



Memorandum

To: Governance/ADR Committee

From: Charlie Robinson, Vice President and General Counsel
Anthony Ivancovich, Assistant General Counsel
Sidney Mannheim Davies, Assistant General Counsel

cc: ISO Board of Governors; ISO Officers

Date: October 12, 2005

Re: *Monthly Regulatory Update*

This is an update of key regulatory activities and requires no Board action.

FERC Matters and Related Decisions of the Court of Appeals

Market Redesign and Technology Upgrade (ER02-1656)

- On September 19, 2005, FERC issued its *Order on Rehearing*, 112 FERC ¶ 61,310 in response to requests for rehearing of the July 1, 2005 *Order on Further Amendments to the California Independent System Operator's Comprehensive Market Design Proposal*. In response to the CAISO's arguments that FERC erred by requiring the CAISO to increase the number of load aggregation point ("LAP") zones and in permitting individual wholesale customers to "opt out" of load aggregation by establishing their own separate LAP zones, FERC directed the CAISO to take into account CRR Study 2 results and deferred its final decision on the number of LAPs to its consideration of the CAISO MRTU Tariff filing. FERC also deferred any discussion of the "opt out" decision to a future order addressing issues discussed at the September 13, 2005 technical conference on demand response. In its rehearing request, the CAISO also argued that FERC erred in rejecting the CAISO's proposal to apply local market power mitigation ("LMPM") measures to Residual Unit Commitment ("RUC") Availability Bids because such mitigation measures are necessary to ensure that RUC market clearing prices are just and reasonable. FERC denied rehearing of this issue while also stating that it was premature to consider the potential exercise of market power in RUC until all the Resource Adequacy ("RA") rules and requirements have been determined. Further, FERC clarified that the CAISO was not precluded from proposing that RA Units would be ineligible for the RUC Availability payment. FERC granted rehearing and clarification request of IEP and Williams that market mitigation in the forward market be based on bid-in load (as opposed to CAISO's forecast of load). FERC also clarified that unit's not dispatched in the IFM but then selected for RUC can resubmit energy bids. The energy bids would still be subject to real-time market power mitigation. FERC also clarified its scarcity pricing directives in response to IEP and Williams. Specifically, FERC clarified that: (1) in its real-time ancillary services ("AS") procurement, all AS that the CAISO relies on must be paid the applicable real-time AS price; (2) scarcity provision outlined for self-scheduled load will be triggered in the event of curtailments at a particular node or when load is curtailed across nodes in an overall supply shortage; and (3) when RUC is inadequate, then scarcity pricing will be triggered. FERC denied rehearing requests of other parties on other issues, including challenges to the CAISO's HASP proposal.

- On September 27, 2005, the CAISO filed its Initial Comments on the issues discussed at the demand response technical conference held in San Francisco on September 13, 2005. The following issues were discussed at the technical conference: (1) Special Case Nodal Pricing (“SCNP”); (2) the establishment of load aggregation zones for individual wholesale customers; and (3) demand response in California and under the CAISO Tariff. In its Initial Comments, the CAISO argued that the Commission should not require it to implement SCNP in MRTU Release 1. The CAISO also argued that the Commission should not permit individual wholesale customers to opt out of the CAISO’s proposed load aggregation scheme. Finally, the CAISO described the demand response mechanisms that would be incorporated into MRTU Release 1.
- On September 30, 2005, pursuant to the *Further Order on the California Comprehensive Market Redesign Proposal*, 105 FERC ¶ 61,140 (2003), the CAISO filed detailed information regarding its allocation of Congestion Revenue Rights (“CRRs”). The CAISO updated FERC on the status of its CRR allocation rules development and provided documents describing its latest proposal. The CAISO informed FERC that it expects to complete its policy development with its stakeholders this month and that it plans to seek Board approval of its CRR allocation rules during the October 18-19 BOG meetings. The CAISO also provided FERC with a brief discussion of the results of the CRR Study 2 conducted by LECG, on which the CAISO has relied to formulate its most recent CRR allocation proposal. Finally, the CAISO informed FERC that it expects to conduct its illustrative CRR allocation from May to July 2006 and will file the outcome of the illustrative allocation within a reasonable time after the completion of the illustrative allocation. CAISO also informed FERC that it expects to conduct its actual allocation September to December 2006 and will file the actual allocation within a reasonable time following the completion of the actual allocation. The informational filing acknowledges that the CAISO is evaluating the costs and benefits of an alternative CRR allocation methodology.
- On October 5, 2005, the CAISO filed an answer to SMUD’s motion for extension of time to submit comments to the CAISO’s November 30, 2005 MRTU Tariff filing and request for clarification that the CAISO’s September 30, 2005 CRR filing should include a proposal for long-term firm service. With respect to the form, the CAISO argued that the motion was premature, since it was made in advance of the November 30, 2005 MRTU Tariff filing. With respect to the latter request, the CAISO noted that it was not under a directive to include long-term firm service rights in its CRR proposal.

