

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

California Independent System Operator Corporation)	Docket Nos.	ER02-250-000
)		ER02-527-000
)		
Pacific Gas and Electric Company)	Docket No.	ER02-479-000
)		

EXPLANATORY STATEMENT

Pursuant to Rule 602(c)(1)(ii) of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.602(c)(1)(ii)(2002), the California Independent System Operator Corporation (“ISO”), Pacific Gas and Electric Company (“PG&E”), and Southern California Edison Company (“SCE”) hereby submit this Explanatory Statement in support of the concurrently filed Offer of Settlement and Settlement Agreement, together with supporting appendices¹ (“Settlement Agreement”) in the above-captioned proceedings, which is either sponsored, supported, or unopposed by all active parties in this proceeding (collectively, the “Parties”). The Settlement Agreement is supported by the California Department of Water Resources and the Staff of the California Public Utilities Commission. The Settlement Agreement is unopposed by the California Electricity Oversight Board, 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, Sacramento Municipal Utility District, San Diego Gas & Electric Company (“SDG&E”), San Francisco Bay Area

¹ The supporting appendices include amendments to the ISO Tariff and to the PG&E Tariff.

Rapid Transit District, Trinity Public Utility District, Transmission Agency of Northern California, and Turlock Irrigation District The Settlement Agreement is not opposed by Commission Trial Staff.

INTRODUCTION

This Explanatory Statement is not intended to alter any of the specific provisions of the Settlement Agreement, and is provided solely in accordance with the Commission's Rules.

The Settlement Agreement follows extensive negotiations among the Parties, and, if accepted by the Commission, will resolve all issues raised by all intervenors and the Commission Staff in the captioned dockets, apart from a single issue of interest to San Diego Gas & Electric Company.

The ISO is requesting expedited consideration of the enclosed Settlement Agreement for reasons stated in the Motion to Shorten Comment Period that accompanies these documents. The Parties respectfully request the Presiding Judge, after the requested shortened comment period, to certify the Settlement Agreement to the Commission, and respectfully urge the Commission to accept the Settlement Agreement without condition or modification.

BACKGROUND

The Grid Management Charge ("GMC") is the administrative charge assessed by the ISO on its customers in order to recover its costs. On November 2, 2001, the ISO

filed its GMC for 2002, which was assigned Docket No. ER02-250-000. On December 5, 2001, PG&E filed modifications to its GMC Pass-Through Tariff (“P-TT”) in Docket No. ER02-479-000. The GMC P-TT allows PG&E to pass-through and recover on a dollar-for-dollar basis the ISO’s GMC from PG&E’s Control Area Agreement (“CAA”) Customers to which the GMC is applicable.

On December 7, 2001, the ISO made an errata filing related to its November 2, 2001 GMC filing. Numerous parties filed protests and motions to intervene in the ER02-250-000 proceedings. On December 20, 2002, the Commission accepted the ISO’s filing in ER02-250-000 for filing, made the filing effective January 1, 2002 subject to refund and to the outcome of the 2001 GMC proceedings, and set the matter for hearing. The Chief Administrative Law Judge designated Judge Bobbie J. McCartney as Presiding Judge for the ER02-250-000 proceeding. During a pre-hearing conference held in ER02-250-000 on January 10, 2002, the Presiding Judge urged the parties “to fully explore the possibility of settlement in this proceeding.” Tr. 20-21.

In an order issued January 31, 2002, the Commission accepted for filing PG&E’s December 5, 2001 filing and assigned it Docket No. ER02-479-000, and the ISO’s December 7, 2001 errata filing and assigned it Docket No. ER02-527-000. The Commission made both filings effective January 1, 2002, subject to refund and the outcome of the 2001 GMC proceedings, and consolidated these dockets with Docket No. ER02-250-000 for hearing.

