

Memorandum

To: CAISO Board of Governors
From: Nancy Saracino, General Counsel
Date: July 9, 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)

- **Order on Compliance Filings (ER06-615)**

On June 25, 2007, the Commission issued an order addressing the CAISO's November 20, 2006 and December 20, 2006 compliance filings submitted in response to the September 21, 2006 order conditionally accepting the MRTU tariff. In this order, the Commission conditionally accepted the compliance filings subject to further modification. The main subject areas requiring further compliance filings include rules and requirements for Market Participant access to the Full Network Model, Demand Response initiatives and Resource Adequacy. The compliance filing will be made on August 3, 2007.

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

- **CRR Related Filings (ER07-613)**

In compliance with FERC's order on May 8, 2007, conditionally accepting certain tariff sheets filed on March 8, 2007 that provide the CAISO authority to implement activity in preparation for the implementation of the first annual CRR Allocation and Auction later this summer, CAISO made the following two filings:

- 1) On May 23, 2007, the CAISO filed changes to tariff language required by FERC. These changes were not substantive and were largely changes that the CAISO had previously agreed to make through its responsive pleadings in this proceeding.
- 2) On June 7, 2007, the CAISO filed with FERC, for informational purposes only, its draft Business Practice Manuals for Congestion Revenue Rights and Candidate CRR Holder Registration.

In addition, on June 14, 2007, the CAISO filed a responsive pleading to comments and protests filed in response to its May 7, 2007, tariff filing requesting changes to implement additional CRR changes. In its answer, the CAISO reiterated its position that the CRR rules as filed with FERC and conditionally accepted are just and reasonable, and are the product of lengthy and robust CAISO stakeholder and FERC processes. The CAISO also reiterated that the CAISO's CRR rules

strike an appropriate balance between Market Participants' desire for flexibility to change their CRR holdings over time and the early certainty sought by other parties for protection against congestion exposure.

Responsible Attorney: Anna McKenna

- **CRR Credit Policy Tariff Amendment (ER07- 1077)**

On June 22, 2007, the CAISO submitted a tariff amendment to implement credit and financial security requirements applicable to Congestion Revenue Rights (CRRs). The CAISO filed revised tariff language on June 29, 2007 to clarify an ambiguity and to make other conforming changes. CRRs entitle CRR Holders to receive payments if transmission congestion flows in the direction of the CRR, but requires the CRR Holder to pay charges if the transmission congestion occurs in the opposite direction. This feature of CRRs requires CRR Holders to have an Aggregate Credit Limit sufficient to cover the projected obligation for the term of the CRR (monthly, yearly or Long-Term). In addition, the tariff amendment includes new credit policies applicable to CRR Auctions due to that fact that CRRs may not always be positively valued. The CRR credit policy tariff amendment filing is another step toward implementation of MRTU as the CRR Allocation begins in June and the first CRR Auction will occur in October. The tariff amendment will be come effective in August 2007 and apply to the CRR Auction. The Auction prices will be used to establish the credit requirements for Holder CRRs. Once this occurs in October, Market Participants will be required to meet the credit requirements for Holding CRRs. There are no credit requirements for participating in the CRR Allocation, since Load Serving Entities are not required to pay for CRRs and will not be paid to hold CRRs.

Responsible Attorney: Sidney Davies

- **CAISO's Answer to SMUD's and CCSF's Emergency Motion for Stay (ER06-615).**

Sacramento Municipal Utility District (SMUD) and the City and County of San Francisco (CCSF) filed a joint Emergency Motion on June 15, 2007 with FERC seeking a stay to prevent the CAISO from implementing the Marginal Losses element of the locational marginal pricing component of MRTU. SMUD and CCSF argued that FERC erred in accepting the CAISO's Marginal Losses pricing proposal and alleged that they will incur irreparable harm if the CAISO were to implement Marginal Losses because the CAISO's implementation costs will be unrecoverable. SMUD and CCSF contend that the CAISO should be required to implement average losses while the Marginal Losses issue is on appeal. On June 25, the CAISO answered SMUD and CCSF explaining that the vast majority of costs have been incurred already in the development of the software that is now being tested and that Market Participants would be subject to far more expense if the CAISO were required to develop, test and implement an alternative, which would also delay MRTU. Finally, the CAISO also argued that there was no merit to the contention that FERC had committed any error in accepting the CAISO's Marginal Losses proposal.

