California Independent
System Operator Corporation

Memorandum

To: ISO Board of Governors

From: Deborah Le Vine, Director, Market Services

Jim Detmers, Vice President, Operations

Date: January 28, 2008

Re: ***Decision on Congestion Revenue Rights Contingency Plan***

This memorandum requires Board action.

EXECUTIVE SUMMARY

As a result of the delay of the start of the California ISO's Market Redesign and Technology Upgrade (MRTU), Management has put forth a Congestion Revenue Rights Contingency Plan (CRR Contingency Plan) to address the need to reduce the term of any Congestion Revenue Rights already released through the first annual CRR allocation and auction process, re-settle those CRRs released through the CRR auction held in December 2007, and make available Firm Transmission Rights (FTR) as of April 1, 2008. Firm Transmission Rights are a product that enables market participants to manage exposure to congestion on Inter-Zonal Interfaces and in the current market design in production. Firm Transmission Rights are auctioned annually for the auction period of April 1 through March 31. Congestion Revenue Rights are instruments that enable market participants to manage exposure to congestion costs in a nodal market as anticipated in MRTU. The CRR Contingency Plan as proposed herein specifically enables ISO to: 1) adjust the term of the annual CRRs released both through the CRR allocation and CRR auction processes for the months in 2008 that MRTU is not in effect; 2) resettle the CRR auction payments and charges for parties who acquired CRRs in the first annual CRR auction; and 3) make available FTRs for April 2008 and any additional months prior to the start of MRTU.

Specifically, Management is proposing to reduce the term of the released CRRs to eliminate those months for which they will not be in effective between April 1 and the launch of MRTU. Management proposes to refund a proportional share of the associated CRR auction prices plus interest, as appropriate, to the holders of positively-valued auctioned CRRs. Holders of negatively-valued CRRs released through the annual CRR auction will be required to repay a proportional share of the associated CRR auction prices that were paid to parties awarded such CRRs in the CRR auction, plus interest, as appropriate. In addition, the ISO will conduct an expedited FTR auction to cover an annual period from April 1, 2008 through March 31, 2009, as is required under the existing ISO Tariff for congestion management. Because in the past an FTR auction has required a four-month process to implement, there is a risk that the expedited FTR auction may not be complete by April 1 or May 1, of 2008. Therefore, Management is proposing that it commence the FTR auction for 2008-2009 as provided for in the currently-effective ISO Tariff, with certain simplified procedures, and adopt a backstop measure that together will ensure the release of FTRs as of April 2008. The backstop measure would consist of an opportunity for parties that obtained FTRs for April 2007 or May 2007 in the last FTR auction to renew those FTRs for April or May 2008, at a price that is a share of the previous auction price; and thereafter FTRs would be released through the FTR Auction for 2008-2009.[1]

In order to proceed with the FTR Auction for 2008-2009, as proposed herein, consistent with Section 36.2.2 of the currently-effective ISO Tariff, Management requests that the Board of Governors approve the FTR quantities that Management has determined are appropriate to release in the FTR Auction for 2008-2009, as described in this Memorandum and in the Attachment A to this Memorandum. Section 36.2.2 of the tariff states that, "The CAISO Governing Board shall, from time to time, approve the amount of FTRs to be auctioned for each FTR Market and the CAISO shall publish this information on the CAISO Home Page at least thirty (30) days prior to the auction." The FTR Auction for 2008-2009, which is scheduled for start in early March 2008, will release FTRs with a full term starting in the hour beginning at 12:00 a.m. on April 1, 2008 and ending with the hour beginning at 11:00 p.m. on March 31, 2009.

In light of the requirement that the ISO must obtain approval of elements of the CRR Contingency Plan both by the Board of Governors and the Federal Energy Regulatory Commission (the Commission or FERC) before implementing the plan, it was necessary to conduct an expedited stakeholder process in developing the CRR Contingency Plan. Despite the time limitations for a stakeholder process, Management is very appreciative of the stakeholder participation that did ensue and the stakeholder input was instrumental in fashioning the recommended CRR Contingency Plan. Management's proposed CRR Contingency Plan, which includes CRR Option 2 and FTR Option1 as described below, is essentially the same as the proposal posted on December 13, 2007, and again on January 22, 2007, with respect to unwinding CRRs, and is substantially improved with respect to releasing new FTRs in a manner that Management believes is responsive to expressed stakeholder preferences and concerns.

