-000, the parties have agreed to postpone any litigation of the pass-through issue until after the ISO makes its new rate filing, which will have a proposed effective date of January 1, 1999.

## SETTLEMENT TERMS

### 1. The Settlement of Grid Management Revenue Requirement

The Grid Management Revenue Requirement Formula is designed to calculate the revenue required by the ISO to cover its administrative and operating costs, including costs incurred in establishing the ISO before the start of operations. As provided for in paragraph 5, this Settlement resolves all issues concerning the Revenue Requirement Formula as set forth in Schedule 1 of Attachment A. As reflected in the equation below, the Revenue Requirement is divided by the ISO's Total Transmission Volume to derive the Grid Management Charge (GMC). Pursuant to paragraph 9 of the Settlement Agreement, the parties agree to a revised calculation of the Grid Management Charge (GMC) such that the GMC equals \$0.7831/Mwh. The revised calculation of the GMC is reflected in Schedule 1, of Attachment A.

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

Pursuant to paragraph 7, the parties stipulate to the reasonableness of three provisions in the GMC formula and consent to their inclusion so long as these provisions are required by the ISO financing covenants and their duration does not extend beyond the tenth anniversary of the ISO's initial debt financing. The three provisions are: (1) the ISO GMC rate formula shall collect an amount equal to 25 percent of its Senior Lien Debt Service as a coverage requirement; (2) the ISO shall establish and maintain a reserve requirement equal to 15 percent of its annual Operating Expenses; and (3) the amount of initial debt financing (to cover start up and development costs, cash working capital, and 1998 and 1999 budgeted capital expenditures) is set at a maximum level of $310,000,000.

Paragraph 7 stipulates that all parties agree that they have no objection to the overall operating revenue requirement specified in the ISO's October 17, 1997 rate filing provided that certain operating costs are reallocated from the ISO to the California Power Exchange (PX) as provided in this Settlement. In this regard, Paragraph 10 provides that the ISO and the PX will reallocate $1,300,000 of annual operating cost related to the MCI Contract from the ISO to the PX. In return, all parties have agreed to withdraw their respective allegations regarding the improper allocation of costs between the ISO and the PX in Docket Nos. ER98-211-000, ER98-210-000 and ER98-1729-000. In addition, pursuant to Paragraph 8, the parties agree to withdraw their allegations regarding the ISO's collection of its 1998 Operating Costs.

**2. Contingency Funds and Curtailment of Costs**

Paragraph 12 of the Settlement provides that in 1999, the ISO will not seek an operating contingency greater than 5 percent of the operating budget. In addition, the ISO agrees in Paragraph 13 of the Settlement that its management will prepare a report documenting the use of all contingency funds included in both its capital and operating budgets.

In Paragraph 14, the ISO agrees that its management will state the criteria it uses to set projected total transmission volumes for the purposes of determining both an interim rate adjustment and for each annual forecast used to set the GMC unit rate for the following year.

In an effort to reduce costs, Paragraph 15 provides that ISO management will develop benchmarks for the cost of services provided by the ISO as well as a plan for reducing such costs and bringing them in line with the established benchmarks.

**3. Filings**

Pursuant to Paragraph 16, the ISO agrees to make an informational filing to FERC on December 15 of each year. This filing will contain cost data on the ISO presented in conformance with the FERC Uniform System of Accounts (USA). This filing shall contain all information presented in the ISO's monthly financial report and any additional information relied upon to set the GMC unit rate for the following year. Should any party object to the unit rate established, such party must file a complaint with the FERC under Section 206 of the Federal Power Act.

In addition, under Paragraph 17, the ISO agrees to create monthly financial reports as indicated by Attachment B. The monthly financial reports will present financial data both in the form created for the ISO Board of Governors as well as in a form that complies with the FERC USA. The ISO also agrees to prepare a preliminary yearly budget forecast for the following year. This report shall include a summary explanation of the bases for management's projections.

Finally, Paragraph 17 of the Settlement calls for the ISO to hold a budget workshop open to all interested parties at which ISO management will present its most current budget forecast. The Settlement specifically reserves approval of the budget for the Finance Committee and the Board of Governors, however, parties have the right to discuss and comment on the proposed budget as presented.

In Paragraph 18, the ISO agrees that special procedures shall apply to the informational filing used to establish the GMC unit rate for the year 2002, (*i.e.*, the informational filing to be submitted December 15, 2001) and each third year thereafter (triennial filings). For these triennial filings, the ISO will submit all the information required under 18 C.F.R. § 35.13, with the exception of pre-filed testimony and agrees to provide existing documents related to these filings. If the FERC orders a hearing for a filing subject to Paragraph 17, then the ISO agrees that it will have the burden of proof on all questions set for hearing, except for the justness and reasonableness of those provisions outlined in Paragraph 7.

**4. Unbundling Study**

Paragraph 19 of the Settlement provides that ISO management will act as a facilitator for the performance of an unbundling study to identify if any ISO services should be separately priced. This paragraph of the Settlement also creates a stakeholder steering committee that will: (1) assist in the selection of a consultant to conduct the study; (2) receive periodic progress reports from the consultant on how the study is progressing, and (3) finally to review the study and provide advice on what should be presented to the ISO Board as the results of the study.