Responsible Attorney: Sidney Davies

- **CAISO's Answer to CDWR's Motion to Reopen MRTU Docket**

The California Department of Water Resources (CDWR) filed a motion on May 21, 2007 to reopen the MRTU docket based on a number of factual concerns stemming from the CAISO's Local Capacity (LCR) Study conducted by the CAISO in 2007. Although the study was conducted in 2007, it has implications for 2008 as this study will be used to determine the local capacity requirements that Load Serving Entities (LSEs) are required to satisfy in 2008. CDWR made numerous factual and legal assertions challenging the LCR study and its applicability to CDWR. On June 5,

2007 the CAISO filed an extensive response rebutting the factual assertions and legal assertions that included detailed documentation of the nature of the stakeholder process involved in the LCR study process.

Responsible Attorney: Sidney Davies and Grant Rosenblum

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, 119 FERC ¶ 61,053. 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.

Responsible Attorney: Sidney Davies

Scheduling Coordinator Certification & Termination Amendments (ER07-1060)

On June 20, 2007, the CAISO filed a set of amendments relating to Scheduling Coordinator (SC) certification and termination, including increasing the application fee for SC certification and addressing application processing issues. The amendments would 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 proposed MRTU-related changes have already been accepted by FERC, with the primary proposed 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 currently sets forth details regarding the Scheduling Coordinator application process – the effective provisions of which are being incorporated into the BPM for SC Certification and Termination.

Responsible Attorney: Mike Dozier

Import Capacity Assignment Amendments (FERC Docket No. ER07-648-000)

On May 18, 2007, FERC accepted, with modifications, the CAISO's Import Capacity Assignment Amendments to be effective May 22, 2007, as requested by the CAISO. The CAISO filed the Import Capacity Assignment Amendments to allocate transmission import capability into the CAISO Control Area to Load Serving Entities for resource adequacy reporting and compliance purposes. The FERC order accepted all of the major substantive elements of the CAISO's proposal, including reliance on a bilateral secondary market for transfers of import capability among market participants. However, the order did require several non-substantive modifications, which were recommended by the CAISO in its answer to improve the clarity of the tariff or were recommended by FERC to enhance its oversight of the secondary market for transfers of import capability.

Responsible Attorney: Grant Rosenblum

Outage Reporting Tariff Amendment (ER07-127)

On July 2, 2007, FERC issued an order resolving all remaining open issues concerning the tariff amendment to change outage reporting requirements. First, FERC denied Southern California Edison's (SCE's) request for rehearing of the order that approved the tariff amendment. The July 2 order rejected SCE's contention that FERC misunderstood the proposed changes to the reporting requirements, and supplied examples from the initial order to support its point. Otherwise, FERC found that SCE "failed to provide evidence to persuade us to direct the CAISO to further relax the reporting requirements in order to further reduce the reporting burden. . . . [T]he reporting requirements are less burdensome under the instant proposal, and are therefore reasonable."

Second, FERC denied SCE's motion to stay the tariff amendment: stating that: "We see no reason, given the request of the CAISO to continue to work with market participants in testing of its systems, to stay the [amendment] indefinitely." Third, FERC granted the CAISO's motion to extend until June 30, 2007 the waiver of all tariff-based penalties for violating the outage reporting requirements. This assures Market Participants that they will not face the prospect of such penalties based on conduct before July 1, 2007 when the CAISO formally began its enforcement efforts.

Finally, FERC granted the CAISO's request to waive, through November 30, 2007, the Forced Outage Reporting requirements – *i.e.*, reports about disconnection from the grid as opposed to changes in availability – for units with a maximum capacity less than 40 MW. "While we do not normally grant such extended waiver timeframes, the history of this proceeding and the effort of the CAISO to fully engage market participants in the stakeholder processes to work through issues, leads us to believe that such a waiver period is appropriate."

Responsible Attorney: Dan Shonkwiler

North American Electric Reliability Corporation (Docket No. RR07-11-000)

On June 8, 2007, FERC approved as mandatory eight regional Reliability Standards that had been submitted to NERC by WECC, and ultimately filed for approval by NERC on March 26, 2007 (*North American Electric Reliability Corporation*; Docket No. RR07-11-000). These regional standards had been part of the reliability criteria developed by WECC as part of the Reliability Management System (RMS) pursuant to which transmission operators in the Western Interconnection agreed to be bound contractually to comply with the WECC criteria. In Order No. 672, FERC stated that as a general matter, regional Reliability Standards will be approved if they are just, reasonable, not unduly discriminatory or preferential, are in the public interest, and are 1) more stringent than the continent-wide Reliability Standard; or 2) are necessitated by differences in the regional bulk electric system.