During a subsequent pre-hearing conference held on May 30, 2002, the Presiding Judge again urged the parties to engage in settlement discussions, with the goal of settling

at least some of the issues in the case. Tr. 181-82. The Presiding Judge instructed the parties to file, by June 28, either a request that a settlement judge be appointed or a new proposed procedural schedule. Tr. 183.

Following the May 30, 2002 pre-hearing conference, the Parties engaged in intensive settlement negotiations. On June 28, the Parties filed with the Presiding Judge a “Joint Motion for Appointment of Settlement Judge and Suspension of the Remaining Procedural Schedule.” As negotiations continued, it became apparent that a settlement in principle could be reached without the assistance of a settlement judge. Therefore, on August 7, the Parties filed with Judge McCartney a “Joint Motion to Suspend the Procedural Schedule.”

On August 15, a “Joint Motion to Institute Interim Rates” was filed with the Commission, in order to allow the ISO’s customers to receive the benefit of the settlement rates while the Settlement Agreement was being finalized. The Commission approved the motion on September 12, 2002 and made the settlement rates effective September 1, 2002. In order to avoid issues of retroactive ratemaking that would arise if the Commission approved higher rates for July and August 2002 as part of the Settlement Agreement, the ISO filed a “Joint Motion to Adjust the Interim Settlement Rates” on October 11, 2002, requesting that the adjustment become effective November 1, 2002. That motion is pending before the Commission.

SETTLEMENT TERMS

The Settlement Agreement provides for rates, effective January 1, 2002, for the three GMC service categories: the Control Area Services Charge (“CAS”), the Congestion Management Charge (“CM”), and the Ancillary Services and Real Time Energy Operations Charge (“ASREO”). In the case of ASREO, the Settlement Agreement provides for a rate effective from January 1, 2002 through August 31, 2002, a rate effective September 1, 2002, through October 31, 2002, and a rate effective November 1, 2002, through December 31, 2002. As discussed below, the rates for ASREO effective January 1, 2003, would be determined by an ISO filing, either informational or under Section 205 of the Federal Power Act (“FPA”), prior to that date. Other settlement terms deal with, *inter alia*, the circumstances under which the ISO must make a filing under Section 205 of the FPA or may otherwise adjust the rates for the GMC applicable to 2003, whether the ASREO should be assessed based on self-provided Ancillary Service volumes, the manner in which stakeholders should have input into the ISO’s budgeting and GMC process for 2003, and how the stakeholder process to revise the GMC for 2004 should be conducted. The specific provisions of the Settlement Agreement are as follows:

Article I. Scope of Settlement.

Section 1.1 deals with the scope of the Settlement Agreement, and states that the Settlement Agreement resolves all issues in the captioned dockets apart from the single issue of interest to SDG&E regarding the Southwest Power Link. Section 1.1 also states that, except as described in Section 10.3, any issue that concerns the ISO’s GMC revenue

requirement and rates is precluded from being raised during the period from the effective date of the Settlement Agreement through the earlier of either December 31, 2003 or the date the ISO makes a rate filing under Section 205 of the FPA.

Section 1.2 states the Settlement Agreement terminates these proceedings except as necessary to implement the Settlement Agreement.

Section 1.3 states the terms of the Settlement Agreement shall be applied on a non-discriminatory basis by the ISO and PG&E to their customers.

Article II. Rates and Revenue Requirement.

Section 2.1 provides the Settlement Rates for CAS, CM, and ASREO. As stated in Section 2.1, the rate for CAS, effective January 1, 2002, is \$0.553/MWh. The rate for CM, effective January 1, 2002, is \$0.312/MWh. The rates for ASREO are \$0.957/MWh, effective January 1, 2002, \$1.048/MWh effective September 1, 2002, through October 31, 2002, and \$1.158/MWh effective November 1, 2002, through December 31, 2002. The ASREO rate effective January 1, 2003, will be determined, and otherwise may be adjusted, by an ISO informational filing or filing under Section 205 of the FPA pursuant to Article IV of the Settlement Agreement.

