

Memorandum

To: ISO Board of Governors
From: Nancy Saracino, Vice President, General Counsel & Chief Administrative Officer
Date: September 1, 2010
Re: **Decision on Extension of Current Grid Management Charges through 2011**

This memorandum requires Board action.

EXECUTIVE SUMMARY

The California Independent System Operator Corporation's current grid management charge, with the exception of the current market usage-forward energy charge determinant, became effective with the new market implementation on April 1, 2009 and was extended through 2010. The current market usage-forward energy charge determinant was the subject of a settlement offer and became effective on June 1, 2010. Pursuant to the terms of the settlement offer, that charge will remain in effect until December 31, 2011, but the other grid management charge components will expire, in accordance with the tariff provisions, on December 31, 2010. Therefore, Management proposes to extend the grid management charge formula rate, the current rate design elements, and the \$197 million revenue requirement "trigger," without change, through December 31, 2011.

At the ISO's April 21, 2010, stakeholder budget meeting, the ISO proposed to extend the grid management charge rate elements and the current revenue requirement cap through 2011, similar to extensions requested in 2006, 2007, 2008 and 2009. The grid management charge extension will be reflected in proposed tariff language to be filed with the FERC prior to November 1, 2010.

Moved, that the ISO Board of Governors approves the proposed tariff change regarding the extension of the grid management charge through December 31, 2011, as detailed in the memorandum dated September 1, 2010; and

Moved, that the ISO Board of Governors authorizes Management to make all necessary and appropriate filings with the Federal Energy Regulatory Commission to implement the proposed tariff change.

DISCUSSION AND ANALYSIS

Background

The basic design of the grid management charge, which is the mechanism through which the ISO recovers its administrative costs, was established in a settlement agreement with stakeholders in 2004 and approved by FERC in 2005. That design consists of a rate formula that allocates costs to rate charge categories reflecting ISO services and an annual revenue requirement cap. As long as the ISO's revenue requirement remains below the cap, the ISO is not required to make a regulatory filing that reflects changes to the annual budget. The actual grid management charge, made up of a series of charge categories, is the product of the application of this rate design to the annual ISO revenue requirement. The settlement agreement provided that the grid management charge would expire upon the earlier of December 31, 2006 or the implementation of the new nodal market structure.

Due to delays in implementation of the new market, the ISO and its stakeholders agreed to extend the grid management charge formula rate and revenue requirement cap in 2006, 2007 and 2008. Concurrently with extending the grid management charge on these three occasions, the ISO worked with its stakeholders to develop the grid management charge rate design modifications that would be necessary to reflect service category changes brought about by the new market structure. Despite the need to make these modifications, however, the formula rate structure design and revenue requirement cap were retained in the proposed new grid management charge. The proposal was approved by FERC on December 18, 2008 and went into effect on April 1, 2009.

Modifications to the Market Usage-Forward Energy Charge

Following the implementation of the new grid management charge, the ISO held a stakeholder process during 2009 to address stakeholder concerns about the application of the market usage-forward energy charge to the inter-scheduling coordinator energy trades in the day-ahead market. This process culminated with a proposal to modify the billing determinants for the market usage-forward energy charge to: 1) eliminate inter-scheduling coordinator trades from the market energy forward usage charge code calculation; 2) eliminate "netting" forward energy from the calculation; and 3) implement a "greater of" mitigation solution in the market usage forward energy calculation. The ISO proposed that the "greater of" mitigation solution would remain in place on an interim basis until the ISO conducts a new cost of service study and considers, with its stakeholders, necessary changes to the grid management charge rate design that would be implemented in 2012.

The market usage-forward energy charge proposal, along with a proposal to extend the rest of the grid management charge until December 31, 2010, was approved by the Board at the October 2009 meeting and filed with FERC on October 30, 2009. On December 30, 2009, FERC approved the extension of the grid management charge but suspended the effective date of the market usage-forward energy charge proposal (subject to refund) until June 1, 2010 and scheduled a settlement conference.

Subsequent to the settlement conference, the ISO and participating parties came to an agreement that market usage-forward energy charge modifications, as proposed by the ISO, could be placed into effect on June 1, 2010 and remain in effect on an interim basis through December 31, 2011. The parties filed a settlement offer with FERC on March 23, 2010 that was approved on August 4, 2010. The market usage-forward energy charge proposal became effective on June 1, 2010.

Proposed Charge for Convergence Bidding

On June 25, 2010, the ISO submitted tariff changes to implement convergence bidding, including two new grid management charge categories applicable to convergence bidding participants. Specifically, the ISO proposed to implement a “virtual award” charge that will be assessed on dollars of cleared gross megawatt hours and a “virtual bid submission” transaction charge assessed on all bid segments that pass the ISO’s bid validation rules and are passed on to the integrated forward market software. The ISO has requested that all of the convergence bidding tariff changes, including the new grid management charges, become effective on February 1, 2011.

Extending the Current Grid Management Charge

As discussed above, all of the grid management charge categories, except for the market usage-forward energy charge and the convergence bidding charge, will expire as of December 31, 2010. Accordingly, Management proposes to maintain the revenue requirement cap at \$197 million (which includes ISO costs related to convergence bidding) and to extend the current grid management charge formula rate through calendar year 2011 until January 1, 2012.

MANAGEMENT RECOMMENDATION

Management recommends that the Board approve the proposed extension of the grid management charge until January 1, 2012 as detailed above.