

Memorandum

To: CAISO Board of Governors

From: Anthony Ivancovich, Assistant General Counsel
Sidney Davies, Assistant General Counsel

Date: May 21, 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 Rehearing of September 21, 2006 MRTU Order (ER06-615).** On April 20, 2007, FERC issued an order granting in part and denying in part various parties' requests for rehearing and clarification of the September 21 MRTU Order. Notably, FERC reiterated its support for MRTU and denied parties' requests for rehearing of any fundamental aspect of the CAISO's MRTU Tariff. The CAISO sought rehearing of only three issues and clarification of an additional six issues. In its April 20 order, FERC granted rehearing and clarification as to all of the CAISO's issues except one—FERC rejected the CAISO's proposed eligibility requirement for one of the Default Energy Bids options used for Local Market Power Mitigation. To the extent FERC granted other parties' requests for rehearing or clarification, the tariff-related issues for MRTU Release 1 will be addressed in a compliance filing to be made on August 3, 2007 or in future releases. The April 20 order also directed the CAISO to address specific issues in its quarterly joint seams reports with other interested parties.

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

- **First Quarter 2007 Joint Quarterly Seams Report (ER06-615).** On April 30, 2007, the CAISO filed the joint Quarterly Seams Reports for the First Quarter of 2007. The report included joint summaries of individual bilateral meetings held in the first quarter of 2007 between the CAISO and the following parties: Western Area Power Administration, Sacramento Municipal Utility District, Arizona Public Service Company, WestConnect, Los Angeles Department of Water and Power and Nevada Power Company/Sierra Pacific Power Company. The report also included joint summaries of bilateral meetings held in the fourth quarter of 2006 with Bonneville Power Administration and PacifiCorp that were not finalized at the time of the seams report filed on January 30, 2007. The seams report also includes summaries of seams discussions that occurred at committee meetings of the WECC, including the Seams Issues Subcommittee, reporting specifically on the following subject areas: congestion management, E-tagging, resource adequacy congestion revenue rights among other seams issues and potential seams issues. Finally the joint report includes a discussion of seams-related directives stemming

from FERC's April 20 order relating to "firmness" of exports of energy from resource adequacy resources, MRTU readiness, E-tagging requirements and data exchange.

Responsible Attorneys: Anna McKenna and Sidney Davies

- **Order Conditionally Accepting Preliminary CRR Implementation Filing (ER07-613).** On May 8, 2008 the Commission issued an order conditionally accepted for filing, subject to modifications, the CAISO proposed tariff amendments, effective May 9, 2007, as requested, that enable the CAISO to implement certain preliminary activity in preparation for the first annual Congestion Revenue Rights (CRR) Allocation and Auction scheduled to begin in July 2007. Such preliminary activity includes the collection of information to model existing transmission rights on the grid, certification and registration of CRR participants, contractual requirements for CRR participants, and determination of the load metric for eligibility for participation in the CRR Allocation. The Commission also directed the CAISO to file within 15 days of the date of issuance of the order a compliance filing reflecting certain tariff revisions, which the CAISO is preparing to make on May 23. The requisite compliance items pertain to further specification and clarification of tariff language that pertains to the collection of necessary data and additional specification on the contractual requirements for CRR participants. In addition, Commission is requiring the CAISO to file within thirty days from the order, for informational purposes only, those Business Practice Manuals the CAISO has developed in support of the CRR Allocation and Auction.

Responsible Attorneys: Anna McKenna, Mike Dozier and John Anders

- **Filing Requesting Certain CRR Allocation and Auction Rule Changes and Seeking July Effectiveness of CRR Rules for Implementation of the First Annual CRR Allocation and Auction (ER07- 869).** On May 7, 2007, the CAISO filed with FERC proposed tariff amendments to implement its first annual CRR Allocation and Auction processes under MRTU. Through this filing the CAISO seeks effectiveness of the already conditionally-accepted CRR rules: (1) as filed and further amended on compliance on November 20, 2006 in Docket ER06-615, (2) as filed on March in Docket ER07-613, (3) as filed in compliance with Commission Order Nos. 681 and 681-A on January 29, 2007 in Docket ER07-475, and (4) as further amended in this filing. The proposed amendments to the previously filed tariff language fall into two broad categories: (a) those CRR-related changes filed under FPA Section 205 that have come out of either the stakeholder process following the CRR Dry Run or the process of reconciling the material in the Business Practice Manual (BPM) for CRRs and the conditionally-approved MRTU Tariff, and (b) those CRR-related changes filed in compliance with either the Commission's September 21, 2006 MRTU Order or the April 20, 2007 Order on Rehearing.