Section 2.2 states that ASREO shall not be assessed based on volumes of self-provided Ancillary Services for 2002 or 2003.

Section 2.2.1 states that the ISO withdraws its filed charge of 50% of ASREO based on self-provided volumes of Ancillary Services for 2002, and will not propose such an assessment in 2003.

Section 2.2.2 states that the ISO will recover through CAS the costs that would have been recovered through the charge withdrawn under Section 2.2.1.

Section 2.2.3 states that PG&E will submit a change to its P-TT, effective January 1, 2002, to reflect the ISO's withdrawal of the charge under Section 2.2.1.

Section 2.3 states that the ISO's stipulated gross revenue requirement for 2002 is \$239,200,000, a reduction of \$5,593,886 (in Operating and Maintenance expenses) from the gross revenue requirement filed on November 2, 2001. As used in the Settlement Agreement, "gross revenue requirement" means the ISO revenue requirement reduced by surplus funds available in the ISO's Operating and Capital Reserves Account at the beginning of the relevant year.

Section 2.3 further states that the individual revenue requirements for the three service categories are \$138,585,863 for CAS, \$27,787,380 for CM, and \$72,826,757 for ASREO.

Section 2.3.1 states that the rates provided in Section 2.1 reflect an adjustment to the revenue requirement figures of Section 2.3 by reallocating the Operating & Maintenance expenses among the three service categories and by reducing the CAS and ASREO categories by a total of \$11,282,847 of the amounts received by the ISO through fines and penalties.

Section 2.4 states that, in the event the Commission requires the ISO to return to sellers an amount of fines and penalties such that the rates described in Section 2.1 are insufficient to allow the ISO to maintain the level of Operating and Capital Reserves Account funds that is required by the ISO Tariff, the ISO may make a filing to increase

the rates in order to restore the Operating and Capital Reserves Account to the required level. If the ISO makes such a filing, Parties may contest only the ISO's calculation of the amount necessary to restore the Operating and Capital Reserves Account to the required level and the extent to which the return of the fines and penalties contributed to the deficiency in the Operating and Capital Reserves Account.

Section 2.5 provides that in determining its revenue requirement for 2003 and 2004, the ISO will apply such amounts of fines and penalties as the ISO reasonably believes will not be subject to refund. An explanatory reconciliation of the dollar amounts of fines and penalties that the ISO had recovered as of September 30, 2002 is included with this filing.

Section 2.6 sets forth the stipulated annual billing determinant volumes for 2002: 246,487,000 MWh for CAS; 88,992,846 MWh for CM; and 63,148,156 MWh for ASREO. Section 2.6 also lists the facts and assumptions on which the stipulated billing determinant volumes are based.

Section 2.7 states that if a filing under Section 205 of the FPA for 2003 to increase the revenue requirement to make up for under-recoveries due to volume shortfalls in 2002 is necessary, no Party may contest the ISO's right to make such a collection, except to investigate and challenge any erroneous aspect of the filing.

Article III. Refunds.

Section 3.1 states that the ISO, within 30 days of the effective date of the Settlement Agreement, will provide refunds plus interest to customers to the extent that amounts have been collected pursuant to the GMC rates filed on November 2, 2001, in

excess of the amounts that would have been collected had the settlement rates of Section 2.1 been in effect as of January 1, 2002, pursuant to the Commission's regulations.

Section 3.1.1 states that if the Settlement Agreement is rendered null and void after such time as the ISO makes refunds plus interest as described in Section 3.1, the ISO may recover the amounts of refunds plus interest through separate charges on invoices.

Section 3.1.2 states that the ISO may recover, in 2003 GMC rates, amounts paid or credited by the ISO to affected GMC service customers as interest on refunds, regardless of whether the ISO must make a filing under Section 205 of the FPA for 2003 GMC rates.

Section 3.2 states that PG&E will pass through any refunds that are associated with amounts previously collected from PG&E's CAA customers.

Article IV. Trigger for a Section 205 Filing.