NERC explained that the proposed regional Reliability Standards the eight RMS criteria binding on the applicable subset of users, owners and operators of the Bulk-Power System in the United States portion of the Western Interconnection, as identified in each proposed standard. The regional Reliability Standards would supplement rather than replace the Commission-approved Reliability Standards developed by the ERO that will take effect in June 2007.

Responsible Attorney: Judi Sanders

RCST Settlement and 2007 RCST Cost Allocation (EL05-146 and ER07-326)

On June 11, 2007, FERC issued an *Order on Rehearing and Compliance*, accepting, effective June 1, 2006, the CAISO's March 15, 2007 compliance filing tariff sheets implementing the Reliability Capacity Services Tariff ("RCST") Offer of Settlement. In the June 11 order, FERC also accepted the CAISO's March 15, 2007 tariff filing to comply with FERC's February 13, 2007 *Order On Amendments and Tariff Revisions* in Docket No. ER07-326 ("RCST 2007 Order"). The RCST 2007 Order approved, *inter alia*, the CAISO's tariff revisions to implement cost allocation methodologies for costs incurred in making 2007 Local and Significant Event RCST designations. The June 11 order denied the requests for rehearing of the RCST 2007 Order and the July 20, 2006 and September 27, 2006 orders on the RCST Settlement. The June 11 order did not address requests for rehearing/clarification of the *Order on Paper Hearing*.

Responsible Attorney: Anthony Ivancovich

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

On May 9, 2007, PacifiCorp filed to terminate its "Capacity Agreement" by which the IOUs have held rights to the use of PacifiCorp's transmission capacity in the Pacific AC Intertie (PACI), over which rights the CAISO has exercised Operational Control as part of the ISO Controlled Grid.

On May 31, 2007, the CAISO filed a protest of PacifiCorp's termination filing and a request for settlement procedures. The CAISO urged that FERC not permit the termination of the Capacity Agreement until PacifiCorp is able to demonstrate that termination can be accomplished in a reliable manner that will not result in operational concerns or financial harm to customers. While the CAISO expressed a preference that PacifiCorp become a "partial" Participating TO with the CAISO in order to continue the CAISO's Operational Control over the facilities, the CAISO asserted that at a minimum (1) PacifiCorp must become a party to the Owners' Coordinated Operations Agreement (OCOA) and the California-Oregon Intertie Path Operating Agreement, (2) PacifiCorp should enter into an "Interim Operations Agreement" with the CAISO to address various operational, scheduling, and service issues that will arise upon termination, and (3) the termination should not become effective until after the end of summer 2007 in order to avoid any potential impact on reliability during the challenging summer season. The CAISO requested that FERC order the implementation of settlement proceedings in order to ensure that the termination of the Capacity Agreement can be accomplished in a reliable manner.

On June 18, 2007, PacifiCorp filed an answer to the protests of the CAISO and others alleging, among other things, that the CAISO had admitted in correspondence with PacifiCorp that its reliability concerns had been addressed. On June 26, 2007, the CAISO filed an answer to PacifiCorp's answer clarifying that the CAISO's correspondence with PacifiCorp is clear that the CAISO's reliability concerns have not been resolved.

On May 31, 2007, PG&E filed unilateral proposed amendments to the OCOA to address some of the reliability concerns expressed by the CAISO in its protest of PacifiCorp's proposed termination of the Capacity Agreement. On June 21, 2007, the CAISO filed comments on PG&E's filing in support of the filing and requested that it be consolidated with the

proceeding on the termination of the Capacity Agreement, reiterating the CAISO's position on the termination of the Capacity Agreement.

Responsible Attorney: John Anders

Riverside Metered Subsystem Agreement (ER07-923)

On May 18, 2007, the CAISO filed a Metered Subsystem (MSS) Agreement with the City of Riverside, together with a notice of termination of Riverside's existing UDC agreement and Meter Service Agreement, with a request for effectiveness as of July 1, 2007. This MSS Agreement would permit Riverside to become an MSS Operator under the terms of the ISO Tariff.

Responsible Attorney: John Anders

Green Borders Unexecuted LGIA (ER07-1034)

On June 14, 2007, the CAISO and SCE filed an unexecuted Large Generator Interconnection Agreement (LGIA) with Green Borders Geothermal, LLC. The LGIA would specify the terms for the interconnection of Green Borders' proposed new 62 MW Generating Facility to the ISO Controlled Grid. It is the CAISO's understanding that the only issue in dispute is SCE's estimate of the costs of the Participating TO's Reliability Network Upgrades associated with the interconnection at \$237,442,000 and SCE's choice of the option not to provide the funding for these upgrades up front – thereby leaving Green Borders to provide the initial financing of their cost.