Approval of the CRR Contingency Plan is necessary because the proposed measures allow the ISO to unwind the results of the annual CRR allocation and auction and settle the collection or return of any net CRR auction payment amounts for any month that MRTU is delayed. In addition, this proposed CRR Contingency Plan enables the ISO to proceed with the expedited FTR Auction for 2008-2009, or implement a backstop measure, that together will ensure FTRs are available as of April 1, 2008.

MOTION

Moved, that the ISO Board of Governors approve the Congestion Revenue Rights Contingency Plan as proposed in the memorandum and related attachments; and

That the ISO Board of Governors approve, as part of the CRR Contingency Plan, the proposed quantities of Firm Transmission Rights for the FTR Auction for 2008-2009, as described in the memorandum dated January 28, 2008 and related attachments; and

That the ISO Board of Governors authorizes Management to make all the necessary and appropriate filings with the Federal Energy Regulatory Commission to implement this proposal.

BACKGROUND

In preparation for the anticipated MRTU Go Live date of April 1, 2008, the ISO conducted its first annual CRR allocation and auction releasing CRRs to be in effect after the anticipated start of MRTU. CRRs were released to market participants through both an allocation and auction process and can be used to manage exposure to the cost of

[1] For example, if ABC Corp had 100 MW of FTRs on the Palo Verde Branch Group in April 2007, the company would be offered the ability to have 100 MW of FTRs on the Palo Verde Branch Group for April 2008 provided it paid the CAISO the April 2007 auction price.

congestion associated with Locational Marginal Pricing. While the allocation process is limited to qualified load serving entities, at no cost to the load serving entities, the CRRs released through the CRR auction, which is open to all market participants that have registered with the ISO, are only obtainable at a market clearing price that is determined by the bids submitted to the CRR auction. The CRR auction yields positively valued CRRs, which are anticipated to yield a stream of congestion revenue to the CRR holder, and negatively valued CRRs, which are expected to result in a stream of congestion charges to the CRR holder. In anticipation that the ISO would commence operations under MRTU by April 1, 2008, when the previously auctioned FTRs were due to expire, Management did not conduct an FTR Auction for any months of beyond April 1, 2008. Once MRTU comes into effect, FTRs are no longer in effective and CRRs are available to manage exposure to congestion associated with the Locational Marginal Price (LMP).

Prior to the close of the bid submission for the CRR auction in December 2007, Management posted a CRR Contingency Plan to inform participants of the actions Management would take to address issues related to CRRs released through the first annual CRR auction if MRTU was not going live on April 1, and what actions Management would take to make FTRs available for the months of 2008 during which MRTU would not be in effect. Management's current proposal is essentially the same as the posted December version with respect to unwinding CRRs, and is substantially improved with respect to releasing new FTRs in a manner that Management believes is responsive to expressed stakeholder preferences and concerns.

OPTIONS TO ADDRESS THE ISSUE

In evaluating the options for dealing with the CRR rights that have been auctioned or allocated already, Management considered three possible solutions.

CRR Option 1: The first option explored involves reducing the term of the released annual CRRs released through the CRR allocation and auction for the months that MRTU is not in effect in 2008, but not unwinding the CRR Action payments made for negatively valued CRRs or charges assessed for positively valued CRRs. (*i.e.,* a 50 MW CRR purchased for on-peak in the spring season from (April 1 to June 30) can be used from the new Go Live date and the purchase amount is not adjusted.) As a consequence of the reduction of the term of all released CRRs, each CRR holder's collateral requirements would be re-adjusted to reflect the new CRR terms. Also as a consequence of the reduction of the terms of the released CRRs, any pre-payment of Wheeling Access Charge (WAC) obligation that applies to Out-of-Balancing Authority Area Load Serving Entities (OBAA LSEs) would also be readjusted and re-settled according to the new terms of the already released CRRs.