Section 4.1 allows the ISO to adjust the rates in Section 2.1 on January 1, 2003 without a filing under Section 205 of the FPA under certain circumstances. The adjusted rates, using the ISO's estimated billing determinant volumes, shall not recover revenues in excess of the ISO's actually budgeted revenue requirement for each service category.

First, Section 4.1 allows the ISO to adjust the rates included in Section 2.1 on January 1, 2003, without a filing under Section 205 of the FPA for each service category based on any changes in the estimated billing determinant volumes from the volumes used in 2002. Subsequent adjustments due to changes in estimated billing determinant

volumes must be through a quarterly rate adjustment pursuant to Appendix F, Schedule 1, Part B of the ISO Tariff or through a filing under Section 205 of the FPA.

Second, Section 4.1 also allows the ISO to adjust the rates included in Section 2.1 on January 1, 2003, without a filing under Section 205 of the FPA, for other reasons if, and only if, certain conditions are met. The circumstances that must be met in order for the ISO to adjust the GMC rates for 2003 without a filing under Section 205 of the FPA (other than to adjust for changes in estimated billing determinant volumes) are four:

1. The gross revenue requirement, *i.e.*, the revenue requirement reduced by any surplus funds in the ISO's Operating and Capital Reserves Account, to be recovered by such rates may not exceed \$239,200,000;
2. The gross revenue requirement to be recovered by such rates may not exceed \$138,585,863 for CAS, \$27,787,380 for CM, or \$72,826,757 for ASREO;
3. The ISO may not propose a change in the three service categories, *i.e.*, CAS, CM, and ASREO; and
4. The gross revenue requirement excluding the effect of Operating and Capital Reserves Account, *i.e.*, the ISO revenue requirement *before* reduction by any surplus funds in the ISO's Operating and Capital Reserves Account, may not exceed \$246,000,000.

Thus, if the ISO's revenue requirement is more than \$246,000,000, but the application of surplus funds in the Operating and Capital Reserves Account produces a gross revenue requirement of \$239,200,000 or less, the ISO must nonetheless file under Section 205 of the FPA. If the ISO's revenue requirement is less than \$246,000,000, but the application of surplus funds in the Operating and Capital Reserves Account produces a gross revenue requirement greater than \$239,200,000, the ISO must still file under Section 205 of the FPA. If the ISO's revenue requirement is less than \$246,000,000, and

the application of surplus funds in the Operating and Capital Reserves Account produces a gross revenue requirement less than \$239,200,000, but the CAS gross revenue requirement is greater than \$138,585,863 (or greater than \$27,787,380 for CM, or \$72,826,757 for ASREO) the ISO also must still file under Section 205 of the FPA. Only if *none* of these revenue requirement “triggers” is met, *and* the ISO does not change the service categories, may the ISO adjust the rates without making a filing under Section 205 of the FPA.

If the ISO adjusts the GMC rates for 2003 without a filing under Section 205 of the FPA, it will make an informational filing with the Commission.

Under the Commission’s order of October 11, 2002, in Docket No. ER02-1656, *et al.*, the ISO must implement a modified day-ahead market by the end of January 2003. In order to ensure that participants in the day-ahead market pay an appropriate share of the costs of operating the ISO’s markets, the ISO will need to make a filing under Section 205 of the FPA to include the costs of administering the day-ahead market in the ASREO service category and to revise the name of the ASREO service category to “Market Operations” accordingly. The Parties intend that such a filing not be deemed a “change in the three service categories” that would require the ISO to make a filing under Section 205 in order to adjust its rates effective January 1, 2003, as described in Section 4.1. This intention and conclusion, however, shall not serve as a precedent, or be cited as such in any dispute regarding whether any other ISO action regarding the service categories requires a filing under Section 205 of the FPA or constitutes a change in service

categories that would require the ISO to make a filing under Section 205 in order to adjust its rates effective January 1, 2003.

Article V. 2003 Budgeting/Rate Development Process.

