

Memorandum

To: ISO Board of Governors
From: William J. Regan, Jr., Chief Financial Officer & Vice President, Corporate Services
Ben Arikawa, Senior Consultant
Date: August 29, 2007
Re: Briefing on GMC under MRTU Stakeholder Process

This memorandum does not require Board action.

Introduction

Changes in the Grid Management Charge (GMC) rate structure will be necessary with the implementation of Market Redesign and Technology Upgrade (MRTU). In anticipation of these changes, The California ISO (CAISO) convened a stakeholder process last year. Despite challenges, the stakeholders and the CAISO are moving forward on finalizing the GMC under MRTU. The cost of service study has been completed and provided to stakeholders. To facilitate discussion, alternative rate structure scenarios have been developed and bill impacts continue to be analyzed.

Management will work cooperatively with stakeholders in an attempt to reach agreement on the appropriate structure for the GMC under MRTU. If consensus is not reached, Management will provide a proposal that balances competing interests and meets the decision criteria listed below. Regardless of whether a consensus is reached, a GMC rate filing must be made no later than November 1, 2007, with an effective date of January 1, 2008, in order to continue the current rate structure until MRTU implementation. Management anticipates bringing this issue to the Board for a decision at the October Board meeting.

This memorandum outlines and summarizes stakeholder comments, issues and concerns. While many of these issues have been addressed and resolved in this process¹, stakeholders have raised several concerns that remain to be resolved. For example, various Scheduling Coordinators with Transmission Ownership Rights (TORs) have argued that the GMC under MRTU should not apply to flows on their TORs. Other stakeholders may contend that the changes in cost allocation disproportionately impact their business or that there is insufficient justification for the new charges.

History of Board Review

In a previous memorandum provided in the May meeting materials, Management briefed the Board on the status of the GMC under MRTU rate design. Management outlined the structure of the current GMC and the structure that would apply to the GMC under MRTU. Management also briefly outlined the GMC under MRTU Stakeholder process. The schedule presented in the May memorandum had called for a Board decision at the July meeting. However, stakeholders requested more time for deliberation on the changes in the GMC to be effective with MRTU startup. Several stakeholders requested that the filing be made only after the proposed CAISO 2008 Budget has been released. They argued that knowing the 2008 Budget would reduce the uncertainty concerning the impact of the proposed changes to rates. After consideration of their request and in consultation with Legal, Management agreed to modify the timeline so that the filing would be made no later than November 1, 2007 with a Board decision at the October meeting.

GMC under MRTU Stakeholder Process

With the potential for changes in the GMC rate structure, the CAISO convened a stakeholder process to discuss the various aspects of these changes. As shown in *Attachment A, Stakeholder Process and Open Issues*, the stakeholder process to date has consisted of 11 meetings or conference calls. Last fall, stakeholders and the CAISO also agreed that a detailed analysis of the CAISO's cost structure was a necessary prerequisite for determining the final calculations underlying the GMC rates. This detailed analysis of CAISO costs (cost of service study) examines the nature of expenditures to determine how expenditures should be allocated to each of the CAISO's functions. Each cost center is surveyed to determine how its activities relate to the defined CAISO functions. Capital expenditures also are evaluated in order to determine their relationship to these functions. Preliminary results were presented to stakeholders in late May.

Throughout the stakeholder process, the CAISO has actively solicited stakeholder comments and questions and has attempted to address each one. Since the process began, stakeholders have commented on the lack of time for deliberation in the schedule. Last fall, the CAISO revised the timeline to first focus on critical details of the rate structure that would be coded into the Settlements and Market Clearing (SaMC) system, allowing more time into 2008 for deliberation of cost allocation issues. As described above, the CAISO more recently revised the timeline to allow a later filing in order to continue discussions.

The CAISO has been responsive to the need to support renewable energy providers as a matter of state policy. Previously, the owners of intermittent resources argued that some mitigation should be applied to the GMC applicable to uninstructed deviations. In this stakeholder process, the CAISO and other stakeholders have agreed to implement an accommodation for intermittent resources in the form of netting uninstructed deviations during the month. This accommodation was coded into SaMC and will be available at MRTU startup.

Once the results of the cost of service study were released in late May, some stakeholders questioned the reasonableness of the results by comparing them to results of the 2003 cost of service results. The CAISO considered these comments by reviewing the cost of service results and developing a high level comparison to show the reasons for these major changes. The CAISO will be discussing this comparison with stakeholders in the coming weeks. The CAISO also responded to questions about how specific cost centers or specific system applications were assigned to the CAISO functions. The detailed documentation on the cost of service study has been publicly available since late May on the CAISO website.

Several stakeholders, including Modesto Irrigation District and the Transmission Agency of Northern California, requested circulation of drafts of the potential changes in the Tariff. The CAISO provided an outline of the potential elements of the GMC filing on August 27 for discussion throughout September. The CAISO will circulate drafts at various stages to those parties that have expressed interest and consider comments on these drafts.

Customers also are concerned about the overall impact of changes in their GMC bills whenever changes are made in the rate structure. To this end, the CAISO has provided preliminary bill impact analysis to participants in June

2007. Based on comments received, the CAISO reviewed the underlying assumptions, with the potential for modification to the cost allocation. Updated bill impacts will be provided to stakeholders in September. The bill impact analysis provides both stakeholders and Management with useful insight into potential impacts from the proposed rate structure changes. The bill impacts may show unexpected, adverse results or disproportionate impacts on certain Scheduling Coordinators. In certain circumstances, it may be necessary to refine the rate structure to mitigate some of the adverse impacts. The bill analysis allows discussion to be focused on more discrete issues and has facilitated discussion in the past.

The CAISO will continue to work cooperatively with stakeholders in the coming weeks to develop the cost allocation detail necessary to complete the GMC filing by November 1.

Decision Criteria, Scope and Challenges

Among the criteria considered in the stakeholder process for developing a rate structure are:

- The FERC “just and reasonable and not unduly discriminatory or preferential” standard;
- The principle of cost-causation, which charges customers for the cost of services that they use or cause;
- The ease of administration (for CAISO and participants) and understandability (for participants);
- Avoiding adverse operational impacts;
- The recovery of CAISO costs in a stable, low risk manner without excessive volatility; and,
- The stakeholder process and the CAISO consideration of the comments and proposals received in that process.

It is possible that the CAISO and market participants will not reach agreement on the final allocation of costs or the extension of the GMC Settlement. It is also possible that parties may request accommodations in the GMC rate structure that other parties or the CAISO may not find acceptable. In either case, there is the potential for expensive and time-consuming litigation at the FERC.

For example, SDG&E has argued that the GMC under MRTU should not apply to flows on Imperial Irrigation District and Arizona Public Service TORs on the Southwest Power Link. CAISO Management disagrees, and FERC has previously affirmed the CAISO’s assessment of GMC on flows on the SWPL. This may be a point of contention that simply will not be resolved prior the filing of the GMC with FERC.

A listing of open issues that may be brought to the Board’s attention by stakeholders is provided in Attachment A.

Conclusion

CAISO Management has highlighted the challenges with reaching stakeholder consensus on the GMC under MRTU to inform the Board of Management’s progress on attempting to reach resolution of the concerns, and alert the Board that even if the stakeholder issues are not completely resolved, Management will be seeking approval of the GMC rate structure proposal in October so that the current rate structure will continue into 2008 and the necessary changes to GMC can be effective on MRTU startup.