

## MEMORANDUM OF UNDERSTANDING

The California Independent System Operator Corporation ("ISO") and the Merced Irrigation District ("MeID") have been engaged in discussions concerning MeID's interest in becoming a participating transmission owner, utility distribution company, load serving entity, and generator owner in accordance with the ISO tariff. The ISO and MeID are each referred to herein as a "Party" and jointly as the "Parties."

The Parties have identified several integration issues that must be addressed prior to the date when MeID formally transitions to the ISO balancing authority area (the "Transition Date"). This Memorandum of Understanding ("MOU") represents the understanding of the Parties which, upon approval by the Parties' respective governing bodies, will form the basis of an agreement (the "Transition Agreement") that will be filed for approval with the Federal Energy Regulatory Commission ("FERC") along with any requests for limited waiver of the ISO tariff necessary for the Parties to implement the Transition Agreement.

The purpose of this MOU is to describe the path forward, from now until the Transition Date, in order to: (1) provide certainty for MeID and its customers as well as ISO market participants, (2) address issues with respect to the treatment of MeID and its customers under the ISO tariff, (3) specify the ISO's responsibilities with regard to MeID and its customers, (4) inform existing ISO participating transmission owners and other ISO stakeholders, (5) identify any foreseeable issues associated with moving load from the Turlock Irrigation District ("TID") balancing authority area to the ISO balancing authority area, and (6) recognize associated waivers of the ISO tariff or amendments to the transmission control agreement that may be necessary to support the transition process.

WHEREAS, MeID is a California irrigation district and local publicly owned utility without stock that operates as a distribution company and generator owner, providing retail electric service to customers within the area where it provides service, which is located in the TID balancing authority area in California.

WHEREAS, the ISO is a California nonprofit public benefit corporation that operates transmission facilities under its operational control and wholesale electricity markets pursuant to its tariff on file with FERC.

WHEREAS, MeID submitted a transmission interconnection request to Pacific Gas and Electric Company ("PG&E") for a 230 kV interconnection between MeID's electric system and the PG&E owned facilities at or near the Wilson substation, which are part of the ISO controlled grid, with the intent of becoming an ISO participating transmission owner pursuant to the transmission control agreement and the ISO tariff.

WHEREAS, MeID anticipates the transmission interconnection facilities will be placed in service as early as July 1, 2015 (the "Transition Date"). The Parties have therefore targeted May 1, 2015 for completion of all agreements and regulatory approvals necessary to recognize MeID as an ISO participating transmission owner, utility distribution company, and generator owner within the ISO balancing authority area on the Transition Date.

WHEREAS, MeID expects to schedule and sell energy and ancillary services produced by its Exchequer/McSwain generating units into ISO markets over the ISO controlled grid, even before the Transition Date.

WHEREAS, the ISO and MeID have identified issues that must be addressed prior to the Transition Date. As such, the Parties have reached an understanding with respect to these issues as well as the steps they intend to complete prior to the Transition Date. It is the Parties' expectation that MeID and its customers will be treated as other similarly situated entities pursuant to the ISO tariff and transmission control agreement following the Transition Date, except as may be required to complete the transition process.

NOW, THEREFORE, the Parties Understand and Agree as Follows:

#### 1. Transmission and Generator Interconnection

The interconnection of the MeID transmission and distribution systems to the ISO controlled grid will be accomplished through construction of a new 230 kV transmission interconnection between the MeID 115 kV Lyons substation and the PG&E 230 kV Wilson substation or via a direct 230/115 kV interconnection at Wilson Substation. The transmission interconnection is being processed in accordance with PG&E's transmission owner tariff, with the ISO engaged as an interested party to review study results and consider other matters related to this transmission interconnection request.

It is the intention of MeID to seek FERC approval for rate recovery for all facilities constructed above 200 kV to connect to the Wilson substation pursuant to the ISO high voltage transmission access charge. It is anticipated that PG&E costs directly assigned to MeID for the transmission interconnection at the Wilson substation and charged to MeID pursuant to an interconnection agreement entered into between MeID and PG&E would be included in MeID's transmission revenue requirement and totally recovered through MeID's transmission access charges. Specifically, MeID costs associated with the 230 kV portion of the 115 kV transformation would be included in MeID's transmission revenue requirement, regardless of whether such transformation occurs within the Wilson substation or at some location outside of the Wilson substation (e.g., the Lyons substation), and regardless of whether such facilities and costs are included in the PG&E interconnection agreement. Reliability upgrades on portions of PG&E's system beyond the Wilson substation triggered by the MeID transmission interconnection will either be completed by PG&E and included in PG&E's revenue requirement, or paid for by MeID pursuant to its interconnection agreement with PG&E and included in MeID's TRR. This determination necessarily remains pending the outcome of the PG&E and MeID interconnection agreement negotiations. On the other hand, the development and cost of the interconnection and other MeID system facilities below 200 kV would be managed by MeID and recovered by MeID from its retail customer rate base.

