

Memorandum

To: ISO Board of Governors
From: Nancy Saracino, General Counsel and Corporate Secretary
Date: July 1, 2008
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)

- **Order Accepting August 3, 2007 Compliance and Section 205 Filing (ER06-615, ER07-1257)**

On June 20, FERC published its "Order Conditionally Accepting, Subject to Modification, MRTU Compliance Filing." This order addressed remaining compliance issues filed as part of the CAISO's August 3, 2007 compliance filing. In this order, FERC generally accepted all the remaining tariff language filed on compliance, subject to additional minor compliance obligations. The order also addressed accepted tariff amendments that the CAISO included in the August 3 filing, including the proposal to change the standard of CAISO liability from negligence to gross negligence and to adopt price correction and validation tariff authority. Finally, FERC accepted the CAISO's March 2007 compliance filing concerning regional Ancillary Services procurement without any further compliance obligation.

Responsible Attorneys: Mike Dozier, Anna McKenna and Sidney Davies

- **Order on Caps for Start-Up and Minimum Load Costs (ER08-73)**

In its June 20 "Order Conditionally Accepting Mitigation Mechanism," the Commission accepted the CAISO's proposal to limit market based start-up and minimum load costs to 200% of actual costs for resources in a local capacity area, and to 400% of actual costs for resources not located in a local capacity area. The Commission directed that the methodology for calculating the caps be modified in a compliance filing to be made within 30 days.

Responsible Attorney: Sidney Davies

- **Integrated Balancing Authority Area Tariff Amendment Filing (ER08-1113)**

On June 17, the CAISO filed its Integrated Balancing Authority Area (IBAA) proposal with FERC. The proposed amendments enhance the CAISO's congestion management solutions by appropriately pricing and modeling interchange transactions, i.e., imports and exports between the CAISO and neighboring Balancing Authority Areas (BAAs). The proposal will apply to interchange transactions with the Sacramento Municipal Utility District (SMUD) BAA and the Turlock Irrigation District (TID) BAA as of MRTU Go Live. The proposal improves the accuracy of the modeling of BAAs within the CAISO BAA, thus preventing unjust and unreasonable scheduling and pricing of such interchange transactions, improving reliability, and preventing CAISO ratepayers from having to pay inappropriate prices and unnecessary uplift charges associated with inaccurate modeling and pricing of such transactions. The IBAA proposal also allows for the ability to enter into alternative pricing arrangements if the affected parties agree to provide additional data that the CAISO may use in its modeling efforts.

Responsible Attorney: Anna McKenna

- **Letter Order Accepting Compliance Filing for Use of RMR Units for Load Following (ER06-615)**

On June 12, FERC issued a letter order accepting the CAISO's compliance filing to permit Reliability Must Run resources to be used as load following resources by load following metered subsystems.

Responsible Attorney: Sidney Davies

Petition for Waiver of Timing Provisions of the Large Generator Interconnection Procedures (ER08-960)

On May 15, the CAISO filed with FERC a petition for a one-time waiver of limited provisions of the existing CAISO tariff governing generator interconnection (Waiver Petition). The Waiver Petition requests temporary suspensions of Interconnection Study obligations and timelines with respect to specific pending and future interconnection requests to facilitate future implementation of the Generator Interconnection Reform Process (GIPR). The Waiver Petition proposes to divide pending interconnection requests into two groups – a “serial study group,” which will continue to be processed first under the existing procedures and financial rules and a “transition cluster” group, which will be subject to the temporary suspension and then studied pursuant to the new GIPR requirements to be filed in a future tariff amendment. The CAISO's approach allows late stage projects, projects with power purchase agreements and projects utilizing new interconnection capacity, to be processed more rapidly under the existing rules to clear the back log of interconnection requests and sets the stage for the GIPR reforms, which will streamline the interconnection process for those interconnection requests in the transition cluster and any future interconnection requests.

