

Memorandum

To: ISO Board of Governors
From: Nancy Saracino, General Counsel
Date: August 29, 2007
Re: 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 (MRTU)

- **MRTU Section 205 and Compliance Filing (ER06-615/ER07-1257)**

On August 3, 2007, the CAISO submitted a filing in compliance with the vast majority of outstanding compliance items that were required to be filed no later than 180-days prior to implementation of MRTU. In addition, the CAISO also included proposed new tariff language for the following key features of the MRTU Tariff: (1) market validation and price correction; (2) amendments to the MRTU Tariff to bring the CAISO's standard of liability for damages for certain actions into conformity with that of other ISOs and RTOs; (3) changes to the Settlements provisions (Section 11) of the MRTU Tariff in order to update those provisions to be fully consistent with the Settlements and Market Clearing software; (4) modifications to the Resource Adequacy provisions (Section 40) of the MRTU Tariff, to reflect Commission directives from the September 21, 2006, April 20, 2007 and June 25, 2007 Orders and to resolve several other issues identified through the Resource Adequacy stakeholder process; (5) changes as a result of the CAISO's stakeholder process aimed at determining whether additional details included in the CAISO's Business Practice Manuals should be reflected in the MRTU Tariff; (6) a transparent process to manage proposed changes to Business Practice Manuals; (7) addition of language relating to Metering and Qualifying Facilities; and (8) limited changes to redress ambiguity created through the creation of the Simplified and Reorganized tariff.

Responsible Attorneys: Sidney Davies, Anna McKenna, Mike Dozier, Grant Rosenblum and Beth Ann Burns

- **Congestion Revenue Rights Credit Policy Tariff Amendment (ER07- 1077)**

On August 29, 2007, FERC issued an order accepting the CAISO's June 22, 2007 Congestion Revenue Rights Credit Policy tariff amendment in its entirety, with one exception. FERC granted the Northern California Power Agency's request concerning calculation of credit requirements for Long Term CRRs. FERC found that using one-year auction results as the basis for future years' credit requirements could inaccurately estimate the value of Long-

Term CRRs. FERC stated a deliberate choice to favor lowering the barriers to entry over risk of requiring excessive collateral. In all other respects, FERC accepted the CAISO's proposal, rejecting other protests raised by NCPA and declining to accept SCE's proposal to use LMP study data rather than CRR auction results to estimate the value of CRRs.

Responsible Attorney: Sidney Davies

- **Request for Extension of Time to Comply with Specified Compliance Requirements (ER06-615)**

On August 3, 2007, the CAISO also filed for an extension of time to comply with six remaining compliance requirements related to MRTU: 1) interim measures to address underscheduling prior to implementation of convergence bidding; (2) additional explanation and tariff language on use of "penalties" for ensuring market clearing at Load Aggregation Points; 3) details concerning Load-following RMR Units; 4) outcome of stakeholder process for curing collective capacity shortfalls; (5) filing of a Demand Response report; and 6) details concerning firm trades to a Trading Hub that are resold. With the exception of the underscheduling requirement, which stems from the September 21, 2006 Order, these compliance directives came from the June 25, 2007 Order. By Notice of Extension of Time dated August 8, 2007, FERC granted the CAISO's request.

Responsible Attorneys: Sidney Davies, Anna McKenna, Grant Rosenblum and Mike Dozier

- **Request for Rehearing of June 25 Order on Compliance (ER06-615)**

On July 25, 2007, the CAISO filed a request for rehearing concerning three issues: (1) that the CAISO not be required to conduct a security check of Market Participants seeking access to the CRR Full Net Work Model; (2) that the CAISO has authority to issue Exceptional Dispatches to address transmission-related modeling limitations outside of Real-Time operations; and (3) the June 25 Order did not impose any limitation on its Exceptional Dispatch authority provided under tariff sections 34.9.1 and 34.9.2.

Responsible Attorneys: Anna McKenna, Sidney Davies and Beth Ann Burns

- **Answer to Rehearing Requests of June 25 Order on Compliance (ER06-614)**

On August 9, 2007, the CAISO filed Motion for Leave to Answer and Answer to the Requests for Rehearing and Motions for Clarification of FERC's June 25 2005 Order On Compliance Filings ("June 25 Order") filed by other parties. The CAISO advocated that the requests for rehearing and clarification filed by the Bonneville Power Authority, Imperial Irrigation District, Metropolitan Water District, and the City and County of San Francisco do not withstand scrutiny and should be denied. The CAISO argued that FERC's determinations with regard to the CAISO's compliance filings of November 20, 2006 and December 20, 2006 on the issues presented by the intervenors should be sustained. The CAISO also reiterated that it has implemented properly the requirements of the Commission's directives from its orders on the MRTU initiative.