Responsible Attorneys: Anthony Ivancovich, Anna McKenna and Sidney M. Davies

Simplified and Reorganized Tariff (ER05-1502)

On September 22, 2005, the CAISO filed a simplified and reorganized version of the ISO Tariff (S&R Tariff). The S&R Tariff simplifies the tariff by deleting duplicative and anachronistic tariff and protocol provisions; and reorganizes the tariff by merging protocol language into the Tariff in related subject areas. The S&R Tariff will also serve as the platform for the MRTU Tariff to be filed on November 30, 2005.

Responsible Attorneys: Sidney M. Davies and Anna McKenna

Tariff Amendment No. 72/Scheduling Coordinator Day-Ahead Scheduling Requirement (ER05-1502)

On September 22, 2005, the CAISO filed Amendment No. 72 to the ISO Tariff. Amendment No. 72 would modify the ISO Tariff to require Scheduling Coordinators (SCs) to submit Day-Ahead Schedules that reflect 95% of their forecasted daily Demand. Amendment No. 72 would also require SCs to provide to the CAISO on a weekly basis data regarding their actual daily loads and would amend Section 20.3 to provide for confidential treatment of this data. The CAISO requested an effective date of September 23, 2005.

Responsible Attorney: Anthony Ivancovich

CAISO Control Area Changes (ER05-1520, ER05-1533 and ER05-1522)

COTP and MID Transition to SMUD Control Area (Docket Nos. ER05-1520 and ER05-1533): On September 28, 2005 the CAISO filed Amendment No. 3 to the Interconnected Control Area Operations Agreement ("ICAOA") with the Sacramento Municipal Utility District ("SMUD") and on September 29, 2005 the CAISO filed Amendment No. 4 to the ICAOA with SMUD. These amendments, among other things, transfer the California Oregon Transmission Project ("COTP") and the Modesto Irrigation District ("MID") from the ISO Control Area to the SMUD control area effective December 1, 2005. In addition, these amendments establish the basis for an CAISO psuedo-tie pilot program and reciprocity with SMUD for similar functionality at some time in the future.

California-Oregon Intertie Control Area Operating Agreement (Docket No. ER05-1522): On September 29, 2005 the CAISO filed the California-Oregon Intertie (COI) Control Area Operating Agreement with SMUD. This agreement was necessary to facilitate the CAISO's role as Path Operator for COI now that the COTP will transition to the SMUD control area. As a result, because the facilities comprising the COI will reside in two control areas, it was important for the Path Operator, currently the CAISO, to have a commitment from both control areas regarding the provision of information necessary to operate the path and to respond to instructions from the Path Operator.

Responsible Attorney: John Anders

Unresolved Issues Docket (ER98-3760)

On September 30, 2005, FERC issued its *Order Granting Rehearing and Directing Compliance Filing*, 112 FERC ¶ 61,350 (2005). In this order, FERC granted rehearing concerning one issue raised by CDWR's following FERC's November 19, 2004 order in this docket. Specifically, the order direct the CAISO to submit plans for the implementation of a competitive procurement of Voltage Support and Black Start services. The plan must include an implementation timeline and must be filed with the FERC within 120 days from the date of the order.