Responsible Attorney: Grant Rosenblum

Transitional Capacity Procurement Mechanism (TCPM) (ER08-760)

On May 30, 2008, FERC issued an order on the CAISO's Transitional Capacity Procurement Mechanism (TCPM). FERC accepted the TCPM proposal effective as of June 1, 2008, subject to modification. FERC accepted the CAISO's payment proposal and definition of Significant Event, as well as the three-step process for making Significant Event designations of capacity. FERC also accepted the CAISO's proposed 30-day minimum term for Significant Event designations. However, FERC directed the CAISO to include an additional Significant Event designation criterion. Specifically, if the CAISO issues a Must Offer Waiver Denial to a resource, it must grant the resource a TCPM

designation for a minimum 30-day period. FERC concluded that because resource adequacy resources are providing essentially the same service as Must Offer Obligation (MOO) units and receive a monthly capacity payment, MOO units should be compensated in a similar manner. FERC also approved the CAISO's proposed cost allocation methodology and proposal to provide credit toward resource adequacy obligations as the result of TCPM designations other than Significant Event designations. FERC directed the CAISO to make a compliance filing within 30 days.

Responsible Attorney: Anthony Ivancovich

Reliability Capacity Compensation Mechanism (RCST) (EL08-20)

On June 19, 2008, FERC issued two orders regarding the extension of the Reliability Capacity Services Tariff provisions. In its "Order on Section 206 Investigation and Denying Complaint," FERC extended the RCST from January 1, 2008 through May 31, 2008. FERC found that the RCST continues to be just and reasonable for the brief period from January 1, 2008 until the effective date of the TCPM. In its order, FERC also denied the complaint filed by Dynegy Moss Landing, LLC, *et al.* which requested that FERC require the CAISO to implement a reliability capacity compensation mechanism whereby (1) a single must offer waiver denial would result in an automatic designation of capacity for three months, and (2) the capacity price would be based on the cost of new entry. FERC rejected Dynegy's claim that the CAISO's commitment of resources through the real time commitment mechanism violates the RCST. Finally, FERC rejected arguments that the RCST pricing provisions discriminate between new and existing resources. In its "Order on Compliance," FERC approved the CAISO's December 28, 2007 and March 5, 2008 compliance filings which extended the RCST effective January 1, 2008.

Responsible Attorney: Anthony Ivancovich

Tariff Amendment Changing Outage Reporting for Generators (ER08-1053)

At its May meeting, the Board approved a tariff amendment that revises outage reporting requirements for generators. The amendment was filed with FERC on May 29, with a requested effective date of June 1. Responses, which were due June 20, were favorable. PG&E and SCE strongly supported the amendment as filed, and no party opposed it.

Responsible Attorney: Dan Shonkwiler

Location Constrained Resources Interconnection (ER08-140)

On June 12, 2008, FERC issued a Letter Order approving the CAISO's January 18, 2008 compliance filing related to location constrained resources. Among other things, the compliance filing added a requirement to the demonstration of interest showing, whereby location constrained resource interconnection generators that have not executed interconnection agreements must demonstrate site control or make a \$250,000 deposit, refundable under certain circumstances.

Responsible Attorney: Anthony Ivancovich

MMC Energy Inc. v. CAISO (EL08-46-000)

MMC Energy filed a complaint on March 13, 2008 alleging that the CAISO unlawfully prohibited its generating units from participating in the spinning reserve ancillary services market. It also alleged that during 2006 and 2007 it was wrongfully subjected to no-pay adjustments for both spinning and non-spinning reserves services in the total amount of \$552,000. The CAISO denied the allegations. On June 6, 2008, FERC issued its order on the complaint ruling in the

CAISO's favor on the key issue of whether MMC has been providing spinning reserves when its spinning reserve service consists of small internal combusting generator synchronized to the grid aggregated with a combustion turbine unit that is not running. FERC determined that this configuration did not provide spinning reserve as defined by the CAISO Tariff. FERC also found that there are issues of fact to be decided related to whether the CAISO was obligated to pay MMC prior to a September 2006 market notice in which the CAISO "clarified and applied the requirements for providing spinning reserve services". FERC set the remainder of the no-pay issues for hearing, but held the order in abeyance pending a settlement process.