Responsible Attorneys: Anna McKenna, Mike Dozier and Sidney Davies

- **Order Denying SMUD's and CCSF's Emergency Motion for Stay (ER06-615)**

On July 30, 2007, FERC issued an order denying the request for stay filed jointly by SMUD and CCSF to prevent the CAISO from implementing the Marginal Losses element of the locational marginal pricing component of MRTU.

FERC agreed with the CAISO's arguments that the applicants had failed to establish that irreparable harm would occur if the CAISO were to implement its marginal losses tariff provisions.

Responsible Attorneys: Sidney Davies and Anna McKenna

- **Second Quarter Seams Report (ER06-615)**

On July 30, in compliance with FERC's September 21, 2006, order directing "the CAISO and neighboring control areas to meet as needed to resolve seams between them" and to "jointly report on the progress of these efforts in quarterly status reports filed with the Commission within 30 days of the end of each calendar quarter," the CAISO filed with FERC its joint quarterly reports with Western Area Power Administration, Sacramento Municipal Utility District, WestConnect, Turlock Irrigation District, and Los Angeles Department of Water and Power. These reports reflect the seams-related discussions that took place during the second quarter of 2007 with these parties. The joint status reports identify and, as appropriate, summarize bilateral discussions between the CAISO and neighboring control areas regarding seams issues. In addition, the report includes additional seams-related activities and discussions facilitated by the Western Electricity Coordinating Council ("WECC") during the second quarter of 2007. During the second quarter of 2007, the CAISO also initiated discussions with both the Bonneville Power Administration and the Imperial Irrigation District regarding the possibility of entering into Inter Balancing Area Authority Operating Agreements with both Bonneville and IID. Such agreements would, among other potential issues, address each party's need to ensure continued compliance with all applicable reliability standards. While the parties continue to identify and work towards resolving seams issues across control areas, no seams issues have been identified that prevents the CAISO and market participants from proceeding with its MRTU implementation.

Responsible Attorney: Anna McKenna and Sidney Davies

- **CRR-Related Compliance Filing (ER06-615, ER07-869 and ER07-475)**

On July 20, 2007, the CAISO submitted its filings in compliance with the Commission's April 20, 2007, June 25, 2007, and July 6, 2007, orders, as well as proposed tariff changes to accommodate certain rule changes to its Congestion Revenue Rights ("CRR") program. There are two general aspects to this filing. The first aspect involves a set of tariff changes on three CRR-related topics that were the subject of a recent CAISO stakeholder process. The three topics involve tariff provisions related to: (i) the transfer of CRRs due to Load Migration and the CAISO's tracking of these transfers, (ii) the modeling of transmission outages in the network model used for CRR purposes, and (iii) the use of common load forecasts for monthly CRR eligibility and monthly resource adequacy showings. The CAISO submitted the proposed tariff revisions on each of these three CRR topics in compliance with Commission prior orders listed above. The second aspect of this filing involves proposed revisions to the MRTU Tariff submitted in compliance with eight requirements contained in the Commission's July 6 Order, discussed below. The CAISO notes that the July 6 Order established several compliance obligations for the CAISO with varying due dates. Certain directives in the July 6 Order require the CAISO to collect additional information from load-serving entities external to the CAISO's Control Area.

Responsible Attorney: Anna McKenna

- **July 6 Order On Long-Term Congestion Revenue Rights (CRR) Related Filings (ER07-869, ER07-475 and ER06-615)**

On July 9, 2007 the Commission issued an order conditionally accepting, subject to modification, the CAISO's proposed tariff provisions related to short-term CRRs and Long Term CRRs to become effective on July 9, 2007. The order addressed the CAISO's January 29, 2007, filing in compliance with FERC's final rule on long-term transmission rights and also addressed the CAISO's filing made on May 7, 2007, requesting authority for changes to certain aspects of its CRR rules in its tariff. FERC, subject to certain limited changes, found the CAISO proposal to be consistent with FERC guidelines established in the final rule on long term transmission rights.

Responsible Attorney: Anna McKenna

Credit Policy Tariff Amendment (ER06-700)

On May 31, 2007, the CAISO submitted its compliance filing as directed by FERC's April 19, 2007 Order on Rehearing and Compliance Filings. FERC affirmed the substance of the CAISO's credit policies as reflected in its initial filings and subsequent compliance filings. In addition, FERC granted the CAISO's request for rehearing subject to certain modifications, which will allow the CAISO to remove the Credit Policy and Procedure Guide from the tariff and return it to the CAISO website. In 2006, FERC had directed the CAISO to file the Guide as part of the ISO Tariff, but invited the CAISO to make a case for removing the Guide from the tariff. FERC accepted the CAISO's proposal subject to specific directives to include additional details in Section 12 of the tariff. Accordingly, FERC affirmed application of the "rule of reason" to credit policies, which allows business practice guides and manuals to be created and maintained as non filed informational materials that support and explain the tariff. In the May 31 compliance filing, the CAISO moved material from the Guide in to Section 12 and removed the Guide from the tariff and republished the Guide on the CAISO's website. By order issued on August 13, 2007, the Commission accepted the May 31 compliance filing in its entirety.

