Memorandum

To: ISO Board of Governors

From: Nancy Saracino, Vice President, General Counsel and Corporate Secretary

Date: May 10, 2010

Re: **Regulatory Update**

This memorandum does not require Board action.

Federal Energy Regulatory Commission (FERC) matters and related decisions of the Court of Appeals

Tariff amendment filings and orders

- **Eligible intermittent resource amendments (ER10-319)**

On April 30, 2010, FERC issued an order conditionally accepting the ISO's filing of a tariff amendment to expand the scope of data required to be provided by wind and solar resources larger than 1 MW. The additional data requirements consist of (1) extending to additional resources the obligation to install forecasting and telemetry equipment and to communicate relevant data to the ISO, and (2) reducing the threshold for reporting a forced outage of an eligible intermittent resource with total capacity of greater than 10 MW from the current outage capacity level of 10 MW to 1 MW. The FERC order is conditioned on the ISO's filing of further tariff language to (1) exclude small conduit hydroelectric facilities from the definition of eligible intermittent resources, (2) make clear that only intermittent resources subject to the ISO's participating generator requirements are subject to the expanded data requirements, and (3) defer the effective date for the requirement for expanded forced outage reporting from the ISO's requested date of February 1 to July 1, 2010.

Responsible Attorney: Mike Dozier

- **Make-whole mechanism for demand bids subject to price correction (ER10-966)**

Under the current market design, the ISO may correct published financially binding prices if the ISO identifies an invalid market solution or invalid prices in an otherwise valid market solution due to data input failure or hardware or software failure, or if a result is inconsistent with the provisions of the ISO tariff. Prices that apply to demand, which includes both internal demand and exports, are also subject to such price corrections. After the start of the new market, market participants brought to the ISO's attention the following issue: when prices for demand are corrected in the upward direction scheduling coordinators with cleared demand bids may be subject to prices that are higher than the prices they submitted in their bid curve. In response to stakeholder concerns, the ISO developed a proposal to minimize exposure of demand bids to the impact of price corrections in this situation. The proposed "make-whole" mechanism would apply to all demand, including internal demand and exports, cleared in the integrated forward market and all export schedules cleared in the hour-ahead scheduling process. On March 31, 2010, the ISO filed tariff amendments to incorporate this new mechanism. The proposal was not protested by any party. The ISO intends to implement this new requirement on June 1, 2010.

Responsible Attorney: Anna McKenna

- **Proxy demand resource (ER10-765-000)**

On February 16, 2010, the ISO filed its tariff amendments to implement its new demand response product, proxy demand resource. Proxy demand resource facilitates the participation of retail demand in the ISO market in compliance with FERC orders authorizing the new market design as well as directives to all independent system operators and regional transmission organizations from Order No. 719. The product allows loads to be modeled as pseudo-generators for purposes of demand response. The resources will be able to submit bids for energy and ancillary services (as non-spinning reserve) into the day-ahead and real-time market. On April 16, 2010, FERC issued a letter to the ISO seeking additional information on the proxy demand resource amendment. The ISO's response is due May 17. As a result of FERC's request, proxy demand resource will be implemented later than the planned for May 1, 2010 implementation.

Responsible Attorney: Bill Di Capo

- **Forbidden operating region (ER10-775)**

The ISO submitted proposed tariff language to FERC on February 12, 2010, to reinstate forbidden operating region functionality in the real-time market. This functionality recognizes resources' forbidden operating regions so that resources will be dispatched above or below any such region. The ISO requested an effective date of April 15, 2010. No protests were filed in response to the ISO filing. The Commission issued a letter order accepting the proposed tariff changes on April 8, 2010.

Responsible Attorneys: Anna McKenna and David Zlotlow

- **Late payment penalties (ER10-753)**

In December 2008, the Board approved several revisions to the ISO credit policy. Most of these were implemented in 2009. The one exception was the implementation of penalties and possible suspension or termination provisions. On February 5, 2010, the ISO filed proposed tariff amendments to impose penalties on market participants that pay invoices later than the tariff's prescribed time limit or post financial security beyond the three day requirement. Penalties apply after the third late payment or posting. In addition, the ISO proposed tariff provisions to permit the ISO to suspend or terminate a market participant after the fifth late payment or posting. On April 6, 2010, FERC issued an order accepting the ISO's tariff amendment subject to a compliance filing to modify the tariff language to avoid any ambiguity. The tariff amendments went into effect on April 7, 2010. The ISO submitted its compliance filing on April 15, 2010.