Small Utility Distribution Company Operating Agreement, Amendment No. 70 and Settlement between CAISO and Trinity Public Utility District (ER05-1025)

On May 19, 2005 the CAISO and Trinity Public Utility District ("Trinity PUD") filed a settlement with the support of the Western Area Power Administration, FERC staff not opposing the settlement, and PG&E ultimately contesting. As part of the settlement, the CAISO also filed on May 25, 2005 Amendment No. 70 to the ISO Tariff, which included a *pro forma* Small Utility Distribution Company ("SUDC") Operating Agreement and new provisions contained in Article 31 of the ISO Tariff to address issues raised by Trinity PUD and others that may be similarly situated. On September 23, 2005 the Commission issued an Order in both dockets conditionally approving of Amendment No. 70 and the contested settlement. Generally the Commission found the CAISO's proposal for an SUDC reasonable due to the relative size and number of customers and employees as compared with a UDC. Accordingly, the CAISO will make a filing in compliance with the Commission's Order and include a provision in the SUDC Operating Agreement requiring the SUDC to notify the CAISO if it becomes aware of an event on its distribution system that may have an adverse impact on the ISO Controlled Grid.

Responsible Attorney: John Anders

Tariff Amendment No. 66/Tariff Amendment No. 69 (ER05-718) Intertie Settlements

On September 30, 2005, the CAISO issued its *Order on Tariff*, 112 FERC ¶ 61,352 accepting the CAISO's July 26, 2005 *Request for Extension of Tariff Authority for "As-Bid" Settlement of Pre-dispatched Intertie Transactions*. Although it accepted the CAISO's proposal to extend the "as bid" settlement rules for inter-tie transactions, FERC characterizes the settlement rules as a continuation of an "interim" or "temporary" solution that should sunset upon implementation of once the long-term solution for settling intertie bids is implemented. The September 30, 2005 order requires the CAISO to continue to monitor the effects of the "as bid" rules and to continue to file weekly reports. In addition, in response to comments by Powerex and BPA, FERC will require the CAISO to expand its weekly analysis and to publish on its website both the average incremental and decremental bid prices accepted for each hour along with the applicable zone and associated average hourly ex-post price.

Responsible Attorney: Sidney M. Davies

Intertie Bidding Investigation (IN05-8-00)

On September 26, 2005, FERC issued its *Order Authorizing Public Disclosure of Staff Report of Investigation*. The Staff Report concluded that Powerex had not violated FERC's Market Behavior Rule 2 or Section 7.1 of the CAISO's Enforcement Protocol (both rules prohibit practices that are without a legitimate business purpose and which are intended to manipulate market prices). Specifically, the Staff Report concluded that: (1) Powerex's bids were made pursuant to its "legitimate business purpose of maximizing its physical energy purchases and sale in the CAISO; (2) Powerex could not have reasonably foreseen that increased bidding activity would cause uplift complained of by the CAISO; and (3) uplift payments to Powerex were the result of CAISO-requested-Commission-approved rule (the "bid or better" rule) that provided an incentive for liquidity at the interties.

Independent Energy Producers Complaint On Must Offer Obligation (EL05-145)

On October 3, the CAISO filed an Answer to the complaint filed by the Independent Energy Producers ("IEP") to implement an Interim Reliability Capacity Services Tariff ("RCST"). IEP had alleged that the Must Offer Obligation was no longer just and reasonable and that the Commission should replace it with the RCST. The CAISO recommended that FERC convene a technical conference to consider the nature and scope of a possible capacity service to replace the Must Offer Obligation subsequent to implementation of the Resource Adequacy program that is being instituted under the direction of the CPUC. The CAISO noted that such a technical conference could be used to (1) receive input from market participants regarding the appropriate nature of a back-up capacity program in connection with implementation of the CPUC's Resource Adequacy program in June 2006, and (2) design the rules for such a backstop. However, the CAISO urged the Commission to deny the complaint to the extent that it seeks a determination that the existing Must Offer Obligation is unjust and unreasonable and should be replaced or revised prior to June 1, 2006.

Responsible Attorney: Anthony Ivancovich

Grid Management Charge (GMC) Proceeding (ER04-115)

On September 22, 2005, FERC issued its *Order Approving Uncontested Settlement*, 112 FERC ¶ 61,139 (2005) in which it approved a Settlement Agreement between SDG&E and the CAISO regarding SDG&E's liability for GMC payments for SWPL transactions. The Settlement was jointly filed by SDG&E and the CAISO following and pursuant to the broader SWPL agreement reported on previously. The Settlement, which was unopposed by any other entities - market participants or regulatory bodies, substituted the new "Line Operator Charge" for the GMC charges previously applied. Although it results in a refund to SDG&E, the greater significance is the resolution of

the charge liability issue for years to come. The filing was made in the 2004 GMC docket, which had been kept open specifically for this issue, and will result in closure of that docket and other dockets with related litigation.