Responsible Attorney: Sidney Davies

Tehachapi Transmission Project Request for Waiver (ER07-447-000)

On August 22, 2007, FERC granted Calpine's request for clarification in the above referenced proceeding. As described below, the FERC order does not alter the CAISO's intended treatment of Calpine's Pastoria Project, which was included in the scope of the clustered system impact study for the Tehachapi Transmission Project (TTP). The CAISO initiated this proceeding when it requested a one-time waiver of two provisions of its large generator interconnection procedures (LGIP) on the basis that such waivers allow it to efficiently and cost effectively identify transmission network upgrades necessary to interconnect the 4,350 megawatts of primarily wind generating facilities in the Tehachapi Wind Resource Area. Calpine protested the CAISO's request, chiefly arguing that forcing its Pastoria Project to repeat its system impact study as part of a cluster would cause it to lose the financial benefits of its current queue position. In the March 2007, FERC rejected Calpine's arguments and instead found that good cause existed to grant the one-time waivers.

Calpine sought rehearing or clarification of the March 2007 order on two points. First, Calpine requested that the inclusion of its Pastoria Project in the clustered system impact study will not subject it to costs for network upgrades greater than those to which it would have been exposed without the cluster. Calpine argued that clarification is necessary because of the potential that SCE could partially or fully withdraw its commitment to fully finance the network upgrades for the TTP. In response to Calpine's protest, the CAISO had stated that if some unforeseen obstacle results in the withdrawal of SCE's commitment to finance the network upgrades for the TTP, the CAISO would attempt to mitigate the risk of additional costs accruing to all affected developers by estimating, as closely as possible, the network upgrades and costs that each particular project would have accrued. This concession was necessary given the standard for obtaining waivers of tariff provisions. Accordingly, the FERC granted Calpine's request for clarification on this topic, but denied rehearing. Second, Calpine requested clarification that it will not be subject to undue delay by its

inclusion in the cluster study. Specifically, Calpine requested that FERC clarify that, if requested by Calpine, the CAISO and SCE shall complete any other serial study requirements not encompassed by the clustered system impact study and that Calpine's ability to obtain a large generator interconnection agreement (LGIA) for the Pastoria Project will not be delayed as a result of its inclusion in the new cluster study. Again, this request is consistent with the CAISO's position that it would serially study each project to determine direct assignment facilities specific to each project and thereby have the ability to execute a LGIA in a timely manner.

Responsible Attorney: Grant Rosenblum

Reference Price Calculation Tariff Clarification (ER07-1038)

By letter order dated July 27, 2007, as modified by letters dated July 31, 2007 and August 6, 2007, FERC accepted the CAISO's June 14, 2007 filing of revised tariff language clarifying CAISO policies that both bid-based decremental and incremental reference prices used in the CAISO's local market power mitigation measures shall be calculated using only positive accepted bids. No adverse comments were submitted by any party.

Responsible Attorney: Sidney Davies

Petition to Waive Sanctions for Failure to Submit Daily Demand Forecasts (ER07-1180)

On July 20, 2007, the CAISO filed a petition to waive financial penalties that otherwise would have been assessed against Scheduling Coordinators for their failure to submit certain daily demand forecasts. The "Enforcement Protocol," which is part of the ISO Tariff and became effective in 2004, specifies a penalty of \$500 for failing to provide information to the CAISO within the deadlines specified in the tariff. The requirement to submit demand forecasts by 10:00 a.m. was adopted as part of the amendment that required Scheduling Coordinators to schedule 95% of their load in the Day-Ahead. As a result of an investigation, the Department of Market Monitoring (or "DMM") found that 16 Scheduling Coordinators had violated this requirement a total of 108 times for the time period prior to October 17, 2006. (Since October 18, 2006, the market's record of compliance has been essentially perfect.) DMM believed that these violations were to some extent caused by technical shortcomings of the CAISO systems, and also within the error rate to be expected when utilities are learning to comply with new requirements. The petition explained the idiosyncrasies of the interface that was used to upload forecasts – essentially, it did not allow Scheduling Coordinators to view the forecasts they had submitted in order to confirm they had uploaded correctly. The petition argued that, for this reason, and because Scheduling Coordinators apparently were making their best efforts to comply during the learning period, a one-time waiver of penalties would be appropriate. Because DMM has no discretion to excuse violations or reduce the financial penalties, the petition requested recommended that the sanctions be waived. Comments supporting the CAISO's position were filed by the Department of Water Resources, and the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside.