The Exchequer/McSwain generating facility is already interconnected to the ISO controlled grid and no reliability or network upgrades are necessary for it to be fully deliverable, particularly since MeID does not intend to request a new point of interconnection associated with these facilities. MeID will nonetheless replace the expiring PG&E generation interconnection agreement with a CAISO large generator interconnection agreement for Exchequer and a CAISO small generator interconnection agreement, including necessary wholesale distribution tariff service for McSwain to provide for interconnection services. In addition, MeID will enter into a participating generator agreement and meter service agreement to manage the energy and ancillary services supplied by these generators in accordance with the ISO tariff. MeID is eligible to undertake this effort under the current ISO tariff at any time prior to the Transition Date. No advance approvals by the ISO or the FERC are necessary.

#### 2. Transmission Planning

The ISO and MeID each perform planning activities to ensure their respective systems meet applicable reliability standards. It is appropriate that development of the planned transmission interconnection, as well as planning for any additional network upgrades that may be needed to reinforce the transmission grid, be coordinated prior to the Transition Date. The ISO's transmission planning process includes the opportunity to work with transmission providers outside of its balancing authority area to jointly plan transmission development. It is anticipated that the Parties will utilize this process to engage in joint transmission planning activities. Since MeID's system currently is not within the ISO balancing area authority, construction of the facilities necessary to interconnect with the ISO grid, as well as network upgrades completed prior to the Transition Date, will be studied as a transmission interconnection request by the ISO under the applicable participating transmission owner process.

### 3. Participating Transmission Owner Status

The ISO tariff and transmission control agreement (TCA) define the process by which an entity files an application to become a participating transmission owner. The Parties expect that MeID will initiate this process at least six months prior to the Transition Date to allow sufficient time for the ISO process, including negotiation of the transmission control agreement with the ISO to add MeID as a party. The transmission control agreement would thereafter be filed with the FERC for approval. MeID will also file its transmission owner tariff (TO Tariff) and transmission revenue requirement (TRR) with the FERC prior to the Transition Date. FERC conditional approval of these filings will be the minimum regulatory approval required as a condition precedent to the Transition Date as defined in this MOU.

MeID will provide the ISO with detailed information with respect to its system and any interconnection or transmission agreements between MeID and TID, PG&E or other entities that entitle MeID to transmission service on these other entities' systems and that would be turned over to ISO operational control in accordance with the transmission control agreement. In addition, MeID will provide the ISO with information regarding any transmission service agreements or third party ownership rights that encumber MeID's system so the Parties can ensure that any such contracts or ownership rights that existed on MeID's system prior to July 1, 2012 will be appropriately treated after the Transition Date.

MeID will become a participating transmission owner effective as of the Transition Date and turn over to the ISO operational control of all MeID network transmission facilities and entitlements above 200kV. MeID currently serves its load via imports over the TID connection via the August and Tuolumne Lines. Upon MeID's transition to the ISO as a participating transmission owner, these interconnections will be operated in the normally open position.

MeID will register as a transmission operator (TOP) with the National Electric Reliability Corporation ("NERC"). The ISO and MeID will also enter into a coordinated functional registration (CFR) agreement to allocate compliance responsibility for NERC and WECC reliability standards compliance for the TOP function. MeID may subcontract its functional responsibilities pursuant to this delegation agreement and to the extent permitted by the reliability standards.

### 4. Utility Distribution Company Operations Status

MeID will enter into a utility distribution company (UDC) operating agreement with the ISO to address operational issues associated with reliably serving MeID's load in the ISO balancing authority area.

## 5. Scheduling Coordinator Status

MeID will become or retain the services of a certified scheduling coordinator to interface with the ISO for scheduling, settlement and billing functions. If MeID wishes to itself become a certified scheduling coordinator, application will be made to the ISO at least six months prior to the Transition Date.