The rule changes proposed under the first category involve:

- 1) the use of Trading Hubs as sources for Long Term CRRs,
- 2) the process of renewing an expiring Long Term CRR as well as allowing expiring Existing Transmission Contracts (ETCs) and Converted Rights (CVRs) to transition to Long Term CRRs,
- 3) a change to the proposed historical reference period for source verification for CRR Year One to calendar year 2006, and
- 4) Tariff changes as a result of reconciling material in the BPM for CRRs and the conditionally-approved MRTU Tariff.

The proposed amendments in the latter compliance category provide:

- 5) additional detail on the allocation of CRRs to the sponsors of Merchant Transmission upgrades or projects in compliance with the Paragraphs 873 and 1357 of the September 21 MRTU Order and Order No. 681 and Order No. 681-A; and
- 6) tariff language as directed by the Commission in the April 20 Order on Rehearing regarding the allocation of CRRs to Load external to the CAISO Control Area (referred to as an "Out-of-Control Area Load Serving Entity" or "OCALSE").

This filing proposes to add to the currently effective ISO Tariff the necessary language to enable the CAISO to implement CRRs later this summer. The process of releasing CRRs to market participants is a multi-stage, multi-month sequential process. This process must be conducted in advance of February 2008 when CAISO plans go live with the Day-Ahead Market and Real-Time Market under MRTU. The actual first CRR Allocation process must begin on or about July 20, 2007 in order for the CAISO to complete its initial annual and monthly CRR Allocation and CRR Auction process leading up to the start of the MRTU markets on Trading Date February 1, 2008. The CAISO therefore requests an effective date of July 9, 2007 for the proposed tariff provisions in order to be able to commence preparations for the nominations process of the annual CRR Allocation.

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

Load Scheduling Amendment – FERC Docket No. ER07-569-000

On February 23, 2007, the CAISO filed its Load Scheduling Amendment, which amends certain scheduling requirements previously approved by FERC as part of CAISO Tariff Amendment No. 72. Specifically, the Load Scheduling Amendments proposed the following:

- A reduction in the existing minimum load scheduling requirement during off-peak hours (HE 1-6, 23 and 24) from 95 percent to 75 percent of each Scheduling Coordinator's demand forecast;
- The creation of a "safe harbor" for Exempt Scheduling Deviations from the forward scheduling requirement at the lower of 3 MW or 5 percent of the Scheduling Coordinator's forecast demand;
- The establishment of 6 on-peak and 6 off-peak monthly exemptions from the forward scheduling requirement for Minor Scheduling Deviations, which are the greater of 25 MW or 2 percent of the Scheduling Coordinator's forecast demand;
- The establishment of one monthly exemption for a failure by a Scheduling Coordinator to submit a demand forecast; and
- The establishment of a general exemption from forward load scheduling requirements for Scheduling Coordinators with less than 1 MW of peak load.

On April 24, 2007, FERC issued its Order (119 FERC ¶ 61,082) accepting the proposed tariff amendments with modifications. FERC found as reasonable the proposal to lower the minimum scheduling threshold during off-peak hours to 75 percent of the Scheduling Coordinator's demand forecast and to establish a safe harbor for Exempt Scheduling Deviations. However, FERC rejected the creation of Minor Scheduling Deviations on the basis that reliability could be compromised by the simultaneous election of Scheduling Coordinators' to utilize this deviation authority. FERC also required that the CAISO clarify that the one-time exemption for a Scheduling Coordinator's failure to submit a demand forecast only operates to preclude application of a \$500 penalty under the CAISO's Enforcement Protocol, but does not

immunize the Scheduling Coordinator from a violation of the CAISO Tariff. Finally, FERC accepted the exemption for small Scheduling Coordinators.

Responsible Attorney: Grant Rosenblum

Credit Policy Tariff Amendment (ER06-700)

On April 19, 2007, FERC issued an Order on Rehearing and Compliance Filings, 119 FERC ¶ 61,053. As it ruled in its May 12, 2006 Order, 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 rehearing for request 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 its May 12, 2006 Order, FERC 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.