CRR Option 2 (Management Proposal): The second option explored involves reducing the term of the annual CRRs released through the CRR allocation and auction to reflect the delay in the start of MRTU, and for auctioned CRRs, refunding a proportional share of the associated CRR auction prices plus interest, as appropriate, to the holders of positively-valued auctioned CRRs. Holders of negatively-valued CRRs released through the annual CRR auction would be required to repay a proportional share of the associated CRR auction prices that were paid to parties awarded such CRRs in the CRR auction, plus interest, as appropriate. The ISO would net these previously-settled auction amounts for each CRR auction participant and would provide payment or impose charges to settle the appropriate net amounts. As of April 1, 2008, the ISO would begin to unwind all the CRRs released through the first annual CRR auction that will not be in effect for the months in 2008 during which MRTU is not operational. Once the length of the delay of MRTU is determined, the ISO would pro-rate and settle the applicable CRRs for the known duration of the delay. CRR Holders would be invoiced at the next issued invoice after FERC approval is obtained. To the extent the outcome of the pro-rata reduction is not settled until after April 1, 2008, would charge the FERC interest rate on all funds due to the ISO and would apply the FERC interest rate on all funds due to participants by the ISO.[2] As in CRR Option 1, as a consequence of the reduction of the term of all released CRRs, each CRR holder's collateral requirements and pre-payment obligation of WAC for OBAA LSEs would be re-adjusted to reflect the new CRR terms.

Interest on any Refunds and Payments by the ISO: In its initial proposal posted on December 13, 2007, Management did not refer to the application of interest to holders of either positively or negatively valued CRRs when the ISO resettles CRRs. However, upon further consideration of the issues, Management determined that it would be appropriate to pay or charge interest but only in certain circumstances. Since the timing of the CRR auction was to occur well in advance of the April 1, 2008 implementation date of MRTU, the economic impact of that gap in time should have been reflected in parties' bids for CRRs. Accordingly, the ISO does not propose to pay or charge interest for any period up to April 1, 2008. Further, the ISO believes that interest should not be paid for any month of MRTU delay, provided the CRRs are resettled on or before the first of any such month. In the event the ISO cannot resettle the CRRs by the first of any given month, the ISO believes that interest should be paid to positively valued CRRs and charged to negatively valued CRRs from the first of any effective month until the CRRs are resettled. Finally, once the ISO announces a new MRTU Go Live date, the ISO proposes to resettle the CRRs for the months prior to the new date without paying or charging interest unless, for whatever reason, the ISO cannot resettle the CRRs until after the first of the month that the CRRs would have been active. In circumstances requiring the ISO to pay and charge interest, the Management believes the FERC interest rate should be applicable rate. An application of the FERC interest rate, however, is likely to result in an application of a rate above the interest rate earned on the funds held by the ISO in the CRR Balancing Account. Any difference in interest would be absorbed by the rest of the market through the clearing of the CRR Balancing Account, where the CRR auction revenues are held until the CRR Balancing Account is settled at the end of the trading month.

Clearing Credit Requirements Related to Valuation of CRRs: The ISO's credit policy as reflected in Section 12 of the currently effective ISO Tariff requires market participants to have a combination of collateral and Unsecured Credit Limit to cover their Estimated Aggregate Liability (EAL). At the same time, market participants are entitled to the return of excess collateral above their EAL. Negatively valued CRR portfolios increase a Market Participant's EAL and, therefore, EAL should be adjusted whenever the CRR instruments are adjusted. However, since the adjustment of the term of negatively valued CRRs requires repayment of amount of value of the CRR for the months in question, Management proposes not to adjust the EALs until such time as the CRRs are resettled and payment has been received. This recommendation also avoids any issues with how to value CRRs pending a FERC order on the CRR Contingency plan.