Responsible Attorney: Paul Dobson

Electricity Crisis-Era Refund Case (EL00-95)

On May 23, the FERC approved a settlement between California Parties and Public Utility District No. 2 of Grant County, Washington, which resolved their differences over refunds for crisis-era transactions. The settlement also releases the CAISO from any liability to Grant County based market defaults. On June 13, Grant County filed to dismiss a lawsuit that it filed against the CAISO in 2004 seeking payment for its crisis-era sales.

Responsible Attorney: Dan Shonkwiler

Order on Compliance Re Order No. 890 (Transmission Planning) (OA08-62-000)

On December 21, 2007, the CAISO submitted revisions to its transmission planning process in compliance with FERC's Order No. 890. In Order No. 890, FERC required that the transmission planning process employed by transmission providers, including independent system operators and regional transmission operators, comply with nine "planning principles." By clarifying and expanding the obligations of transmission providers with regard to its transmission planning process, Order No. 890 seeks to ensure that transmission service is provided on a non-discriminatory basis.

On June 19, 2008, FERC issued an order on the CAISO's compliance filing. The order found that the CAISO's transmission planning process generally complies with the planning principles. The order, however, identified certain areas that require further clarification or modification and directed the CAISO to file an additional compliance filing within 90 days of the order. Many of the areas subject to the additional compliance requirement relate to the relationship between the CAISO and its Participating Transmission Owners (PTOs). In particular, the CAISO and PTOs must further explain how stakeholders participate in PTO expansion activities, how PTO and other stakeholder proposed projects are treated in the planning processes' "request window," and generally how PTO local planning is incorporated into the CAISO's overall transmission plan.

Responsible Attorney: Grant Rosenblum

Transmission Access Charge (TAC) Appeal (Ninth Cir. Docket No. 06-74506)

On June 5, 2008, the United States Court of Appeals for the Ninth Circuit heard oral argument on an appeal that challenges the CAISO's Transmission Access Charge or "TAC". The Department of Water Resources and the State Water Contractors had argued that FERC erred in approving the TAC because the rate does not vary according to the time of use. The CAISO together with a range of stakeholders – Southern California Edison, Pacific Gas & Electric, NCPA, the Electricity Oversight Board, and the cities of Azusa, Banning, Colton, Riverside, and Vernon – jointly filed a brief supporting FERC and participated in the argument. A decision is expected in the next few months.

Responsible Attorney: Dan Shonkwiler

CPUC Matters

Application for Approval of the Sunrise Powerlink Transmission Project (A.06-08-010)

On May 30, 2008, the CAISO submitted its opening brief in Phase 2 of the Sunrise Powerlink CPCN proceeding at the CPUC, and on June 13, 2008, the CAISO filed its reply brief responding to the arguments raised by the interveners in their opening briefs. Phase 2 addresses the environmental impacts of the proposed project and alternatives (including alternative routes) described in the Draft Environmental Impact Report/Environmental Impact Statement (DEIR/EIS) issued by the CPUC and the Bureau of Land Management (BLM) on January 3, 2008. Pursuant to the June 20, 2008, Scoping Memo issued by the Administrative Law Judge and Assigned Commissioner, the procedural schedule has been revised with the proposed decision deferred to October, 2008, a delay of approximately three months which will, in turn, likely delay the final decision. The Scoping Memo also requested the CAISO to conduct additional reliability and economic studies using certain modified assumptions.