Responsible Attorney: Sidney Davies

The Nevada Hydro Company, Inc. (Docket Nos. ER06-278-000; ER06-278-001)

By Order dated November 17, 2006, the FERC directed the CAISO to hold a stakeholder process to address operational control and cost recovery issues associated with The Nevada Hydro Company's (TNHC) proposed Lake Elsinore Advanced Pump Storage (LEAPS) combined transmission and pump hydro storage project. Specifically, the CAISO was asked to consider, with its stakeholders, whether the costs of the pumped hydro storage facility should be recovered through the Transmission Access Charge (TAC), and whether the CAISO could assume operational control over the facility without compromising its independence. The CAISO filed its report setting forth the results of its stakeholder process with the FERC on May 1, 2007.

The CAISO report argued against inclusion of the costs of the LEAPS facility in the TAC. In support of this recommendation the CAISO relied on several justifications:

- EPC Act 2005 does not dictate or compel a particular cost recovery mechanism for advanced transmission technology;
- The Commission should not permit the costs of the pumped hydro storage facility to be recovered through the TAC which would be subsidized by transmission ratepayers;
- Direct or indirect operational control of LEAPS by the CAISO would jeopardize the independence of the CAISO and the stakeholders' perception of the CAISO's neutrality; and
- Reliability and economic studies done to date related to the combined project demonstrate that there is nothing unique or compelling about the combined project that cannot be provided by the market and no further studies are needed.

The report noted that all of the stakeholders (except one) were strongly opposed to the inclusion of the pumped hydro facility costs in the TAC.

Responsible Attorney: Judi Sanders

Refund Case (EL00-95) and Related Civil Litigation

This is the docket in which the IOUs and the state, collectively known as the "Cal Parties," are seeking refunds for high prices during the 2000-2002 electricity crisis. In March 2006, the CAISO completed the settlements rerun to reflect the mitigated prices ordered by FERC. Since then, the case has centered on certain offsets that the Commission ordered to reflect suppliers' costs – emissions permits, fuel costs, and any overall entity revenue shortfall – plus interest calculations. The parties have litigated the amount of these offsets, and the CAISO has been calculating how the costs will be allocated among the parties. The CAISO's work will lead to an initial compliance filing, probably in July, with the results of the refund calculations and offsets. After the Commission approves the numbers, a second compliance filing will be necessary to account for the settlements reached by various parties. These final numbers will form the basis for the ultimate financial clearing.

Recent activity concerns the appellate court decision that the Commission lacks authority to order refunds from municipalities and other governmental suppliers. This ruling became final only last month, and the issue is back before the Commission. As noted in last month's report, the Cal Parties are pursuing civil litigation against these governmental suppliers, now in state court in Los Angeles County. In April, they also proposed to FERC that the CAISO and the California Power Exchange should complete their refund calculations, and wait until the end of the proceeding – and until further developments in the civil litigation – to address issues that may arise from the governmental suppliers' immunity from refund obligations.

The CAISO filed a response that did not take a position on the merits of the Cal Parties' proposal, but instead focused on how the CAISO will ultimately account for the "refund immunity" of the governmental suppliers. The CAISO cautioned the Commission that one of the possible solutions would be particularly unwise – i.e., a full-system rerun of CAISO settlements to "immunize" the sales of governmental suppliers from mitigation – because it would require 10 to 18 months of work, and work could not even begin until after MRTU implementation due to staffing constraints. The CAISO urged the Commission to consider alternatives that require fewer resources from the CAISO, even if the calculation might be less precise.

The governmental suppliers also responded to the Cal Parties' motion by requesting payment of the remaining balance for their crisis-era sales. The Commission is in a position to direct this to occur due to its responsibilities under the bankruptcy plan for the California Power Exchange. The CAISO's filed response was neutral on the primary issue (while reserving its right to take a position later) but focused instead on the details of any possible distribution, disputing particularly the suggestion of certain suppliers that in the final distribution the CAISO might have payment obligations other than those established by our tariff and that any such issue must be resolved before any distribution can be ordered.