Article V refers to Appendix A, which describes Stakeholder² input into the ISO's budgeting and GMC rate development process and provides milestones for Stakeholder involvement.

Article VI. 2003 Re-evaluation Process for 2004 GMC.

Article VI refers to Appendix B, which provides procedures and milestones for the general GMC re-evaluation process required by the Initial Decision of Judge McCartney in the 2001 GMC proceeding, *California Independent System Operator Corporation*, 99 FERC ¶ 63,020 (2002). In addition, Article VI provides a description of some of the issues to be discussed during the re-evaluation process.

Article VII. Changes to Section 8.5 and Appendix F, Schedule 1, Part B of the ISO Tariff.

Section 7.1 provides for the following language to replace that in Section 8.5 of the ISO Tariff in the November 2, 2001 GMC filing:

“Revenue collected to fund the ISO financial operating reserves shall be deposited in an Operating and Capital Reserves Account until such account reaches a level specified by the ISO Governing Board. If the Operating and Capital Reserves

² Stakeholders are all ISO customers and regulators.

Account is fully funded, surplus funds will be considered revenues in the next fiscal year's operating budget.”

Section 7.2 provides for the following language to replace that in Appendix F, Schedule 1, Part B of the ISO Tariff in the November 2, 2001 GMC filing:

“Each component rate of the Grid Management Charge will be adjusted automatically on a quarterly basis, up or down, so that rates reflect the ISO's FERC approved revenue requirement, if the estimated billing determinant volumes for that component, on an annual basis, change by 5% or more during the year.

“Each year the Grid Management Charge may be recalculated to reflect the following year's budget estimates and to adjust for any difference between the previous year's revenue and cost estimates and actual revenues and costs, as reflected in Part D of this Schedule, ‘Information Requirements’. The annual or periodic filing (which is described in Part D and is not the quarterly adjustment) shall not affect the automatic adjustment of the Grid Management Charge on a quarterly basis as set forth in the first paragraph of this Part B.”

Article VIII. Precedential Effect.

Section 8.1 states that the Settlement Agreement shall have no precedential effect, but that the Parties may enforce the terms of the Settlement Agreement in future proceedings.

Article IX. Reservations.

Section 9.1 states that agreement to the terms of the Settlement Agreement shall not be deemed an admission by any Party that any allegation or contention in these proceedings is valid, and no Party shall be deemed to have accepted or agreed to any concept, fact, or other matter underlying or purporting to underlie the Settlement Agreement. Finally, Section 9.1 states that the Commission's approval of the Settlement Agreement shall not constitute approval of or precedent regarding any principle or issue in the case.

Section 9.2 states that the resolution of any matter in the Settlement Agreement shall not constitute a "settled practice."

Section 9.3 states that the discussions leading to the Settlement Agreement were conducted under Rule 602(e) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.602(e) (2002).

Section 9.4 states that the titles and headings of the Articles of the Settlement Agreement are not to be used for interpretative purposes.

Article X. No Protest or Appeal of Settlement; No Challenge to Rates.

Section 10.1 prohibits any Party from filing comments or reply comments opposing the Settlement Agreement; seeking rehearing of a Commission order unconditionally approving the Settlement Agreement; seeking appellate review of a final order unconditionally approving the Settlement Agreement; seeking to set aside the Settlement Agreement if it is unconditionally approved; or challenging the applicability of the Settlement Agreement to any Party once it has become effective.

Section 10.2 explains that under the Commission's regulations, an entity that fails to file Comments within the time allowed for comments waives all objections to the Settlement Agreement, and cannot seek review of the Commission's approval or otherwise challenge the terms and conditions of the Settlement Agreement.

Section 10.3 provides that Parties retain the right to ask the Commission to investigate, under Section 206 of the FPA, any aspect of the ISO Tariff not covered by the Settlement Agreement or whether the ISO has implemented the Settlement Agreement consistently with its terms.

Article XI. Successors and Assigns.