Responsible Attorney: John Anders

CDWR v. FERC, Ninth Circuit No. 04-76131 (Review of FERC Docket No. ER99-2326)

On June 7, 2007, the U.S. Court of Appeals for the Ninth Circuit denied a petition for review of FERC orders that approved PG&E's Transmission Revenue Requirement and, in particular, the inclusion of \$132 million of transmission lines that had previously been classified within PG&E's transmission system as "generation ties" or "generation step-up transformers" (primarily the Diablo Loop, Morrow Bay Loop and Moss Landing Loop facilities).

The California Department of Water Resources (CDWR) had challenged FERC's orders on the ground that the facilities were not properly classified as "transmission." In addition, it claimed that FERC should have required "subfunctionalized" pricing of transmission, meaning that customers would pay for only those functions of the transmission system that they use – e.g., backbone or generation ties.

The Ninth Circuit rejected CDWR's arguments and endorsed rolled-in transmission pricing for all components that serve some transmission function. In particular, the Court endorsed the "exclusive use" test, under which facilities are excluded from transmission pricing only if they are used exclusively to generate power, step up power, or transmit power from the generator to the grid. The Court refused to disturb FERC's ruling that, under this test, the PG&E facilities qualified as transmission, stating that "because DWR benefits from the integrated grid, FERC reasonably required it to pay its share of the cost." The CAISO, together with PG&E and SCE, filed a joint brief in support of FERC.

Responsible Attorney: Dan Shonkwiler

ANOPR On Organized Wholesale Power Market Reforms (Docket No. RM07-19)

On June 22, 2007, FERC issued an Advanced Notice of Proposed Rulemaking regarding potential reforms to improve the operation of organized wholesale electric markets. FERC requests comments on the following subjects: (1) the role of demand response in organized markets and greater use of market prices to elicit demand reductions during power shortages; (2) steps that can be taken by ISOs and RTOs to facilitate long-term contracting; (3) strengthening the market monitoring function; and (4) enhancing the responsiveness of ISOs and RTOs to customers and other stakeholders. In particular, FERC would require ISOs and RTOs to allow demand resources to provide certain ancillary services. Further, FERC would modify ISO and RTO tariffs to eliminate certain charges for purchasing less energy in real-time than in the day-ahead during a system emergency. FERC also proposes to amend market rules to permit an entity that aggregates demand responses of individual retail customers to bid the aggregate demand reduction directly into an ISO or RTO market. FERC proposes to remove the Market Monitoring Unit (“MMU”) from ISO/RTO operations. Also, FERC is considering whether to require the MMU to report directly to the ISO/RTO governing board or a sub-set of the board. FERC also inquires how stakeholders and customers can be provided with direct access to the ISO/RTO governing board. Some of the options FERC is considering include the adoption of hybrid boards or stakeholder board advisory committees. FERC also seeks comments regarding ISO/RTO stakeholder and budget processes.

Responsible Attorney: Anthony Ivancovich

CPUC Matters

Resource Adequacy (Docket No. R05-12-013)

On June 21, 2007, the Commission adopted the proposed decision prepared by the presiding Administrative Law Judge in its ongoing Phase 2 – Track 1 Resource Adequacy Proceeding. This latest decision adopts local procurement obligations and related elements for resource adequacy compliance for year 2008 for Commission jurisdictional Load Serving Entities (LSEs). The decision was highly consistent with the policy positions taken by the CAISO. In summary, this decision adopts:

- The CAISO’s recommended Local Capacity Requirement Study reliability standard for setting local procurement obligations, including the inclusion of the newly identified Big Creek/Ventura local area.
- The “Joint Parties” proposal for a Path 26 counting constraint. This proposal was supported and proffered by the CAISO in conjunction with SCE, PG&E, SDG&E, and TURN as a workable solution for meeting the CAISO’s zonal capacity needs.
- Rejected aggregation of the two SCE territory local areas to ensure greater efficiency in LSE procurement..
- Permitted the counting of dispatchable demand response (DR) for local areas assuming the DR can be mapped to a local area and adopts, as reasonable, the mapping of DR to local areas by zip code.