Responsible Attorney: Sidney Davies

- **Scarcity pricing (ER10-500)**

The ISO submitted proposed tariff language to FERC on December 24, 2009 to implement its reserve scarcity pricing design approved by the Board in response to FERC's directive to implement scarcity pricing by April 1, 2010. Several parties have intervened in the FERC proceeding and filed comments. Western Power Trading Forum, Dynegy and J.P. Morgan argued the ISO should establish scarcity premiums in ancillary service sub-regions that match scarcity premiums in the ISO's expanded system region and that the ISO should conduct annual reviews of its scarcity pricing design during the first years of implementation. The ISO filed an answer addressing these issues. On March 31, 2010, FERC requested additional information to evaluate the ISO's proposed scarcity pricing design, including information on how the ISO's proposed scarcity demand reserve curve values reflect applicable reliability standards and provide adequate price signals for customers to invest in generation and demand response technologies and for customers to participate in the ISO's market. The ISO filed a response to FERC's questions on April 30, 2010. As part of that response, the ISO amended its scarcity pricing design to include a sub-regional scarcity demand curve for regulation down reserve. The ISO has requested a new effective date of July 7, 2010 to implement scarcity pricing.

Responsible Attorney: Andrew Ulmer

- **Grid management charge (GMC) rate design proceeding (ER10-188)**

This proceeding involves the 2010 extension of the currently-effective GMC and the proposed market usage-forward energy charge rate design to remove inter-scheduling coordinator trades from the allocation of the charge. In the October 30, 2009 GMC filing, the ISO proposed not only to remove such trades from the billing determinants used to calculate the charge, but to move towards applying the charge to all energy (supply and demand) scheduled in the day-ahead market. As an interim step, the ISO proposed to apply the market usage-forward energy charge to the greater of supply or demand.

FERC approved the extension of the current GMC but suspended the effective date of the new market usage-forward energy allocation until June 1, 2010 and ordered settlement discussions. Following formal and informal settlement discussions, the ISO filed an offer of settlement on March 23, 2010 containing the same market usage-forward energy reallocation proposal set forth in the October 30, 2009 filing. The settlement offer was supported by PG&E, SCE, SDG&E, Calpine, Citigroup, Dynegy, Powerex, and Morgan Stanley. Comments and protests were filed on April 12, 2010 and no parties opposed the settlement.

Responsible Attorney: Judi Sanders

- **Historic GMC proceeding (ER01-313)**

In the 2001 GMC rate filing, the ISO proposed to unbundle the GMC into three service categories: load, congestion, and market-related activity. On May 2, 2003**,** FERC issued an opinion concluding that the ISO had incorrectly assessed the control area service charge to retail load served by internal generation ("behind-the-meter" load). This issue became the subject of numerous requests for rehearing and ultimately an appeal to the United States Court of Appeals for the District of Columbia Circuit (*Western Power Administration v. FERC*, 525 F.3d 40, 2008).

In 2008, the court resolved the dispute by affirming subsequent FERC decisions (Opinion Nos. 463-B and 463-C) as to how the costs should be allocated and remanded the matter to FERC in January 2009. FERC ordered the ISO to file a refund report by June 2009 or, alternatively, a status report explaining when the refund report would be made. Due to the implementation of the new market design in the spring of 2009, the ISO provided a status report explaining that the refund issues would be addressed with stakeholders during the third and fourth quarters of 2009, and that the refund would likely be completed in early 2010. Consistent with that schedule, the ISO completed the 2001-2003 refund process on April 1, 2010 and submitted a refund report to FERC on April 16, 2010.