CRR Option 3: Finally, Management considered reducing the term of the released annual CRRs in proportion to the delay in the start of MRTU, and refunding a share of the associated CRR auction prices plus interest, as appropriate, for auctioned CRRs as in CRR Option 2, but calculating the auction resettlement in a manner that reflects expected differences in the values of each CRR over its term. For example, a seasonal CRR that is defined for the months April, May and June may be expected to have a higher magnitude revenue stream in June than in April due to the higher levels of load and hence higher congestion expected in June. Although Management recognized that such an approach might be justified in concept, in practice there would not be a way to perform such a calculation to reach a reliable and non-controversial result based on the absence of any market data.

[2] The CRR auction price adjustments will be calculated separately for on-peak and off-peak CRRs, by scaling the appropriate CRR auction price in accordance with the ratio: [number of on-peak (or off-peak) hours in the delay period] divided by [number of on-peak (or off-peak) hours in the term of the CRR for that season]. The proposed auction price adjustment will be paid or charged to the parties that were initially issued the affected CRRs in the annual CRR auction. CRR auction participants and other parties considering bilateral trades of CRRs should be aware of this impending auction settlement adjustment when arranging any CRR trades.

Management also considered three options for ensuring the Firm Transmission Rights are still available to cover the time frame before MRTU goes into effect.

FTR Option 1: The first option Management explored was to fully extend the FTRs released for the March 2007 to April 2008 period to the remaining months of 2008. Management would offer holders of FTRs for April through May 2007 the opportunity to renew the 2007 FTRs at a proportional share of the 2007 auction prices, subject to the possible quantity limitations. For those months in which holders of 2007 FTRs would be allowed to extend them to 2008, and for those transmission paths for which all of the 2008 maximum FTR quantities have not been taken up by renewal of 2007 FTRs, the ISO would release any remaining available FTR capacity to other interested and qualified parties through a simplified auction process that could be easily and quickly implemented. Before renewing the 2007 FTRs, however, the ISO would calculate revised FTR maximum quantities for each FTR transmission path based on the same 99.5 percent availability criterion as previously approved by FERC to determine maximum FTR quantities for previous FTR auctions. In the event that the 2008 maximum FTR quantity for any transmission path is less than the quantity of 2007 FTRs released for that path, parties who wish to renew their 2007 FTR auction awards would be limited to a *pro rata* share of the 2008 quantity for that path. Otherwise, parties would be allowed to renew any quantity up to 100 percent of their 2007 FTR auction awards for each path. Parties would pay a *pro rata* price for the proportion of previously issued FTRs that they are allocated in this process. For example, last year the term ran from April 1st to January 31st, which is 306 days. If FTRs were issued to the FTR holders previously during that time, the FTR holder would now pay a fraction of what they paid last time equal to the length of the new FTR in days (*e.g.*, an April FTR would have 30 days) as a fraction of the total number of days of the old season (306 days), multiplied by the price of the old FTR. This option would also include a manual auction for residual FTR quantities and to allocate any residual positive incremental grid capacity. The manual auction would be as proposed in FTR Option 3 below.

FTR Option 2 (Management Proposal): The second option considered was conducting an expedited FTR Auction for 2008-2009. The FTR Auction would be for the April 1, 2008 through March 31, 2009 time period, as provided in the currently effective Tariff. The FTRs would be made available in segments as was done last year. If MRTU is then launched prior to the expiration of the issued FTRs, the ISO would appropriately reduce the terms of the outstanding FTRs and refund their auction prices proportionately. ISO would provide time for a mock auction and would not hold the one-week training course. However, all FTR bidders would continue to have access to the necessary technical equipment to participate in the electronic auction. As provided in the currently effective ISO Tariff, certified Scheduling Coordinators or entities that have met financial requirements equivalent to the financial certification criteria required of all Scheduling Coordinators, would be eligible to participate in the expedited FTR Auction for 2008-2009. As shown in Attachment A to this Memorandum, the FTR quantities are based on the 2007-2008 FTR Quantities. However, it is likely that there will be some downward adjustments once the ISO completes its analysis of the current transfer capability of each Inter-Zonal Interface as required under the currently effective ISO Tariff. While Management has recently identified resources to make the implementation of this option feasible, because of the shortness of time between now and April 1, 2008, a backstop measure would available in the event that the expedited FTR Auction for 2008-2009 cannot be implemented in time for April or May 2008. For the remainder of the term, FTRs would be released through the FTR Auction for 2008-2009. The backstop measure would consist of the methodology described in FTR Option 1.