Section 11.1 states that the rights conferred and obligations imposed on any Party or other customer of the ISO by the Settlement Agreement shall inure to the benefit of or be binding on that Party's or customer's successors in interest or assignees.

Article XII. Execution in Counterparts.

Section 12.1 states that the Settlement Agreement may be executed in counterparts, that each counterpart shall be deemed an original, and that the counterparts together shall constitute the same instrument.

Article XIII. Parties' Rights and Obligations.

Section 13.1 provides that Section 3.1.1, which authorizes the ISO to recoup refunds made under the Settlement Agreement if the Settlement Agreement is for any reason voided, survives the nullification of the remainder of the Settlement Agreement unless Section 3.1.1 is itself specifically rejected by the Commission or a court.

Section 13.2 provides that if the Settlement Agreement is conditioned or modified by the Commission in a manner that significantly affects the benefits for any Party, a Party other than the ISO may object to and withdraw from the Settlement Agreement within eight days of the Commission order conditioning or modifying the Settlement Agreement. If any Party objects to and withdraws from the Settlement Agreement during that period, the other Parties have an additional five days (*i.e.*, thirteen days from the Commission order) to object to and withdraw from the Settlement Agreement. If the Settlement Agreement is conditioned or modified by the Commission in a manner that significantly affects the benefits for any Party, the ISO may object to and withdraw from the Settlement Agreement within twenty days of the Commission order conditioning or modifying the Settlement Agreement. Any Party that does not object to and withdraw from the Settlement Agreement within the specified period will be deemed to have accepted the Settlement Agreement as conditioned or modified.

Section 13.3 provides that the Settlement Agreement shall survive the objection and withdrawal of any Party other than the ISO.

Section 13.4 provides that if the ISO provides notice of its objection and withdrawal, then the Settlement Agreement shall not become effective and it shall be a nullity for any and all purposes.

Section 13.5 provides that failure of a Party to notify the other Parties and the Commission pursuant to section 13.2 shall be deemed agreement by such Party to the Settlement Agreement as modified or conditioned.

Article XIV. Giving Effect to Commission Opinion in Docket Nos. ER01-313-000, et al., During the Term of this Settlement Agreement

Section 14.1 provides that the ISO will conform the rates, terms and conditions of the GMC to the Commission opinion in Docket Nos. ER01-313-000, *et al.*, or to a court decision reviewing the Commission's opinion in Docket Nos. ER01-313-000, *et al.* Section 14.1 also provides that parties will meet within 10 days of a Commission opinion or court decision that would result in the ISO's failure to recover or retain the amount of its gross revenue requirement, in order to determine how to modify the Settlement Agreement to enable the ISO to recover or retain its gross revenue requirement. The Parties shall have thirty days from the date of such Commission opinion or court decision to submit an amended settlement agreement to the Commission for approval. If Parties are unable to submit a modified settlement agreement to the Commission within such period, the ISO shall be free to make a filing under Section 205 of the FPA in order to ensure the recovery or retention of its gross revenue requirements.

Section 14.2 provides that if a Commission order or reviewing court decision reduces the revenue requirement filed by the ISO in Dockets ER01-313-000, *et al.*, such a reduction in an order or decision shall not affect the terms of the Settlement Agreement.

Section 14.3 provides that should the 2001 GMC Initial Decision in Docket Nos. ER01-313-000, *et al.*, be reversed as to the propriety of PG&E's ability to pass-through GMC costs to CAA customers, then provisions in the Settlement Agreement addressing PG&E's ability to pass-through GMC costs shall be removed without otherwise affecting the Settlement Agreement. Section 14.3 also provides that PG&E will refund all amounts

from CAA customers pursuant to its P-TT to the extent directed by the Commission in Docket Nos. ER01-313-000, *et al.*

Article XV: Effective Date.

Section 15.1 provides that the Settlement Agreement will be effective upon issuance by the Commission of a Final Order, as defined, approving the Settlement Agreement.

Respectfully submitted,

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