Responsible Attorney: Judi Sanders

- **Battery storage demonstration project (ER10- 660)**

On January 27, 2010, the ISO filed a letter agreement with AES and a related request for tariff waivers to establish a pilot program for testing the operation and capability the Sano Regulation Center as new technology to provide regulation in the ISO market. Sano is the first battery storage facility to seek participation in the ISO market. The agreement covers two phases of Sano's relationship with the ISO. The first stage is a test period, during which the ISO will evaluate and confirm Sano's ability to provide regulation service within the parameters set forth in the agreement. The second phase will commence following successful resolution of any predefined issues that may arise during the test period. For this second phase, the agreement provides interim terms and conditions under which AES will actively bid Sano into the ISO market to provide regulation service. These provisions, in conjunction with the current ISO tariff provisions, will govern Sano's participation until completion of the stakeholder process and amendment of the ISO tariff to better accommodate the provision of regulation by non-generation facilities. FERC issued a letter order accepting the letter agreement and request for waivers on March 26, 2010.

Responsible Attorney: Beth Ann Burns

Regulatory contracts filings and orders

- **Gila River Power non-conforming Dynamic Scheduling Host Balancing Authority Area Operating Agreement (ER10-1015)**

On April 5, 2010, the ISO filed this agreement with FERC to facilitate imports of regulation and dynamic scheduling of energy and ancillary services from the generator-only Gila River Power balancing authority area to the ISO balancing authority area. The agreement was filed with FERC because it does not conform to the ISO's pro forma version due to provisions relating to imports of regulation service and the calculation of area control error and integrated interchange values between the Gila River Power and ISO balancing authority areas. In conjunction with this filing, the ISO also requested that FERC grant a waiver of the ISO tariff sections which would otherwise require Salt River Project and Arizona Public Service Company each to execute an agreement with the ISO to support the dynamic scheduling functionality as intermediary balancing authorities. The ISO determined that additional commitments are not needed from SRP and APS in order for this particular configuration of the dynamic scheduling functionality to be implemented.

Responsible Attorney: Mike Dozier

- **Solar Partners I Large Generator Interconnection Agreement (LGIA) (ER10-732)**

On February 12, 2010, SCE filed this LGIA with FERC for the interconnection of the Solar Partners I DPT 1 project to the ISO grid, including construction of a portion of SCE's proposed Eldorado-Ivanpah transmission project as a network upgrade to accommodate this interconnection. FERC determined that the LGIA does not conform to the ISO's pro forma LGIA. FERC ordered SCE to submit a compliance filing revising the termination cost provisions of the LGIA that relate to FERC's conditional approval of SCE's recovery of the costs of "abandoned plant" for the Eldorado-Ivanpah project in Docket No. EL10-1. The ISO will join in the compliance filing as a consequence of FERC's finding that the LGIA is nonconforming.

Responsible Attorney: Mike Dozier

Report filings

- **New market quarterly report (ER06-615)**

In its September 2006 order, FERC directed the ISO and its Department of Market Monitoring to file quarterly reports for one year after implementing its new market design. On April 30, 3010, the ISO filed its fourth quarterly report covering the January 1 through April 30, 2010 period. Subject to one reporting obligation of the Market Surveillance Committee, the ISO's quarterly reporting obligation has now concluded. The ISO filed a motion for extension of time on behalf of the MSC to allow it to submit its report by May 28, 2010.

Responsible Attorneys: Sidney Davies, Anna McKenna and David Zlotlow

- **Quarterly report on large generator interconnection reform (ER08-1317)**

The ISO filed its quarterly report summarizing the status of pending large generator interconnection requests on April 30, 2010. The report indicates progress as measured against tariff timelines.

Responsible Attorney: Bill Di Capo

- **Monthly convergence bidding status report (ER10-300)**

On April 1 and April 30, 2010, the ISO filed its April and May reports on the status of convergence bidding. FERC directed the ISO to file monthly status reports to track progress toward the ISO's implementation of convergence bidding by February 2010. The reports indicate that the ISO is on track.

Responsible Attorney: Sidney Davies

- **Market disruption reports (ER06-615)**

On April 15, 2010, the ISO submitted its monthly market disruption report. A market disruption is an action or event that causes a failure of an ISO market, related to system operation issues or system emergencies. Section 7.7.15 of the tariff authorizes the ISO to take one or more of a number of specified actions in the event of a market disruption, to prevent a market disruption, or to minimize the extent of a market disruption.