FTR Option 3: The third option considered was to conduct a manual auction. The manual auction would be based on bid-in price quantity pairs for the available capacity. It would not use the traditional FTR auction software used in the past. Bids would be rank ordered, a market clearing price would be established and the capacity would be allocated accordingly.

ATTRIBUTES FOR COMPARING OPTIONS

Any measures and procedures considered must be feasible for implementation by April 1, 2008. In addition, because the ISO must obtain authority to implement these measures by the Commission in time for implementation on April 1, 2008, limited time is available for development of the measures before January 30, 2008, which is the date by which ISO must submit its application to the Commission in compliance with the notice requirements under the Federal Power Act and the Commission regulations in order to obtain an order in time to implement such measures by April 1, 2008. Also, to actually conduct an FTR auction, as required by the ISO Tariff, ISO must obtain approval of the FTR quantities that will be made available at the FTR auction, which would have to be obtained at the January 29, 2008 Board of Governors meeting given that no other meeting is scheduled in time to provide the notice as required under the Tariff prior to the start of the FTR auction. At the time that the ISO was considering these measures, Management has not determined the start date of MRTU beyond April 1, 2008. Because the term of the delay is unknown, the measures must be able to conform to any length of the delay. Any measures to deal with the delay require the dedication of ISO resources that are also necessary for implementation of MRTU, including the implementation of the monthly CRR allocation and auction for when MRTU is launched. Any measures adopted should not require the duplication of efforts in the event of a delay beyond a single month.

PROS AND *CONS* OF EACH OPTION

Congestion Revenue Rights Released through the Annual CRR Auction for 2008.

CRR Option 1 is not viable because it does not provide a remedy for market participants that paid for the value of a CRR obtained in the CRR auction for which the market participant anticipated they would receive a stream of revenue associated with the hourly clearing of the LMP markets under MRTU as of April 1, 2008. The product that was sold to participants in the CRR auction has changed in light of the fact that MRTU will not go live on April 1, 2008. Therefore, the value paid for the product is lost to holders of such rights, as is the value paid by the ISO to market participants that received negatively valued CRRs. CRR Option 1 could be implemented as of April 1, 2008, subject to the Board of Governors and Commission approval of CRR Option 1.

CRR Option 2 could also be easily implemented on April 1, 2008, subject to Board of Governors and Commission approval, and would allow the ISO to return value paid for the CRRs that were released through the CRR auction and the ISO to recover the value paid for the negatively valued CRRs that will no longer provide revenue to the ISO for its settlement of CRRs. While CRR Option 3 provides the same remedy as does CRR Option 2, CRR Option 3 would require the design of a more sophisticated rate structure to implement the refund process. Either CRR Options 2 or 3 require approval by the Board of Governors and also approval by the Commission since these remedies are not already reflected in the ISO's Tariff, nor were they previously approved by the Board of Governors. In light of the limited time available to design the pro-rata formulation, CRR Option 2 is more favorable as it does not require the calibration and stakeholder process for developing the weighting factors that would be required under CRR Option 3. Moreover, ISO has determined that the benefits of the finer tuning under CRR Option 3 are not significant enough to warrant the development of the more complicated methodology since under CRR Option 2 each month that is delayed will be provide a close valuation of the CRR for that month based on the hours for each month.

Release of FTRs for Remaining Months of 2008 during which MRTU is not in Effect.

FTR Option 1 provides the most easily implemented methodology for ensuring that FTRs will be made available to market participants as of April 1, 2008. FTR Option 1 also provides a reasonable approximation of a load serving entity's needs for 2008 since while load does migrate and resources do change, the ISO has not generally observed large variations over time. Therefore, FTR Option 1 provides a reasonable opportunity for load serving entities to manage their exposure to congestion in 2008. FTR Option 1 is limited, however, by the probability that market participants that did not obtain FTRs in the last FTR auction would not be able to obtain FTRs for the months in 2008 during which MRTU is not in effect. The benefits of FTR Option 1are also limited because of the possibility that a particular load serving entity's load and resource requirements may have changed so significantly over the past year that last years FTRs would no longer meet its needs. The residual auction could mitigate for this in the event other load serving entities do not nominate the capacity, but under FTR Option 1, there is a risk that a particular load serving entity will not have access to the capacity that it needs based on its requirements for 2008. ISO must also obtain Commission approval of tariff language associated with this FTR Option 1 before it could become effective.