Responsible Attorney: Dan Shonkwiler

California ISO Bond Offering (ES07-20)

On February 9, 2007, the CAISO filed an application (the "Application") pursuant to Section 204 of the Federal Power Act (FPA), 16 U.S.C. Sec. 824(c) (2000), requesting that the Commission authorize CAISO's proposed \$60 Million Dollar bond offering. The purposes of the bond issuance are to provide funding for projected capital expenditures through 2007 and certain "carryover" project expenditures in early 2008, namely costs associated with CAISO's Market Redesign and Technology Upgrade. The bond funds would also provide funding for the establishment of a debt service reserve fund (DSRF). Approximately \$6 million of the total bond offering would be used to establish the DSRF, which would be available

to pay debt services in the event of financial difficulties affecting the CAISO. On March 30, 2007, the Commission issued an order approving the CAISO's FPA Section 204 application, authorizing CAISO to issue the bond for the purposes set forth above in an amount not to exceed \$60 Million. On March 9, 2007, the CAISO filed the resolution of the CAISO Board that authorized the CAISO Management to proceed with the bond offering. The Commission approved the Application by a letter order issued on March 30, 2007 (the "Order") and the bond offering took place on April 5, 2007. The Order required the CAISO to submit a Report of the Securities issued. Thus, on May 4, 2007, in order to comply with the Order, the CAISO submitted such a report.

Responsible Attorney: Grace Arupo

CPUC Matters

Petition to Lift Suspension of Direct Access Program (R. 06-12-002)

On April 24, 2007, the CPUC (Chairman Peevey) issued a Proposed Decision (PD) regarding the Petition of Alliance for Retail Energy Markets (AREM) to open a proceeding to determine whether, and under what conditions, the current suspension of the rules allowing for direct access should be lifted. "Direct access" is a retail service option whereby retail service customers purchase electricity from a retail supplier rather than an investor-owned utility. Direct access was suspended in California on February 1, 2001 when the legislature passed AB 1x in the midst of the energy crisis.

The AREM requested that the CPUC open a rulemaking to explore, among other things, the statutory authority to lift the direct access suspension, the structure of the retail market, rules for switching and default service providers and measures to protect the California Department of Water Resources (CDWR) bond cost recovery relating to long-term electricity contracts entered into during the electricity crisis. The PD largely agrees with AREM, stating that it was time to take a fresh look at the status of the direct access suspension. The PD proposes to open a formal rulemaking proceeding to consider whether it is appropriate to lift the direct access suspension, and how it would be accomplished, noting that "by considering the policy and timing implications of any reinstated direct access market as we develop policy in other proceedings, more coordinated and integrated policies and market structures may result."

The PD establishes three sequential phases for the direct access rulemaking proceeding. The issues to be addressed in written comments in each phase are set forth in Appendix A to the PD. Under Phase II, the PD specifically solicits comments on what effect MRTU would have on the design of a reinstated direct access program. Because this is a Proposed Rulemaking Order, parties will have an opportunity to file comments and reply comments before it is adopted and a firm procedural schedule established.

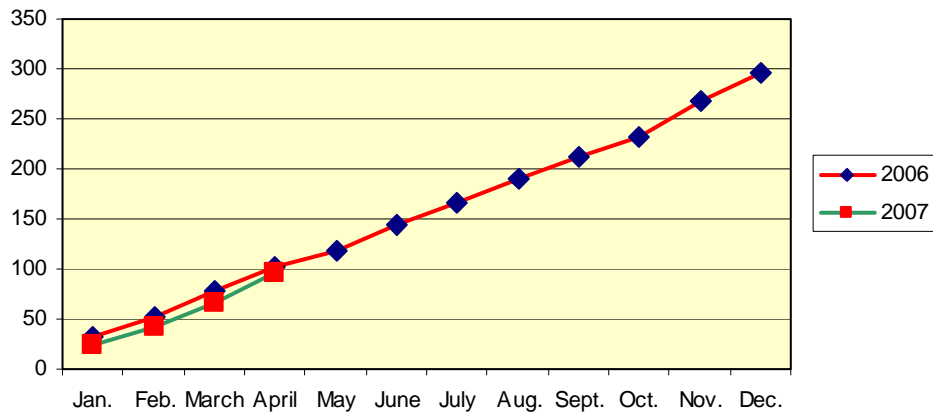
Responsible Attorney: Judi Sanders

Sunrise Powerlink proceeding (A.06-08-010/05-12-014)