Responsible Attorney: Anna McKenna

- **Exceptional dispatch reports (ER08-1178)**

The ISO submits two monthly exceptional dispatch reports. On April 15, 2010, the ISO submitted transactional data including incremental and decremental MW volume, duration and location for exceptional dispatches occurring during the month of February 2010. On April 30, 2010, the ISO submitted MW hour data and cost data for exceptional dispatches occurring during the month of January 2010.

Responsible Attorney: Sidney Davies

Other FERC proceedings

- **Petition for disposition of proceeds of penalty assessments (ER10-891)**

On March 16, 2010, the ISO requested authority from FERC to distribute the proceeds from penalties collected during the 2008 calendar year. Under Section 37.9.4 of the tariff, the ISO must place all proceeds of penalties collected under the rules of conduct into a trust account. After the calendar year is over, the ISO must then distribute the funds contained in the trust account to all market participants that did not have a penalty assessed against them in the relevant calendar year. The ISO must receive permission from FERC before distributing the funds. The funds to be distributed for 2008, including interest, total approximately $310,000.

Responsible Attorney: David Zlotlow

Rulemakings and policy statements

- **Integration of variable energy resources notice of inquiry (RM10-11)**

On January 21, 2010, FERC issued a Notice of Inquiry (NOI) seeking comments on the extent to which barriers exist that may impede the reliable and efficient integration of variable energy resources (VERS) into the electric grid and whether reforms are needed to eliminate those barriers. Variable energy resources consist of renewable energy resources that are characterized by variability in the fuel source that is beyond the control of the resource operator, such as wind and solar generation facilities and certain hydroelectric resources. FERC also requested comments on how best to reform any FERC rules, regulations, tariffs, or industry practices so that barriers may be eliminated. On April 21, 2010, the ISO submitted its comments while recommending that FERC allow system operators sufficient flexibility in fashioning rules that meet their regional needs as identified by their own studies.

In addition, on April 12, 2010, the ISO/RTO Council (IRC), of which the ISO is a member, submitted a white paper in response to FERC's January 21, 2010 NOI. The white paper presented the current development of state-of-the art procedures and analytical tools being used by ISOs and RTOs in the United States. It also highlighted operational and market design considerations being driven by the increase in VERS within the different ISOs and RTOs, reflecting regional differences such as resource mix, electric topology, market design and regulatory framework. The white paper discussed the next steps being taken to advance these operational tools and procedures, as well as market design changes to address the substantial growth of VERS expected in the future. Finally, the white paper included a comparative survey of the experiences and developments in Canada and Europe with respect to the integration of VERS.

Responsible Attorneys: Anna McKenna and Anthony Ivancovich

- **Credit policy notice of proposed rulemaking (RM10-13)**

On March 29, 2010, the ISO filed comments in response to FERC's January 21, 2010 NOPR on proposed reforms to reduce the credit risk of participating in organized wholesale electricity markets. Highlights of FERC's proposal include: (1) to shorten the settlement cycle to one week and then to daily settlements; (2) require any ISO or RTO to become a counter party to all transactions; (3) separate credit requirements for firm transition rights (or congestion revenue rights); (4) further reductions in unsecured credit limits and the time for a market participant to comply with requests for additional financial security; and (5) minimum credit requirements for ISO/RTO participation. The ISO's comments indicated support for FERC's attention to credit policy while urging FERC to recognize the role of ISOs and RTOs in reducing credit risk through stakeholder processes and tariff amendments. For example, the ISO commented that the decision to move to a one week or daily settlement cycle should be decided by the ISO and its stakeholders. The ISO took a strong position in a joint filing with the Midwestern ISO in comments filed on March 15, 2010, that FERC not impose the counterparty requirement on all ISOs. The joint California ISO and Midwestern ISO filing pointed out that the risk of particular concern to FERC was highly unlikely and largely mitigated by existing tariff provisions. In addition, the ISO participated in a filing of the IRC. The IRC filing did not address all issues—notably there was no IRC position on the counterparty issue—but the IRC found common ground on a number of other issues such as development of minimum credit requirements but also endorsed ISO and RTO flexibility in most areas.

Responsible Attorneys: Sidney Davies, Dan Shonkwiler and Grace Arupo

- **Demand response compensation notice of proposed rulemaking (RM10-7)**

On January 21, 2010, FERC issued a notice of proposed rulemaking proposing to consider standardized compensation on a nationwide basis for demand response that participates in a regional transmission organization or independent system operator market. The notice proposes that all demand response resources that participate through a bid in the wholesale energy markets should be compensated at the full locational marginal price. The ISO plans to submit comments by the deadline date of May 13, 2010.