Responsible Attorney: Dan Shonkwiler

Scheduling Coordinator Certification & Termination Amendments (ER07-1060)

On August 17, 2007, FERC issued an order accepting as filed the CAISO's set of amendments to the current version of the ISO Tariff modifying the provisions relating to the process for Scheduling Coordinator ("SC") certification and termination in several respects, including increasing the application fee for SC certification and addressing application processing issues. The amendments also implement certain modifications to the SC certification provisions that FERC had already approved for use in the CAISO's MRTU markets. The amendments are effective as of August 20, 2007 and apply to all new applications for SC certification.

The amendments implement the following revisions:

- Change the SC certification processing window from 60 days to 120 days.
- Change the SC certification application fee from \$500 to \$5000, while the fee for additional SCIDs is specified to be the \$500 per month Grid Management Charge (GMC) fee, subject to GMC changes.
- Enable the CAISO to close an SC application if certification has not been achieved within a 12 month period.
- Enable the CAISO to suspend or terminate the certification of an SC that does not schedule or bid in the CAISO's markets for 12 months, subject to a 120-day period for the SC to obtain reinstatement of its certification by meeting all applicable training and testing requirements.
- Incorporate new requirements for SC certification from the MRTU Tariff and the BPM for SC Certification and Termination. Many of these MRTU-related changes were already accepted by FERC, with the primary new revisions to make clear the need for an SC Applicant to comply with CAISO system security requirements, meet additional training and testing requirements, and submit an emergency plan, plus the deletion of Appendix T, which previously set forth details regarding the Scheduling Coordinator application process. The effective provisions of former Appendix T have been incorporated into the BPM for SC Certification and Termination, which has been posted on the CAISO website and made effective for application to all new applications for SC certification.

As the CAISO addressed all stakeholder concerns through the stakeholder process, no adverse comments or protests were filed regarding the amendments, and FERC was able to accept the filing by means of a letter order.

Responsible Attorney: Mike Dozier

Termination of South West Power Link (SWPL) Operations Agreement (ER07-1188)

On July 23, 2007, the CAISO filed a Notice of Termination of the SWPL Operations Agreement ("Operations Agreement"), Original Rate Schedule FERC No. 60, to be effective at the end of the Trading Day, September 30, 2007. The Operations Agreement effectuated a settlement between the CAISO and SDG&E that resolved protracted litigation related to the CAISO's assessment of rates and charges to SDG&E as the Scheduling Coordinator for certain transactions by its co-owners of the Southwest Powerlink ("SWPL") transmission line. As the result of a series of decisions by the U.S. Court of Appeals and the Commission, SDG&E is now authorized to recover through its Transmission Revenue Requirement the SWPL cost differentials that were addressed through the settlement. The Operations Agreement, accordingly, terminates under its own terms.

Responsible Attorney: Beth Ann Burns

PacifiCorp Termination of PACI Agreement and PG&E Amendment to OCOA (ER07-882 and ER07-962)

On July 30, 2007 the Commission issued an order addressing issues that were raised with respect to eight dockets, all related in one way or another to the California Oregon Intertie (COI). The CAISO is a party to two of the eight proceedings, one concerning PacifiCorp's request for termination of the Capacity Agreement with PG&E and the other PG&E's filing of an amendment to the Owners Coordinated Operations Agreement (OCOA). As noted in the most recent Regulatory Report, issues with respect to the continued reliable operation of the COI, among others, are raised by these proceedings.

FERC suspended the termination of the Capacity Agreement for five months subject to further order, set the issues for a paper hearing and encouraged settlement negotiations. In its Order FERC noted that "PacifiCorp has not demonstrated that appropriate coordination and operating arrangements are in place and, therefore, that coordinated and reliable operation and planning of the COI would be preserved. FERC also accepted PG&E's amended OCOA, suspended it for five months subject to further order, set the issues for a paper hearing and encouraged settlement negotiations. On August 16, 2007 the Commission issued an Order in response to PacifiCorp's motion for appointment of a settlement judge filed on August 10, 2007. The CAISO filed comments in support with some clarification, which were incorporated into the Order. The settlement process will consider all of the issues discussed in the Commission's Order and the settlement process will not delay the paper hearing process. The initial settlement conference before Judge Cintron will be held on August 23, 2007.

Responsible Attorneys: John Anders

Green Borders Unexecuted LGIA (ER07-1034)

This proceeding concerns issues raised with respect to an unexecuted Large Generator Interconnection Agreement (LGIA) filed by SCE on June 14, 2007 with respect to Green Borders Geothermal, LLC. Green Borders requested that the Commission order settlement proceedings, the CAISO and SCE did not oppose this request, and on August 10, 2007 the Commission directed the Chief Judge to appoint a settlement judge. On August 16, 2007 the Chief Judge appointed Judge Birchman and the initial settlement conference will be held on August 27, 2007.