Refund Proceeding (EL00-95 *et al*)

- **Refund Calculations and Cost Recovery.** This is the proceeding in which the IOUs and the state are seeking refunds for unreasonable prices during the energy crisis. It is now in the “financial adjustment” phase, meaning that the ISO completed the calculations of refunds due under the mitigated prices ordered by the Commission, and will next process certain adjustments that the Commission has ordered to account for sellers’ costs. These adjustments will be for sellers’ emissions costs, fuel prices, and overall entity revenue shortfalls. Since the update of August 24, 2005, there has been much activity relating to how these adjustments are calculated and allocated.
- **Ninth Circuit Court of Appeals Decision.** On September 6, 2005, the United States Court of Appeals for the Ninth Circuit issued an opinion on a petition for review of a FERC order finding that governmentally owned utilities, defined as nonpublic utilities under the Federal Power Act (FPA), were subject to FERC refund liability. The Court of Appeals found that FERC did not have refund authority over such governmental entities under the FPA. The governmental entities, which primarily include municipal utilities, had petitioned for review of FERC orders holding them liable for refunds, arguing that these orders contravened the FPA’s express exclusion of FERC jurisdiction over the rates of governmental entities. As the court put it: “The dispute centers on whether the general applicability of the FPA to ‘the sale of electric energy at wholesale in interstate commerce,’ [as FERC had argued] . . . overrides more specific FPA provisions that exclude non-public utilities and governmental entities from FERC’s authority to enforce just and reasonable rates and to order refunds.” The IOUs and the state intervened on behalf of FERC, arguing that it had jurisdiction to order refunds from governmental entities. The ISO also filed a brief in support of FERC, which explained the difficulties that the ISO might encounter implementing orders that provide for a different price for one group of sellers (*i.e.*, the governmental entities) than for the remainder of ISO market participants. The court rejected the arguments of FERC and the supporting intervenors, held the specific exclusion in the FPA immunized the governmental entities from orders to make refunds, and remanded the case to FERC for further proceedings.

Responsible Attorney: Dan Shonkwiler

New Rulemakings and Administrative Proceedings

- **Establishment of Federal-State Joint Boards re Economic Dispatch (AD05-13).** Pursuant to the Energy Policy Act of 2005, on September 30, 2005, FERC established the framework for the creation of FERC-state joint boards to study the issue of security constrained economic dispatch and how it affects reliability and affordability of electric service. The West Board (covering the states of Arizona, California, Colorado, Idaho, Montana, Nevada, New Mexico, Oregon, South Dakota Utah Washington and Wyoming), will be chaired by Commissioner Kelly. Each state may designate a representative to serve on the Board.
- **New Rulemaking Relating to Repeal of PUHCA (RM05-32).** On September 15, 2005, FERC published a Notice of Proposed Rulemaking to implement the repeal of the Public Utility Holding Company Act of 1935 and to enact the Public Utility Holding Company Act of 2005, (which was enacted as part of the Energy Policy Act of 2005). Repeal of PUHCA 1935 replaces Security Exchange Commission oversight of public utility holdings with FERC oversight. The rulemaking will consider rules exempting certain holding company systems and what SEC requirements under PUHCA 1935 should be maintained under PUHCA 2005. Comments are due within 21 days of publication in the Federal Register.

- **New Rulemaking to Consider Order 888 Reforms (RM05-25).** On September 16, 2005 FERC issues a Notice of Proposed Rulemaking to consider whether reforms are needed to Order No. 888 to prevent undue discrimination and preference in transmission services. Specifically, FERC is seeking comment on whether reforms of the *pro forma* open access transmission tariff (OATT) are needed to prevent undue discrimination. Comments are due within 60 days of publication in the Federal Register. Among the topics the FERC is seeking comment on are:
 - What further remedies are necessary to address undue discrimination?
 - Should reforms to the Commission's pricing policies be considered as part of OATT reform?
 - Should changes be made to various services required under Order No. 888?
 - Should the obligations of public utility transmission providers be better defined?
 - Should there be specified penalty charges for violations of the tariff provisions?
 - Should hourly firm transmission service be required?
 - Have transmission customers been discriminated against in modifying receipt and delivery points?