Responsible Attorney: Bill Di Capo

- **FERC Order No. 676-F--communication protocols for public utilities (RM05-5)**

On April 15, 2010, FERC issued Order No 676-F, which adopts certain standards for demand response products and services that have been promulgated by the North American Energy Standards Board. The standards are intended to support national standardized measurement and verification for demand response products and services to promote increased demand response penetration by national entities. The order requires each ISO and RTO to revise its tariff and business practices to immediately incorporate Phase 1 measurement and verification standards immediately and to incorporate Phase II standards by April 2011.

Responsible Attorney: Bill Di Capo

- **Independent system operator/regional transmission organization metrics (AD10-5)**

On March 19, 2010, the ISO/RTO Council (IRC) filed joint comments in reply to the comments submitted by interested parties in response to FERCs February 3, 2010 notice seeking providers. In its reply comments, the IRC argued, *inter alia,* that (1) the scope of the metrics should not be expanded beyond what they are intended to do, (2) disaggregated revenue and cost data for specific generating units or market participants should not be included in the metrics report, and (3) FERC should explore the development of metrics to assess the performance of non-ISO/RTO regions.

Responsible Attorney: Anthony Ivancovich

- **Interplay between curtailment priorities and reliability standards (RM10-9)**

On March 29, 2010, the IRC filed joint comments in response to FERC's January 21, 2010 notice of inquiry regarding the interplay between Reliability Standard IRO-006-4 (Reliability Coordination—Transmission Loading Relief) and the curtailment priorities set forth in FERC's *pro forma* Open Access Transmission Tariff. The primary point raised by the IRC was that the proposed 12-18 month timeframe for parallel operations testing of new software for the Interchange Distribution Calculator (IDC) was unnecessary and inappropriate given the numerous deficiencies in the existing IDC production system that are creating equity and accuracy concerns. The IRC proposed a six month parallel testing period.

Responsible Attorney: Anthony Ivancovich

- **Time error correction notice of proposed rulemaking (RM09-13)**

On April 28, 2009, the IRC filed joint comments in response to FERC's NOPR regarding changes to the existing Time Error Correction Reliability Standard. The IRC's comments address the following two issues: (1) the process for designating an interconnection time monitor; and (2) the scope of the time monitor's responsibilities under the Reliability Standard.

Responsible Attorney: Anthony Ivancovich

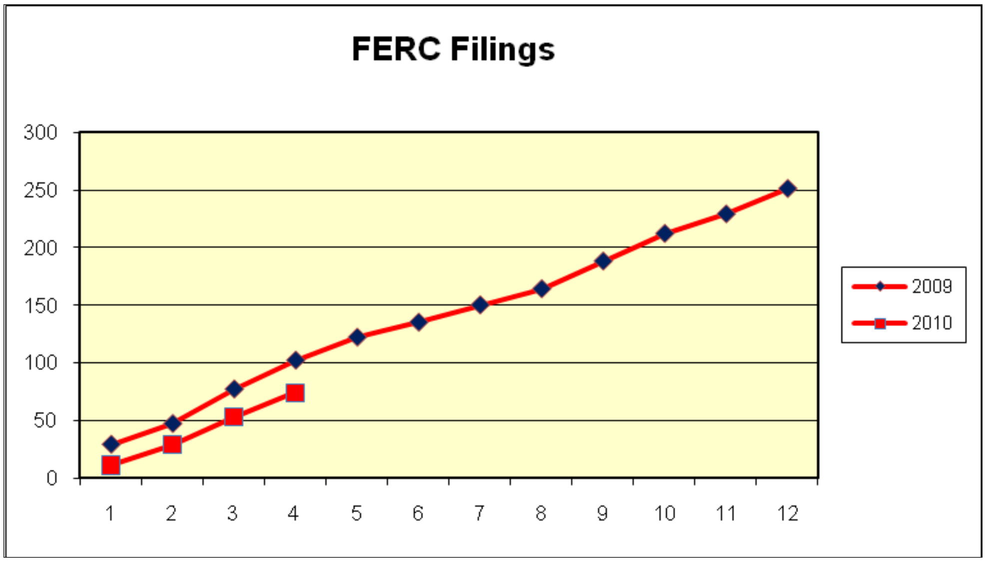
<u>California Public Utilities Commission (CPUC) matters</u>