FTR Option 2 provides the most opportunity for market participants to obtain coverage that best meets their needs for 2008. FTR Option 2, however, is limited by the fact that it normally takes approximately four months to conduct an FTR auction as the ISO has done in the past. FTR Option 2 has the advantage over FTR Option 1 of not requiring further tariff changes in order for the ISO to begin implementation of the FTR auction, provided that the ISO obtains approval of the amount of FTRs to be made available in the 2008 FTR auction as described in the Attachment to this Memorandum. Management anticipates that expedited FTR Auction proposed in FTR Option 2 can me implemented by April 1, 2008 based on the following requirements: 1) a reduction of the timeline by not requiring and providing training to market participants that intend to participate in the FTR auction, and 2) using the verified FTR quantities determined last year as described above. In addition, Management has retained the services of qualified employees and contractors that have previously conducted the FTR auction, which will enable management to continue to focus towards implementation of CRRs for MRTU and also conduct the expedited FTR auction over the next two months. In response to the strong preference for an FTR Auction for 2008-2009, immediately following the stakeholder conference call, Management explored further its ability to conduct the expedited FTR auction and has retained the services of qualified persons to conduct the expedited FTR auction as well as has made available the technological resources. Management believes that under these circumstances, the implementation of the monthly CRR processes in time for an MRTU start is not jeopardized. However, Management continues to recognize that there is risk with this effort given that normally the FTR auction is conducted over a period of at least four months. Therefore, the backstop measures continue to be important for the ISO to ensure that FTRs are available as of April 1, 2008.

Management considered the manual auction as proposed in FTR Option 3 because a manual auction would require the assignment of fewer resources towards conducting the auction than a full FTR auction. FTR Option 3, however, is less attractive because it would require further development of the methodology to be used to conduct the auction and approval of such methodology by the Commission before its results become effective. Given the shortness of time to ensure that FTRs are available by April 1, 2008, FTR Option 3 is inferior to FTR Options 1 and 2 because the next two months would be spent on the refinement of the design of the manual auction through the process at the risk of not having FTRs available as of April 1, 2008.

POSITIONS OF THE PARTIES

Congestion Revenue Rights Released through the Annual CRR Auction for 2008.

The majority of participants that submitted comments and participated in the stakeholder conference call supported the pro-rata adjustment of the term of the released annual CRRs for the months in 2008 that MRTU is not in effect and the resettlement of the auction payments and charges for parties who acquired CRRs in the first annual CRR auction. Participants requested further clarity in the plan on what interest would be assessed on the resettlement amounts, for what time periods, and timing of the payments, which Management has provided above as described under CRR Option 2. Participants also favored, as provided in CRR Option 2, the application of the interest rate on the resettlement amounts and that any shortfalls due to an inability to apply the interest on the negatively valued CRRs should be borne by the whole market and not just the holders of the positively valued CRRs.

Release of FTRs for Remaining Months of 2008 during which MRTU is not in Effect.

In response to the CRR Contingency Plan posted on January 22, 2008, and during the stakeholder conference call held on January 24, 2008, the majority of participants expressed a strong preference for an auction approach for the release of FTRs for the months during which MRTU will not be in effect. Participants argued that an FTR auction will be the most efficient and equitable approach for the release of FTRs. Participants also argued that the extension approach in FTR Option 1 could have adverse impacts since the FTRs were valued last year and would not reflect the commercial conditions in 2008, and would be discriminatory since provides an advantage to current holders of FTRs.