Paragraph 20 of the Settlement provides that the ISO may file with FERC new GMC rates based on the results of the unbundling study. However, this decision is left to the discretion of the ISO Governing Board. The parties to this settlement reserve 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, are not subject to future challenge. If the

ISO Board does not approve an unbundled rate, the ISO will nevertheless make a new rate filing to be effective January 1, 1999.

**5. GMC Assessment**

Paragraph 22 of the Settlement provides that entities receiving energy under "Existing Contract" rights, as this term is defined in the ISO Tariff, will be assessed the GMC rate contained in Rate Schedule 1 of Attachment A, on 50 percent of their metered consumption for 1998.

Paragraph 23 provides that during 1998, the ISO will bill the GMC for entities receiving energy under Existing Contracts and for any QFs serving on-site or contiguous site Load on a "net" basis, as provided in Schedule 1. Pursuant to paragraph 23 Parties will have the right to litigate the January 1, 1999 assessment of the GMC, whether or not the ISO files unbundled rates.

Under paragraph 24 of the Settlement, the ISO agrees that in 1998, the ISO will not assess any Grid Operations Charge, charge for Black Start, Voltage Support, or Unaccounted For Energy (the "Specified Charges") or a GMC for any transmission service that does not use any part of the ISO Controlled Grid. Paragraph 24 provides that parties agree that with respect to any revenue unrecovered for the Specified Charges, the ISO will include such amount as provided in ISO Protocol SABP3.1.1, regarding the settlement of additional charges and payments.

With respect to the PG&E pass-through cases, Docket Nos. ER98-556-000 and ER98-557-000, Paragraph 25 provides that when PG&E makes its compliance filing pursuant to the March 31, 1998 order in California Independent System Operator, 82 FERC ¶ 61,348 (1998), parties reserve their right to comment and PG&E reserves the right to reply to those comments to the extent allowed by FERC's Rules of Practice and Procedure. Paragraph 25 also provides that in the event the Commission sets for hearing the Existing Contracts to which PG&E seeks to apply the GMC or PX Administration Charge, all parties agree that the litigation respecting such proposed application will be deferred until 1999. Parties, however reserve their rights to seek rehearing or appellate review, according to Paragraph 25. Parties to Existing Contracts set for hearing will pay the GMC or PX Administration Charge as ordered by FERC. Parties that have paid the GMC or PX Administrative Charge and later establish that the payment was inappropriate will be entitled to refunds from April 1, 1998. Litigation of all other issues before an ALJ covered by the Offer of Settlement will be deferred until January 1, 1999.

In the SoCal Edison pass-through case, Docket No. ER98-462-000, Paragraph 25 states that the parties agree, for 1998, to settle all issues based on the rate proposal that SoCal Edison filed with the Commission on October 31, 1997, including the Scheduling & Dispatch rate, effective from the ISO operations date through December 31, 1998. The proceeding in Docket No. ER98-462-000 will be terminated with this Settlement.

Paragraph 25 further states that no party may challenge the level of the GMC for 1998 at any time and in any forum. Parties are not precluded from litigating the amount of the PX Administration charge in Docket Nos. ER98-210-000 and ER98-1729-000, except as to the issue regarding the proper allocation of costs between the ISO and PX, as provided in Paragraph 10.

Paragraph 26 states that after the Commission's order on the ISO's new GMC filing, a prehearing conference will be held to set new procedural schedules for the GMC filing (if necessary) and for the PG&E pass through cases in Docket Nos. ER98-556-000 and ER98-557-000.

Paragraph 27 provides that the Offer of Settlement is submitted on the condition that, in the event the Commission does accept this Settlement in its entirety, this Offer of Settlement shall be deemed withdrawn and, upon such withdrawal, it shall not constitute any part of the record in this proceeding or be used for any other purpose. If, however, the ISO and one or more of the Parties specifically agree, in writing, to all modifications ordered by the Commission, then the Settlement shall become effective as to those parties accepting such modifications.

**6. Motions**

The ISO is filing with the Offer of Settlement a Motion to Shorten Response Time For Comments to Offer of Settlement. As explained in the motion, the ISO is about to undertake its permanent financing and a certification of the Settlement to the Commission would reduce the uncertainty of the ISO's revenue stream and allow the ISO to obtain its full financing at a lower interest rate. Lower financing costs will benefit all parties. In addition, the ISO is filing a Motion to Consolidate for Settlement Purposes and to Suspend Procedural Schedules. This motion seeks to consolidate all the issues that would be resolved by this Settlement so that the Chief Judge can certify them to the Commission. Suspension of the procedural schedules with respect to the issues that would be resolved by this Settlement will prevent parties from incurring the time and expense of preparing unneeded testimony. The ISO can represent that no party, nor the Commission's Trial Staff, objects to these motions.

If the ISO's motion to shorten response time is granted, the initial comments to the Offer of Settlement will be due on April 17, 1998 and reply comments will be due on April 22, 1998. [2]

Respectfully submitted,

**CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

By: ____________________________

N. Beth Emery
Vice President and General Counsel
California Independent System
Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: (916) 351-2334
Fax: (916) 351-2350

Stephen Angle
Linda L. Walsh
Howrey & Simon
1299 Pennsylvania Avenue, NW
Washington, DC 20004-2402
Tel: 202-383-7261
Fax: 202-383-6610

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[2] If the ISO's motion to shorten response time is denied, the Commission's regulations provide that the initial comments would be due on April 27, 1998 and reply comments on May 7, 1998.