Responsible Attorneys: John Anders and Grant Rosenblum

North Star Steel Company v. CAISO et al. (EL06-68)

In an order issued August 10, 2007, the Commission declined to rehear a 2006 order that dismissed a complaint seeking to begin a new refund proceeding for certain crisis-era sales. The complaint was filed on May 2, 2006 by North Star Steel Company, which operated a mill in Arizona during 2000 and 2001. North Star purchased electricity under a contract with the Arizona Electric Power Cooperative that required North Star to pay AEPCO's costs of procurement at wholesale plus a markup. The complaint sought refunds from the CAISO and seven other entities that allegedly sold electricity to AEPCO at unreasonably high prices, which passed them along to North Star between January 1, 2000 and June 21, 2001. In 2006, the Commission granted the motions to dismiss brought by the CAISO and other defendants on the basis that North Star lacked privity with the ISO or any of the other respondents, and also because North Star was a retail consumer, which meant that refunds would be beyond the scope of the Commission's jurisdiction. The August 10 order denied North Star's motion for rehearing, which had argued that any person may seek refunds in a § 206 complaint, including a retail customer such as itself. The Commission's order clarified that it lacked authority to grant relief to a retail customer and that, even if it had such authority, it would exercise its discretion not to grant such relief to North Star. In reaching the latter conclusion, the Commission picked up on a point that the CAISO made in its motion – *i.e.*, that North Star's claims should have been litigated in other proceedings.

Responsible Attorney: Dan Shonkwiler

NOPR on Mandatory Reliability Standards For Critical Infrastructure Protection (CIP Standards) (RM06-22)

On July 20, 2007, the FERC issued a Notice of Proposed Rulemaking (NOPR) regarding eight Critical Infrastructure Protection (CIP) reliability standards that have been proposed for approval as mandatory and enforceable, similar to those that were approved by the FERC in Order 693 issued on March 16, 2007 (Docket RM06-16-001) and became effective on June 18, 2007.

The following CIP standards are the subject of the NOPR:

- **CIP-002-1 – Cyber Security – Critical Cyber Asset Identification:**
Requires a responsible entity to identify its critical assets and critical cyber assets using a risk-based assessment methodology.
- **CIP-003-1 – Cyber Security – Security Management Controls:**
Requires a responsible entity to develop and implement security management controls to protect critical cyber assets identified pursuant to CIP-002-1.
- **CIP-004-1 – Cyber Security – Personnel & Training:**
Requires personnel with access to critical cyber assets to have an identity verification and a criminal check. It also requires employee training.
- **CIP-005-1 – Cyber Security – Electronic Security Perimeters:**
Requires the identification and protection of an electronic security perimeter and access points. The electronic security perimeter is to encompass the critical cyber assets identified pursuant to the risk-based assessment methodology required by CIP-002-1.
- **CIP-006-1 – Cyber Security – Physical Security of Critical Cyber Assets:**
Requires a responsible entity to create and maintain a physical security plan that ensures that all cyber assets within an electronic security perimeter are kept in an identified physical security perimeter.
- **CIP-007-1 – Cyber Security – Systems Security Management:**
Requires a responsible entity to define methods, processes, and procedures for securing the systems identified as critical cyber assets, as well as the non-critical cyber assets within an electronic security perimeter.
- **CIP-008-1 – Cyber Security – Incident Reporting and Response Planning:** Requires a responsible entity to identify, classify, respond to, and report cyber security incidents related to critical cyber assets.
- **CIP-009-1 – Cyber Security – Recovery Plans for Critical Cyber Assets:** Requires the establishment of recovery plans for critical cyber assets using established business continuity and disaster recovery techniques and practices.

Part of the review process for these proposed reliability standards includes the assignment of Violation Risk Factors (low, medium and high), which are used in the calculation of penalties. FERC's analysis of the proposed CIP standards included a discussion and proposed modifications to the risk factor levels proposed for each standard. Comments on the proposed CIP standards will be due on October 5, 2007.

Responsible Attorney: Judi Sanders

NOPR on Facilities Design, Connections and Maintenance Reliability Standards (FAC standards) RM07-3-00

On August 13, 2007, FERC issued a Notice of Proposed Rulemaking (NOPR) proposing to approve three new reliability standards setting requirements for the development of system operating limits of the Bulk Power System for use in the planning and operations horizons. The stated purpose of the three new standards is to ensure that system operating limits and interconnection reliability operating limits are developed using consistent methods and contain certain essential elements. Comments are due on September 19, 2007.

Responsible Attorney: Judi Sanders

Transmission Agency of Northern California v. FERC (D.C. Circuit Docket No. 05-1402)

On July 20, 2007, the U.S. Court of Appeals for the D.C. Circuit ruled on a Petition for Review of the Federal Energy Regulatory Commission's order reviewing the Transmission Revenue Requirement, or "TRR," filed by the City of Vernon but collected by the CAISO through its Transmission Access Charge (TAC). The Court affirmed the Commission's authority to review Vernon's TRR under the just and reasonable standard notwithstanding FERC's lack of general authority over the City's transmission rates, but reversed FERC's determination that it had the authority to order Vernon to make refunds.