Participants argued that the plan should ensure that if the maximum FTR quantities for 2008 are greater than they were for 2007, they would be made available. In the event that the ISO could not implement a full auction, certain participants noted that a manual auction, as reflected in FTR Option 3 above, with an ability to release FTRs based on a market approach would be preferable to the extension of the previously allocated FTRs as reflected in FTR Option 1. Others did not support a manual auction at all because of the lack of vetting and testing of such an auction, and therefore argued that in the event that a full blown auction cannot be conducted, that the ISO should adopt the extension of FTRs from prior years for the applicable months.

Certain participants expressed a preference to ensure that all of the ISO's efforts towards implementing MRTU as opposed to developing or implementing other FTR auctions and therefore adopt the most straightforward method for handling FTRs for 2008. Other participants argued that the extension of FTRs from previous years could only be supported in the event that the MRTU delay did not go beyond June 2008; otherwise the only acceptable option is the FTR auction.

Management had not had the opportunity to put forth FTR Option 2 as it is reflected in this memorandum during the stakeholder conference call because at that time Management had not been able to retain the resources required to make FTR Option 2, successful as discussed above. However, in response to the strong preference for the FTR auction as summarized above, Management endeavored further to find a solution that would satisfy the concerns identified by participants. The success of FTR Option 2 hinges on the ability for management to conduct the FTR auction in the two months before April 1 and on its ability to have available trained individuals as discussed above. A backstop measure is therefore crucial because in the event the FTR auction is not complete in time for April or May of 2008, Management requires a mechanism to make FTRs available. FTR Option 1 is the most reasonable backstop measure given that the manual auction would require the expenditure of more resources to implement. Rather than implement the manual auction, Management believes its efforts should be concentrated towards implementing the FTR auction as described in FTR Option 2 and then use the most simplified mechanism to make FTRs available for April and at most May should the FTR auction not be completed on time.

FINANCIAL IMPLICATIONS

As an FTR auction was not contemplated for 2008, it was not budgeted. The additional estimated cost to expedite the process is $200,000 of O&M from Market Services that was not budgeted: $120,000 for additional costs associated with the need to retain additional contractor resources and $80,000 for the estimate of overtime cost for ISO staff.

MANAGEMENT RECOMMENDATION

Management proposes the adoption of CRR Option 2 and FTR Option 2 as the CRR Contingency Plan.

ATTACHMENT A

BACKGROUND

An FTR is a right that has both financial and physical attributes. FTR holders share in the distribution of Usage Charge revenues received by the ISO in the Day-Ahead and Hour-Ahead Markets associated with Inter-Zonal Congestion during the term of the FTR. FTRs also entitle the holder to scheduling priorities in the Day-Ahead Market for the transmission of energy across a congested Inter-Zonal interface. As a result of the financial and physical attributes of FTRs, holders of these instruments enjoy a degree of certainty with respect to the delivery of energy and costs associated with its delivery. In addition, Participating Transmission Owners are entitled to receive all revenue raised in the annual FTR auction in proportion to their respective ownership interests in the paths on which FTRs are sold. This auction revenue is applied toward each PTOs Transmission Revenue Requirement.

It should be noted that the term of the FTRs to be released in the FTR Auction for 2008-2009 overlaps with the anticipated implementation of MRTU. Consequently the ISO will include a buyer beware clause in the FTR auction documentation. If MRTU is then launched prior to the expiration of the issued FTRs, the ISO would appropriately reduce the terms of the outstanding FTRs and refund their auction prices proportionately.

Basic Methodology for Determining FTR Quantities to Release in the FTR Auction

For the FTR Auction for 2008-2009, the ISO has produced proposed FTR quantities based on FTR Quantities from the FTR Auction for 2007-2008. These values are detailed in the table below. As has occurred in previous years the ISO will treat these approved values as a maximum and will reduce the quantities available if further analysis indicates that such reduction is necessary. In previous years such downward adjustments were the exception rather than the rule. However, given the preliminary nature of these figures, the ISO anticipates that such adjustments will be more likely for the FTR Auction for 2008-2009. In any case, the final quantities auctioned in the FTR Auction for 2008-2009 will not exceed the board-approved numbers.