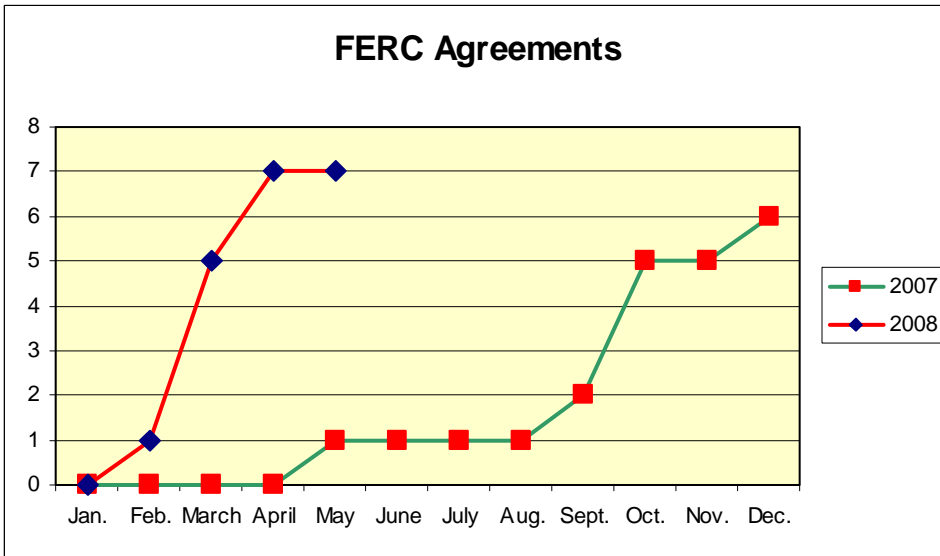
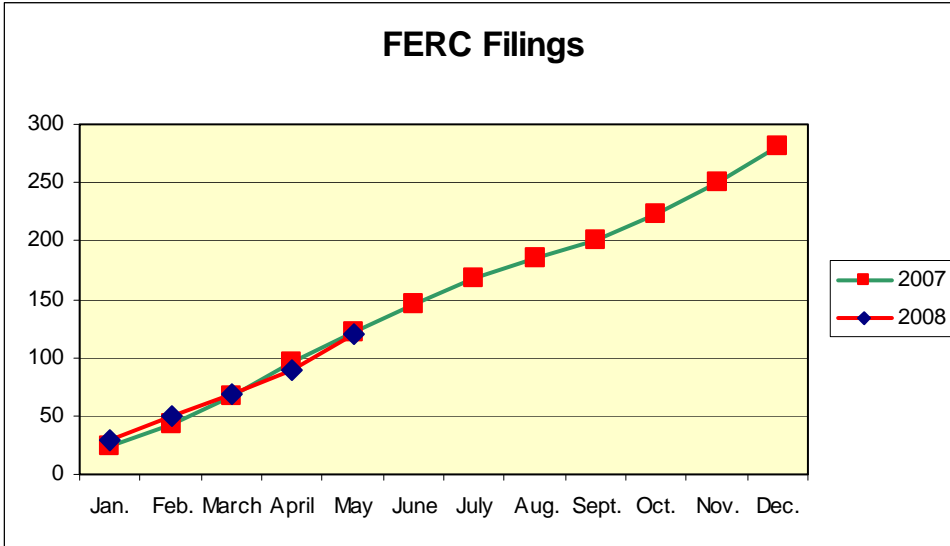
Responsible Attorney: Judi Sanders

Rulemaking re Annual Revisions to Local Capacity Obligations and Refinements to the Resource Adequacy Program R.08-01-025)

On May 27, 2008, the Presiding Administrative Law Judge issued a proposed decision in the CPUC's resource adequacy docket. The proposed decision focuses on review and approval of the CAISO's 2009 Local Capacity Technical Study, which the CPUC will use to establish the basis for local capacity procurement obligations of CPUC-jurisdictional load serving entities for calendar year 2009. The proposed decision also addresses certain resource counting rules, modifications to resource adequacy reporting requirements, and administration of the local capacity obligations. The proposed decision adopts the results of the CAISO's Local Capacity Technical Study without modification, noting that "even though peak loads are expected to increase in all but one of the defined local areas, the total [local capacity requirements] for all such areas combined has declined slightly." In addition, it generally adopts modifications to resource counting rules and other matters consistent with the position taken by the CAISO in this proceeding. The CAISO submitted comments and reply comments supporting the proposed decision and identifying specific clarifying language.

Responsible Attorney: Grant Rosenblum

FILINGS THROUGH MAY 2008



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