FERC is also seeking comment on: processing of requests for transmission services; rollover rights, rules and standards governing transmission service; joint transmission planning; capacity expansion obligations; joint ownership; tariff compliance reviews; hoarding of transmission capacity; curtailments; reservation priority; designation of network resources; queuing for long-term transmission service; ancillary services; energy imbalances; generator imbalances; OATT definitions; and applications of these matters to independent system operators, regional transmission organizations and independent transmission companies.

FERC is also seeking comment on the implementation of a newly established section of the Federal Power Act (FPA) – section 211A. The new energy law gives FERC authority to require non-public utilities – or “unregulated transmitting utilities” – to provide open access transmission service. Among other things, FERC is seeking comment on whether it should require unregulated transmitting utilities to provide transmission service under rates comparable to what they charge themselves, and under terms and conditions that are comparable to those that they apply to themselves and that are not unduly discriminatory or preferential.

- **New Rulemaking to Update FERC Merger Policy (RM05-34).** On October 3, 2005, FERC issued a Notice of Proposed Rulemaking to implement the merger review provision of the Energy Policy Act of 2005. Among other things, the Energy Policy Act amended section 203 of the Federal Power Act to:
 - increase the value threshold from \$50,000 to \$10 million for certain transactions subject to section 203;
 - extend the scope of Commission review to include transactions involving certain transfers of electric generation facilities and public utility holding company transactions;
 - require the Commission to make cross-subsidization findings and generally determine that the transaction will not result in a regulated utility subsidizing a non-utility associate company; and
 - direct the Commission to adopt, by rule, procedures for the expeditious consideration of applications for the approval of dispositions, consolidations, or acquisitions under section 203.

CPUC Matters

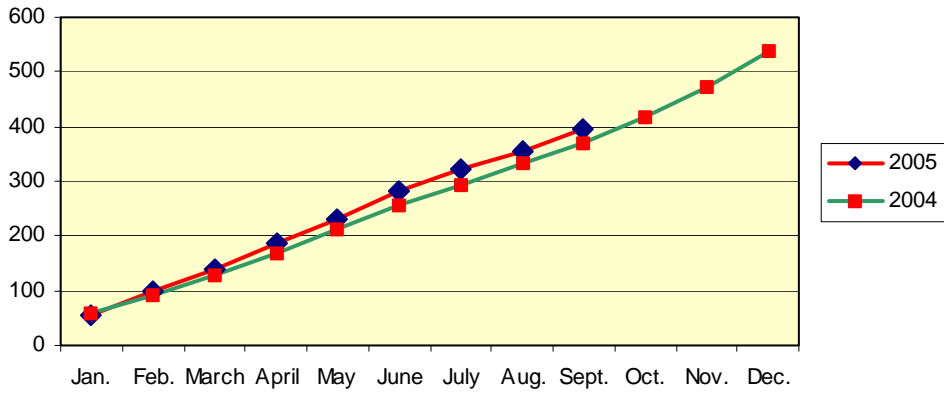
Resource Adequacy Proceeding at the CPUC: R04-04-003

On September 27, 2005, Administrative Law Judge Mark S. Wetzell issued his proposed decision on Phase 2 resource adequacy requirements ("Proposed Decision"). The Proposed Decision is intended to facilitate the proposed June 1, 2006 resource adequacy effective date by specifying many of the implementation details left unresolved by the CPUC's October 28, 2004 Interim Decision on Resource Adequacy Issues. Opening comments and reply comments on the Proposed Decision are due October 17 and 23, 2005, respectively. The CPUC may either adopt the Proposed Decision or issue an alternate decision, which would be subject to comment. The CPUC's next business meeting following the submission of comments is October 27, 2005. Some particularly salient aspects of the Proposed Decision are:

- Local Capacity Requirements to be deferred until 2007
- Adoption of other CAISO deliverability tests and allocation of import capacity for counting RA resources based on an LSE's share of CAISO system peak load and if allocation on a particular path is oversubscribed, LSEs with contractual commitments would obtain priority.
- Intra-control area energy contracts or Firm Liquidated Damages (LD) contracts will be phased-out for resource adequacy purposes. An LSE can rely on Firm LD contracts for 25% of its portfolio for 2006, 15% for 2007, 5% for 2008, and none thereafter. Firm LD contracts signed after September 27, 2005, will not count.
- Interruptible programs triggered under emergency conditions may count in an LSE's portfolio.
- Established penalty of 150% of the monthly cost of new capacity for failure to comply with RA requirements.

Responsible Attorney: Grant Rosenblum

Total Filings



FERC Filings