Allows qualifying emergency/interruptible demand response resources towards meeting an LSE’s procurement obligations. The Commission, however, did acknowledge the CAISO’s concern that counting these resources is inconsistent with the intent of resource adequacy, but deferred the issue to another ongoing rulemaking proceeding.

Responsible Attorney: Grant Rosenblum

Sunrise Powerlink (Docket No. A.06-08-010)

On June 15, 2007 the CAISO filed rebuttal testimony in the Sunrise Powerlink CPUC CPCN proceeding. The testimony responded to the direct testimony of UCAN, Nevada Hydro, DRA and the South Bay Parties. Some of the UCAN and DRA study assumptions were incorporated into alternative runs of the CAISO analysis, but even with these changes the Sunrise project continues to show positive net benefits starting in 2010.

Responsible Attorney: Judi Sanders

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

The current Phase 2 is a collaborative proceeding with the CEC, for the purpose of developing joint recommendations for establishing GHG emissions limits for retail electric providers. Phase 2 recommendations are to be delivered to the California Air Resources Board (CARB) for CARB's use in establishing AB 32 reporting GHG regulations. The CPUC and CEC held joint workshops resulting in a June 12, 2007 draft whitepaper. The whitepaper sets forth a proposal for monitoring GHG emissions (CO2 only at this stage) associated with serving California's retail electric load.

The whitepaper assigns various default emission factors to in-California system purchases, Pacific NW imports, and SW imports. Default emission factors for the Pacific NW and SW are based on marginal system resources which generators in these areas are assumed to dispatch to make power for export to California.

The whitepaper also assigns default emission factors for CAISO real time market (of 900lbs/MWH) and CAISO's day-ahead forward Market (1000lbs/MWH).

Responsible Attorney: Bill Di Capo

SCE Advice Letter Proceeding/New Subregional Transmission Planning Process For Renewables

In Draft Resolution E-4052, the CPUC staff outlined a proposed new CPUC subregional transmission planning process to promote renewable resources. The Draft Resolution granted SCE's request to establish a renewable transmission feasibility study costs memorandum account, to allow recovery for expenditures of up to \$6 million in costs for study efforts preceding specific transmission projects.

Draft Resolution E-4052 is set for consideration at the the Commission's July 12, 2007 full Commission meeting.

Responsible Attorneys: Grant Rosenblum and Bill Di Capo

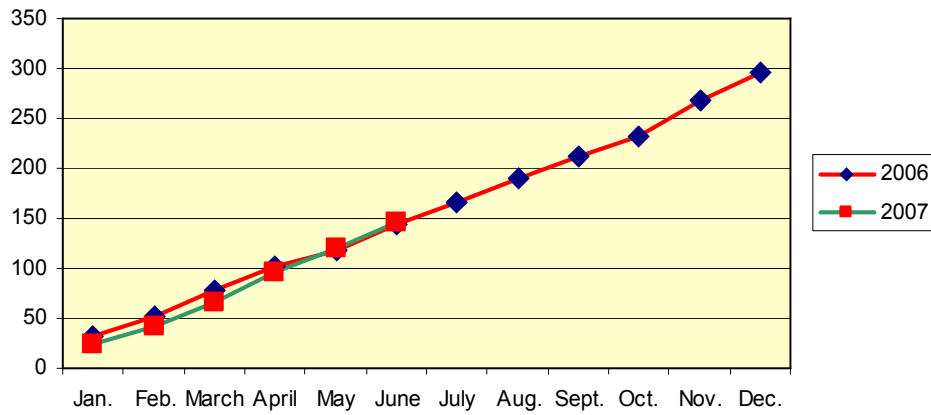
Future Policies for Qualifying Facilities (Docket No. 04-04-025)

In this proceeding, the CPUC considered future policies for treating Qualifying Facilities (QFs). Although the proceeding was devoted primarily to how QFs should be compensated for Power Purchase Agreements (PPAs) entered into pursuant to the mandatory purchase requirements in Section 210 of Public Utility Regulatory Policies Act (PURPA), other issues were under consideration, including the applicability of the ISO Tariff to QFs. The CAISO previously filed testimony in this proceeding recognizing that PURPA delegated to state ratemaking agencies the authority over QFs that would otherwise be within FERC's jurisdiction, but urging the CPUC to direct QFs to comply with the CAISO's interconnection policies as