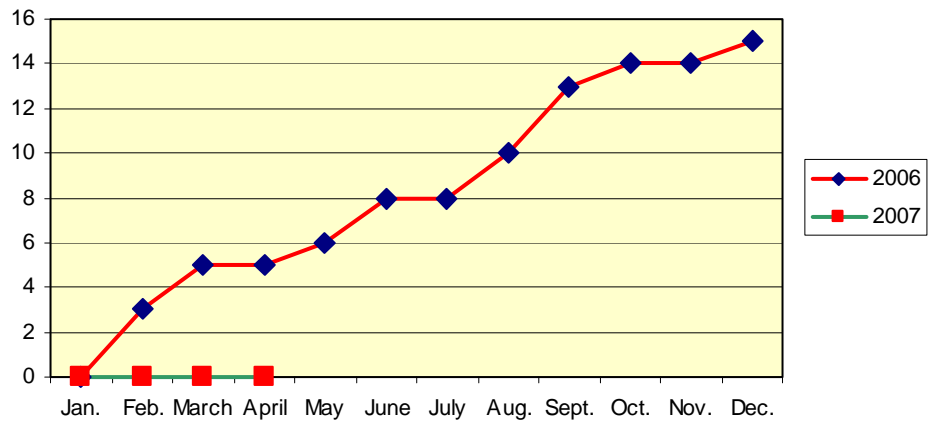
On April 20 the CAISO submitted the third part of its initial testimony in the Sunrise CPCN proceeding. This portion of the testimony contained the study results of the intervener alternative scenarios. The CAISO also submitted a second Errata to its March 1 testimony submission providing updates and modifications to the scenarios already completed. The CPUC has scheduled a workshop for May 15 at which the CAISO will present an overview of its study results and answer questions from the interveners.

Responsible Attorney: Judi Sanders

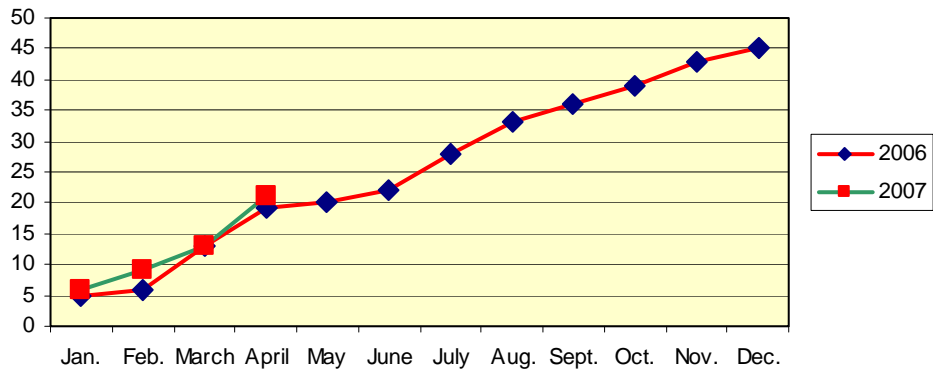
FERC Filings



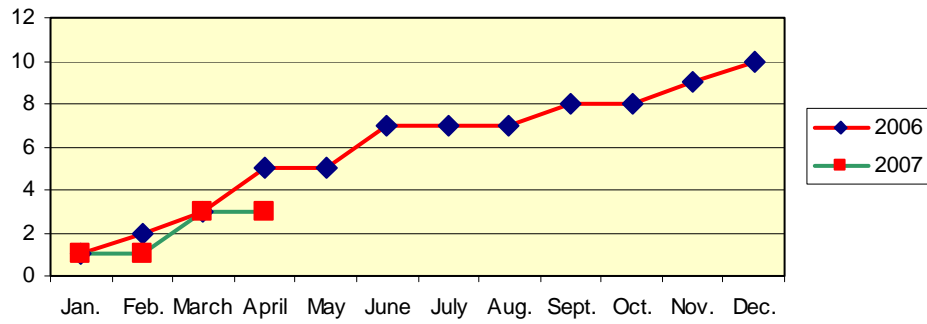
FERC Agreements



CPUC/Other Commission Filings



Court Filings



Total Filings