Vernon's TRR has been the subject of earlier litigation that is necessary background to understand the recent ruling. Vernon filed its TRR with the Commission upon joining the CAISO as a Participating Transmission Owner in 2001. Under recently-approved tariff provisions designed to accommodate the addition of Participating Transmission Owners that were not subject to FERC jurisdiction (mainly municipalities), Vernon was required as a condition of becoming a Participating Transmission owner (and thus of recovering its TRRs through the CAISO's TAC) to voluntarily file it for review with either a CAISO panel, subject to subsequent Commission review, or FERC. Although Commission initially approved Vernon's submission, this decision was the subject of an appeal filed by PG&E and SCE, who argued that the Commission had failed to apply sufficient scrutiny. In 2002, the D.C. Circuit had ruled that because Vernon's TRR is included in the CAISO's TAC as part of a pass-through rate formula rate, the Commission must review it to ensure that it does not render the CAISO's TAC rate unjust or unreasonable. The Court's decision required the Commission to articulate and apply a standard that ensures the pass-through of Vernon's costs in the TAC, based on substantial evidence, and remanded for further proceedings. On remand, the Commission held, among other things, that the only way to ensure just and reasonable CAISO rates, as mandated by the Court, was by "examining whether each component of Vernon's TRR is just and reasonable" – the same standard applied to the rates of jurisdictional utilities. It also ruled that Vernon must pay a refund based on the receipt of its TRR in excess of the lawful level since 2001. Vernon challenged these rulings on appeal. The CAISO intervened and, together with PG&E, SCE, and the Electricity Oversight Board, filed a brief in support of the Commission.

In its July 20 Order, the Court rejected Vernon's argument that its non-jurisdictional status was relevant with respect to the standard of review that the Commission should apply to Vernon's TRR and found that this issue had been resolved in the first appeal. It concluded that the Commission's decision to review Vernon's TRR under the just and reasonable standard was a reasoned, fully supported decision. Further, the Court rejected arguments that the decision in the first appeal required the Commission to review directly the CAISO's rate for its Access Charge, rather than merely the component that derives from Vernon's TRR.

With respect to the Commission's directive that Vernon pay refunds, however, the Court found that this exceeded the Commission's authority. FERC's refund authority is set forth in section 206 of the Federal Power Act. The Court found the exemption of municipalities from section 206 to be clear and unambiguous. The Court also rejected FERC's argument that it was simply ensuring that the CAISO's rate for its TAC was just and reasonable under Section 205, finding that this did not provide a basis for avoiding the clear language that exempted municipalities from the refund authority. In support of its conclusion, the Court cited the Ninth Circuit's decision that found the Commission had exceeded its authority when it ordered municipalities to pay refunds in the crisis-era refund case. The Court appeared to agree with FERC that Vernon was obligated by the Transmission Control Agreement between Vernon and the CAISO to pay refunds, but found that this contractual obligation was not relevant to the Commission's authority. "FERC has cited no persuasive authority to support its claim that the Agreement therefore provides FERC with authority to order Vernon to issue refunds to CAISO where Congress has not granted such authority." In the joint intervenors' brief, the CAISO argued the Court had allowed indirect effects on non-jurisdictional entities in the course of regulating jurisdictional entities. The Court, however, found that the Commission's order had more than an indirect effect. The

Court declined to address the intervenors' argument that the Commission could have achieved the same result by merely ordering the ISO to use generally applicable tariff provisions. The case will be remanded to the Commission for further proceedings.

Responsible Attorney: Dan Shonkwiler

CPUC Matters

Rulemaking Regarding Greenhouse Gas (GHG) Implementation Standards (R.06-04-009)

This is a collaborative proceeding with the California Energy Commission for the purpose of developing joint recommendations for tracking and reporting of GHG emissions, and establishment of GHG emission limits for retail electric providers, culminating in recommendations are to be delivered to the California Air Resources Board (CARB) for CARB's use in establishing AB 32 reporting GHG regulations by CARB's January 2008 deadline.

In a June 30, 2007 report, the Market Analysis Committee recommended that CARB consider a regulation approach which it called a "First Seller Approach." The approach is meant as an alternative to a Load Based approach, under which the retail electricity provider is the point of GHG regulation. Under this alternative approach, the first seller or deliverer of electricity into the California wholesale electricity market is the point of regulation. For in-state regulation, the first seller is the generator. The report states that "for power imported from outside the state, the first seller is most often an investor-owned or municipal utility or a wholesale power marketer who sells the electricity to an in-state, load serving, another power marketer, or a large end-user.