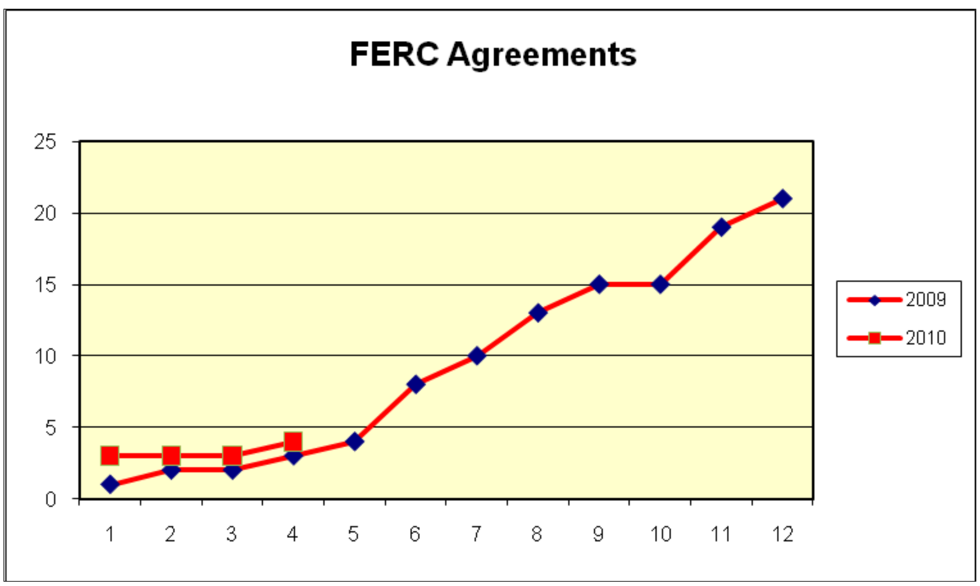
Demand Response Rulemaking (R.07-01-031)

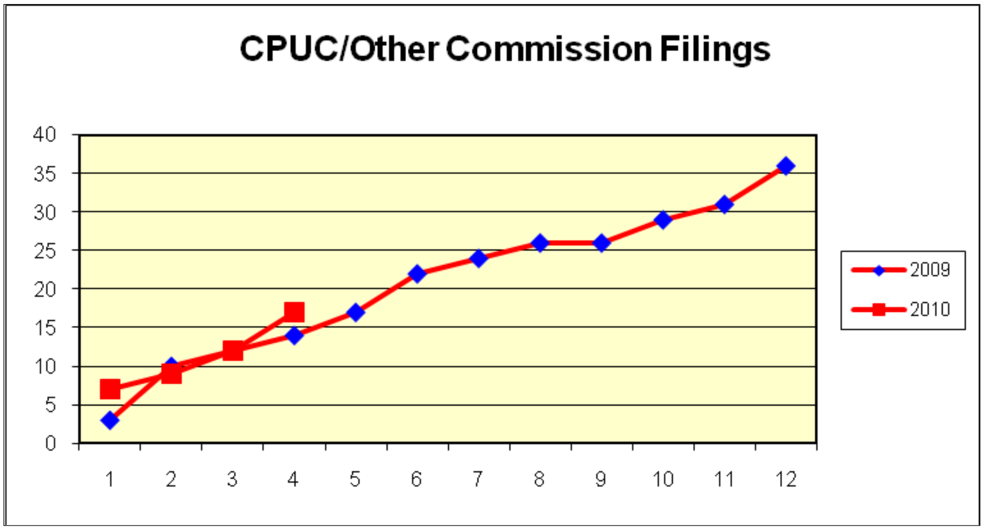
On March 23, 2010, the assigned administrative law judge issued a proposed decision outlining the scope of permissible direct bidding by retail demand in the ISO's 2010 proxy demand response market enhancement. The proposed decision authorizes IOU pilot activity for 2010, but defers authorization of expanded participation by IOU retail demand for future consideration. The proposed decision allows energy service providers to participate on behalf of their retail customers but defers the question of whether existing customers of IOUs can be represented by third party demand response providers. The ISO noted in its comments that the proposed decision left open whether third party providers were permitted to represent direct access customers and whether existing energy providers would be limited to representing their own customers or whether they could represent other direct access customers as well. The proposed decision will be considered by the CPUC on May 6, 2010.