## 6. Resource Adequacy Requirements

MeID will need to meet the resource adequacy (RA) requirements of the ISO tariff applicable to load serving entities as of the Transition Date. Pursuant to the ISO tariff, the ISO will recognize MeID as a non-CPUC jurisdictional entity and its own "local regulatory authority."

MeID can establish its own system RA requirements based on its share of ISO system peak load. MeID will provide sufficient historical load data to enable the ISO to perform a coincident peak historic load analysis for purposes of determining the MeID share of ISO system peak load. In addition, the Parties will work together to develop a mutually acceptable method for forecasting MeID's load as needed for both the RA process and, as discussed below, the allocation of congestion revenue rights, which will be described in the Transition Agreement.

MeID may or may not have local RA requirements, which ISO engineers will assess not later than six months prior to the Transition Date. MeID may be able to estimate what its local RA requirement would be after transitioning to the ISO system, by doing its own local congestion study that follows a process to be specified by the ISO prior to the Transition Date.

MeID, through its scheduling coordinator, will need to participate in the year-ahead and month-ahead demonstrations to demonstrate that it has met its RA requirements, and the entities that supply resource adequacy capacity to MeID will need to file supply plans with the ISO. MeID anticipates that most RA requirements will be met by commitments of Exchequer/McSwain generating units.

## 7. Congestion Revenue Rights

MeID, as a load serving entity in the ISO balancing authority area, will be eligible for an allocation of congestion revenue rights (CRR) at a quantity based on its load metric, which is calculated based on historical load data for the ISO's annual congestion revenue rights allocation process and is based on forecast data for each monthly congestion revenue rights process. The following matters need to be addressed with respect to the congestion revenue rights allocation process:

- Tier 1 of the ISO's annual congestion revenue rights allocation process (the priority nomination process) is restricted to load serving entities who want to nominate renewal of congestion revenue rights they were allocated the previous year. Because MeID will not have been allocated congestion revenue rights for periods prior to the Transition Date, it would be ineligible under the ISO tariff to participate in the priority nomination process for its first full year as an ISO load serving entity, which may adversely affect its ability to acquire sufficient congestion revenue rights to hedge the congestion cost of serving its load. In light of this, during its first year as an ISO load serving entity, the ISO will permit participation by MeID in Tier 1 nominations as if MeID held a portfolio of congestion revenue rights developed

by the Parties to reflect MeID's historic use of the grid to serve its load and consistent with the quantity of congestion revenue rights that MeID would be eligible for based on the historical analysis of MeID's load.

- To construct such a congestion revenue rights portfolio, the Parties will establish the eligible sources, sinks and MW quantities as follows. The sink will be the MeID custom load aggregation point. Eligible sources will be determined based upon MeID's expected pattern of acquiring energy to serve its load and planned use of the Exchequer/McSwain generating units, any relevant energy contracts, similar to how the ISO developed the initial allocation of congestion revenue rights for the start of its locational marginal priced markets with the understanding that MeID's historic pattern of acquiring energy to serve its load does not make sense since the intertie with TID will be operated normally open.

Assuming MeID becomes a participating transmission owner and load serving entity in the ISO balancing authority area by July 1, 2015, MeID would participate in the ISO's annual congestion revenue rights allocation process for the 2015 calendar year, which is conducted over the summer of 2014, and would receive annual congestion revenue rights for 2015. Should the Transition Date be delayed past June 30, 2015, any rights allocated to MeID otherwise applicable prior to the occurrence of the Transition Date will be deemed not effective.

The ISO will modify its congestion revenue rights network model to reflect the planned incorporation of MeID's facilities, effective as of the Transition Date, for purposes of the 2015 annual congestion revenue rights allocation process. This will result in the allocation of congestion revenue rights to MeID that will be contingent on the Transition Date, which is other than the date when 2015 congestion revenue rights normally become effective. This could also result in the allocation or auction to other ISO participants of 2015 congestion revenue rights that are feasible as a result of including MeID's facilities and import rights in the network model. The ISO will inform market participants of this contingency and will include relevant network information within the congestion revenue rights network model. In the event that the transition doesn't occur on July 1, 2015, the ISO will develop a transparent and equitable method for pro rata reductions to congestion revenue rights that utilize MeID's facilities, and appropriate adjustments to congestion revenue rights auction settlements, for the period from July 1, 2015 until the transition occurs, which will be addressed in the Transition Agreement.