To date, the First Seller approach has not been detailed in any writing. After expanding the proceeding to consider the First Seller Approach, the joint ALJs in the joint CPUC-CEC proceeding issued a ruling setting forth some 53 questions for parties to brief, as preparation for an August 21, 2007 En Banc Hearing held at the CPUC to consider the First Seller Approach. These questions are intended to contrast the Load Based and First Seller approaches, and to discuss potential constitutional Commerce Clause and Federal Power Act preemption concerns of the agencies.

A separate track for consideration of GHG regulations for the Natural Gas Industry has also been established, and a Pre-Hearing Conference was held August 1st. The CPUC is recommending that regulation of natural gas usage for electricity production remain with the current, electricity sector GHG regulation track, and the Natural Gas Track govern only non-electricity usage of Natural Gas. A scoping memo has not yet been issued in this track.

The CPUC has also issued a Proposed Decision of Commissioner Peevey on August 15, 2007, containing recommendations for tracking and reporting under a Load Based cap, for use if the Load Based Cap is ultimately recommended to the CARB. This Proposed Decision largely adopts the Joint Staff Tracking and Reporting Proposal issued June 12, 2007, which has electric providers reporting emissions from its power sources, broken down as follows:

- Power received from specified sources, i.e.
 - Owned/partially owned facilities
 - Specified contracts

CO2 Emission factors for these sources are generally based upon the reported emission factor that the source has or will provide to CARB

- Power received from unspecified purchases, i.e.
 - Asset Owning Suppliers (system purchases)
 - Marketers and Brokers; and
 - Electricity Markets (e.g. CAISO)

For unspecified sources, the Proposed Decision assigns various default emission factors to cover i) in-California system purchases, ii) Pacific NW imports; and SW imports; and CAISO's real time market and CAISO's day-ahead forward Markets. The Proposed Decision assigns 1000lbs/MWH for each of CAISO's markets.

Responsible Attorney: Bill Di Capo

SCE ADVICE LETTER PROCEEDING/NEW CPUC SUBREGIONAL TRANSMISSION PLANNING PROCESS FOR RENEWABLES

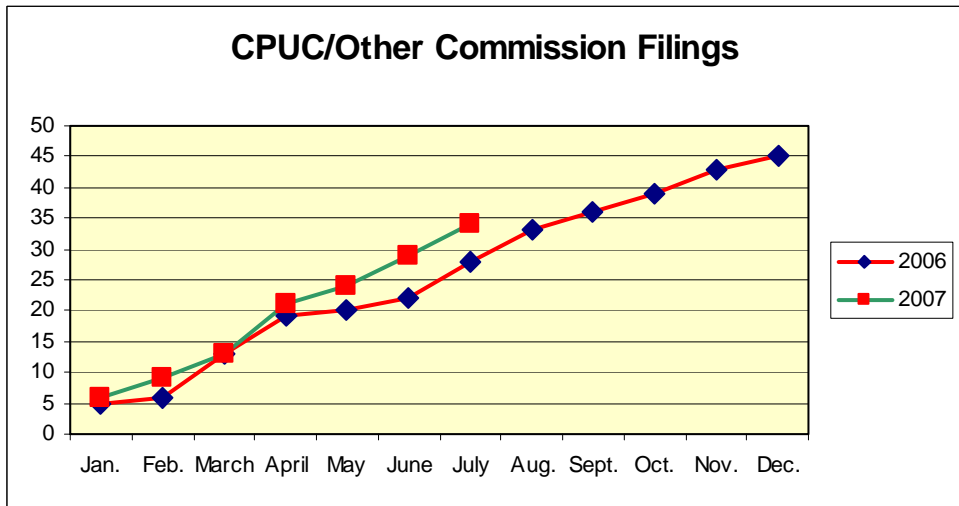
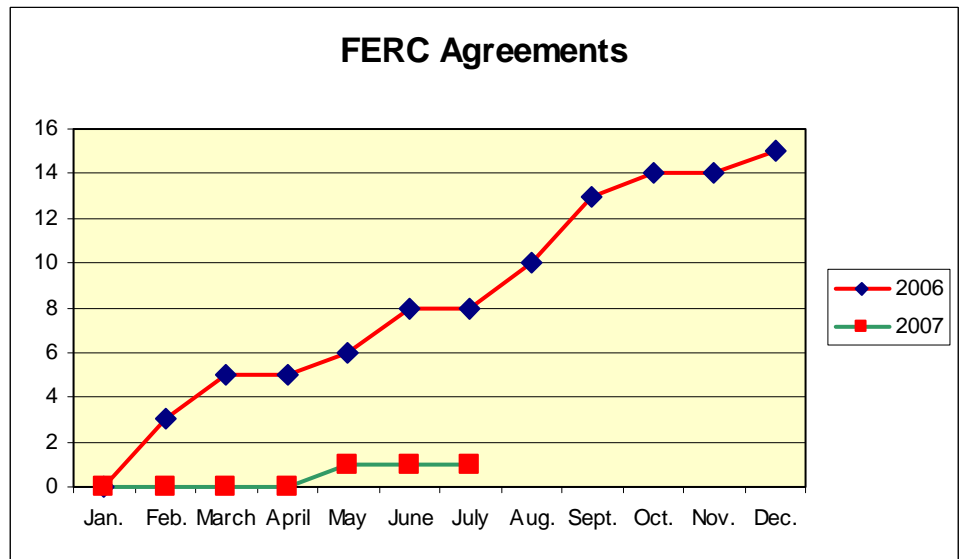
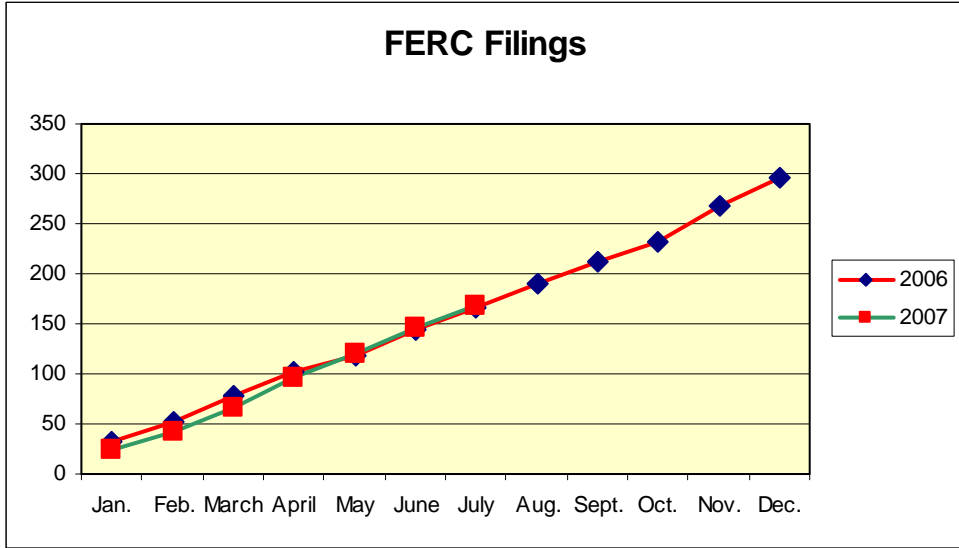
In August, the CPUC staff re-wrote Draft Resolution E-4052, to include as part of the resolution a proposed new CPUC sub-regional transmission planning process to promote renewable resources. The new process is known as CRETI, for California Renewable Energy Transmission Initiative.