Responsible Attorney: Bill Di Capo

Regulatory Filings
April 2010 Charts



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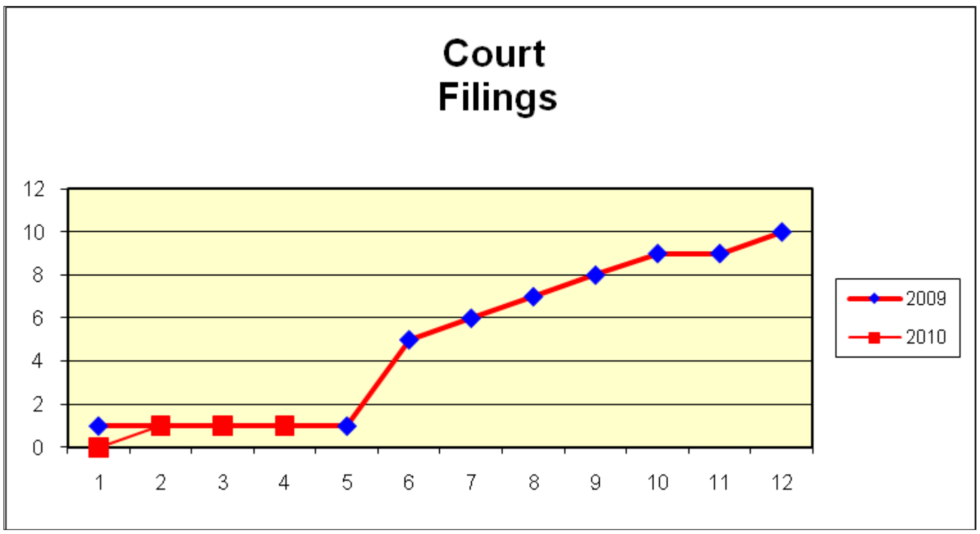
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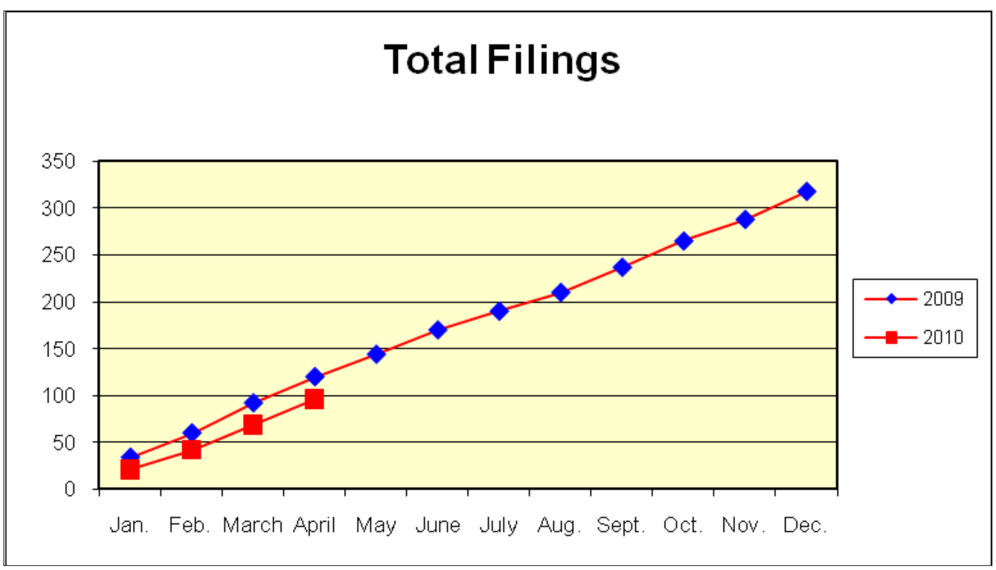
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