## 8. Network Model Updates and Market Simulation

The ISO operates the transmission system and wholesale electricity markets utilizing a full network model. The network model is updated approximately every other month, and there is approximately a two-month lead time for updating the network model. In addition to including MeID's facilities in the ISO's full network model, the ISO may find it prudent to add or modify its intertie points.

The Parties will cooperate to incorporate MeID's facilities into the full network model in advance of the Transition Date such that the revised model can be used in market simulation and be proven accurate and reliable prior to the Transition Date. Parties will make best efforts to initiate this process such that an applicable revised full network model will also be available to the ISO for the generator interconnection process and the transmission planning process. The Parties will also exchange any additional network

information needed to coordinate with TID to facilitate any necessary balancing authority boundary changes to be incorporated into amendments to the ISO's contractual arrangements with these entities.

The ISO generally conducts a market simulation exercise when new facilities are added to its system to assure all market participants have the opportunity to test the impacts of the change on their systems, practices and procedures. This will be scheduled approximately two months prior to the Transition Date. In addition, the ISO may need to update operating procedures and other materials to account for the additional facilities and interties. The ISO and MeID will work together to establish a timetable for these activities that supports the intended Transition Date.

In addition to the needs for the ISO spot markets and pre-Transition Date market simulation, MeID will provide to the ISO the transmission, generation and load data required for its congestion revenue right system data bases, approximately six months prior to the beginning of the annual congestion revenue rights allocation process for the 2015 calendar year.

## 9. Agreement

The Parties agree to negotiate in good faith a definitive Transition Agreement, suitable for filing with FERC, consistent with the timelines outlined in this MOU. Unless otherwise agreed by the Parties, if the Parties have not completed a mutually agreeable definitive Transition Agreement by September 30, 2013, either party may terminate this MOU with 30-days written notice. In addition, the Parties may develop a detailed implementation plan consistent with the Transition Agreement to address details and accommodate changing circumstances.

## 10. Proposed Transition Timeline

The Parties will seek authorization from their respective governing bodies no later than March 31, 2013 to enter into the Transition Agreement, subject to completion of a definitive agreement with terms acceptable to both Parties, which will be filed with FERC no later than September 30, 2013. The effective date of the Transition Agreement will be January 1, 2014 to facilitate transition activities. However, MeID will not become a participating transmission owner and be treated as a load serving entity in the ISO balancing authority area until the Transition Date, currently estimated to be July 1, 2015. The Parties have assumed January 1, 2014 to be the effective date of the Transition Agreement for purposes of some of the transition-related activities discussed in this MOU. If the transition is delayed so as to affect any such activities in ways that were not anticipated in this MOU, the Parties will cooperate to revise the time lines of those activities as needed.

## 11. Costs

Each party shall be individually responsible for all of its own costs, expenses, or financial obligations that may be incurred as a result of this MOU.

## 12. Third Parties

The Parties intend to engage in discussions with third parties essential to the transition process, including in particular PG&E and TID. In addition, the Parties will enter into binding

agreements with such third parties as may be necessary to implement the terms and conditions of the Transition Agreement. These agreements will address interconnected operations and other matters as necessary and appropriate.

### 13. Necessary Approvals

The Parties will seek to obtain all necessary regulatory and other approvals with respect to implementation of this MOU. For the ISO, this will include approval by the ISO board of governors and authorization by FERC. For MeID, the approval process will include approval by MeID's Board of Directors. Further approvals will be sought as necessary to support the transition process, including any state or federal regulatory approvals necessary to exit the TID balancing authority area or to comply with applicable reliability standards.

### 14. General

This MOU is a non-binding statement of intent and only creates an obligation for both Parties to negotiate in good faith to complete the Transition Agreement as outlined above. The decision to execute the Transition Agreement shall be within the sole discretion of each Party, and no party shall have any liability for failure to execute the Transition Agreement. In addition, the Transition Agreement shall not become effective until all necessary approvals have been obtained, which itself may require further approvals to implement its terms including conditions necessary for the Transition Date (e.g., acceptance of MeID as a new participating transmission owner).

IN WITNESS WHEREOF, the Parties have caused this memorandum of understanding to be executed by their respective authorized representatives.

#### California Independent System Operator Corporation

By: 

Name: Steve Berberich

Title: President and Chief Executive Officer

Date: 2/14/13

#### Merced Irrigation District

By: 

Name: John Sweigard

Title: General Manager

Date: 2/11/13