CAISO has submitted comments to the new Draft Resolution expressing support conditioned upon the CPUC making certain changes to the Draft Resolution and CRETI draft Mission Statement. These CAISO-recommended changes are intended to inject into the CRETI process the recognition that the third phase of the process, under which conceptual transmission plans would be refined into specific transmission projects, must be consistent with CAISO transmission planning processes and feed into such processes established by CAISO under FERC Order 890. In general, the CRETI process, as applied to Edison's specific request for transmission planning funding, would be as follows:

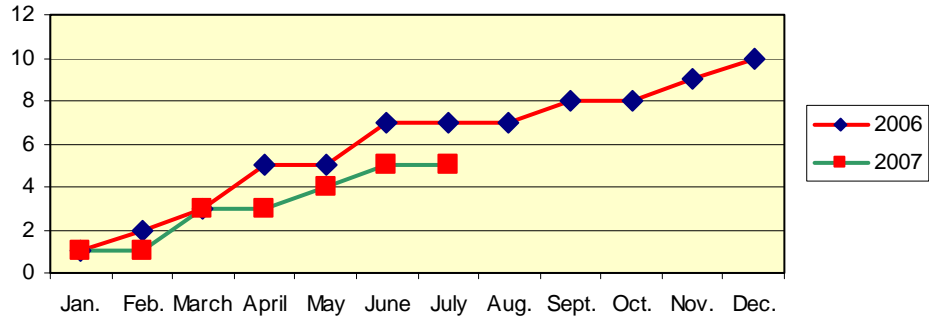
- In Phase 1, the Edison would spend \$1.5 million to study potentially economically rich renewable generation areas and identify and rank Competitive Renewable Energy Zones in a report to the Energy Division
- The Energy Division would then determine if the IOU could make further expenditure of up to \$4 million to proceed. Phase 2 which would identify preliminary transmission routes, and
- In Phase 3, Edison would design the route for a specific renewable transmission project which would coordinate with the CAISO process.

Responsible Attorneys: Grant Rosenblum and Bill Di Capo

**FILINGS THROUGH JULY 2007
LEGAL & REGULATORY**



Court Filings



Total Filings