The methodology for determining the FTR Quantities that was used in the FTR auction for 2007-8 is consistent with the approach described in Section 36 of the ISO Tariff. This methodology is described below.

- The full Operating Transmission Capability (OTC) in the Day Ahead market is determined for each hour during the historical reference period, which is the most recent prior twelve month period, typically November of the previous year through October of the current year.
- The Existing Transmission Contract (ETC) values corresponding to the hourly Day Ahead OTC values are then determined.
- The ETC values are subtracted from the OTC values to arrive at the Available Transmission Capability (ATC) values for each Branch Group.
- The ATC values are ordered in descending order and the ATC value at the 99.5 percent confidence level is determined. This value is the ATC that is available, based on the historical reference period data, in the Day Ahead Market 99.5 percent of the time.
- The proposed FTR release quantity is computed by subtracting the converted ETC amounts turned over to the ISO from New Participating Transmission Owners, if any, from the ATC values at the 99.5 percent confidence level. This is done pursuant to Tariff section 36.3.

Other Considerations

From time to time planned maintenance outages and other outages of a unique nature occur on transmission paths in which FTRs are sold. For past Auctions, the ISO calculated the FTR release quantities at the 99.5

percent confidence level after these outage hours were removed from the data. The number of outage hours excluded from the calculations was then disclosed to market participants prior to the Auction.

The table below lists the transmission paths on which the ISO proposes to release FTRs, along with the proposed sale quantities for each FTR Branch Group to be auctioned

Path Number	Branch Group Name	From Zone	To Zone	2008 Proposed Release Amounts
1	BLYTHE _BG	SP15	LC2	133
2	BLYTHE _BG	LC2	SP15	180
3	CFE _BG	SP15	MX	408
4	CFE _BG	MX	SP15	400
5	CTNWDRDMT_BG	NP15	SMD3	336
6	CTNWDRDMT_BG	SMD3	NP15	336
7	CTNWDWAPA_BG	NP15	SMD2	1,167
8	CTNWDWAPA_BG	SMD2	NP15	1,167
9	ELDORADO _BG	SP15	AZ2	739
10	ELDORADO _BG	AZ2	SP15	739
11	IID-SCE _BG	II1	SP15	600
12	IID-SDGE _BG	SP15	II2	57
13	IID-SDGE _BG	II2	SP15	62
14	MEAD _BG	SP15	LC1	767
15	MEAD _BG	LC1	SP15	598
16	NOB _BG	SP15	NW3	418
17	NOB _BG	NW3	SP15	418
18	PACI _BG	NP15	NW1	961
19	PACI _BG	NW1	NP15	883
20	PALOVRDE _BG	SP15	AZ3	1,943
21	PALOVRDE _BG	AZ3	SP15	1,943
22	PARKER _BG	LC3	SP15	160
23	PATH15 _BG	ZP26	NP15	3,571
24	PATH26 _BG	ZP26	SP15	2,127
25	RNCHLAKE _BG	NP15	SMDE	963
26	RNCHLAKE _BG	SMDE	NP15	1,044
27	SILVERPK _BG	SP15	SR3	10
28	SILVERPK _BG	SR3	SP15	10
29	TRACYCOTP_BG	NP15	SMDH	83
30	TRACYCOTP_BG	SMDH	NP15	36
31	TRACYPGAE_BG	NP15	SMDL	1,879
32	TRACYPGAE_BG	SMDL	NP15	1,879
33	VICTVL _BG	SP15	LA4	560
34	VICTVL _BG	LA4	SP15	1,375
			Total	**27,952**

ATTACHMENT B

Stakeholder Outreach Activities and Response to Comments for the CRR Contingency Plan

ISO posted draft documents on the following dates:

CRR Contingency Plan – Posted December 13, 2007
Revised CRR Contingency Plan – January 22, 2008

Stakeholders submitted one (1) round of written comments to the ISO on the following date:
Round One – January 25, 2008

Stakeholder comments are posted at:
http://www.caiso.com/1bb4/1bb4745611d10.html

Other stakeholder efforts include:
List conference calls- Jan 24,2008 (> 150 phone participants)