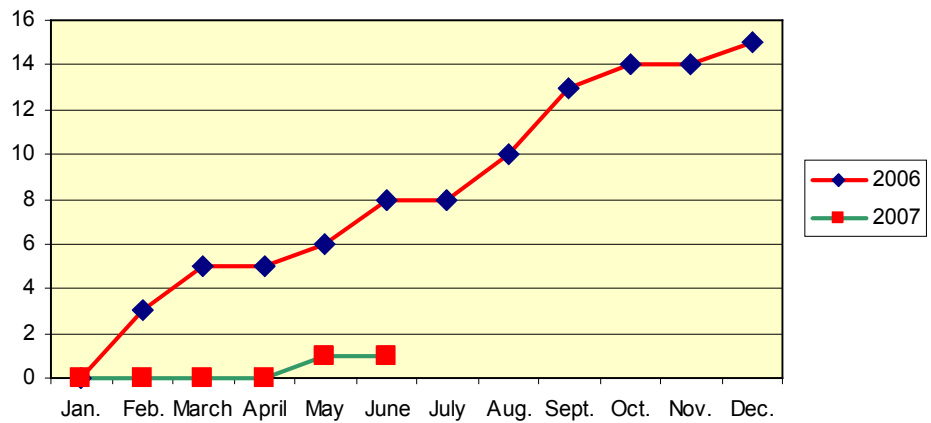
set forth in the ISO Tariff and to require QFs entering into new PURPA PPAs also to be subject to the ISO Tariff. The CAISO made a supplemental filing after the Energy Policy Act of 2005 was enacted, noting the likelihood that the mandatory purchase requirements of PURPA would end once the CAISO had implemented MRTU. Once this occurred, QFs would be subject to the ISO Tariff on a going forward basis. On June 4, 2007 the assigned Administrative Law Judge issued a Proposed Decision supporting the CAISO's position. The Energy Producers and Users Coalition and the Cogeneration Association (EPUC/CAC) of California filed comments in opposition to the ALJ's proposed decision on QF compliance with the ISO Tariff. On June 4, 2007, the CAISO filed reply comments rebutting EPUC/CAC's comments and supported this aspect of the Proposed Decision. The CAISO also commented that only "firm" QF PPAs should be counted toward a Load Serving Entity's Resource Adequacy Requirements.

Responsible Attorney: Sidney Davies

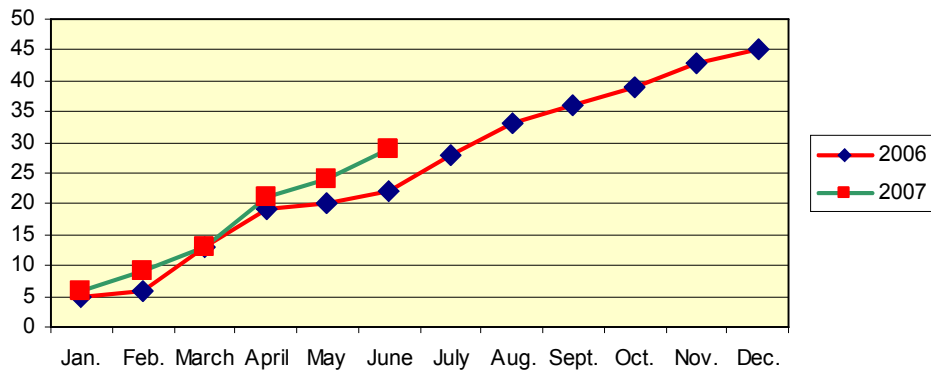
FERC Filings



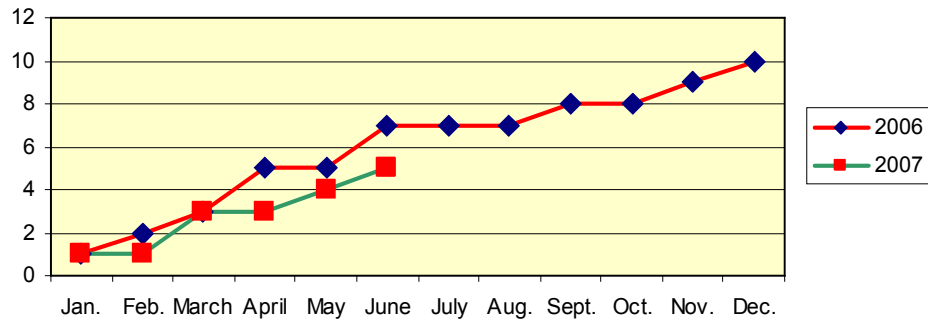
FERC Agreements



CPUC/Other Commission Filings



Court Filings



Total Filings

