

Memorandum

To: ISO Board of Governors

From: Nancy Saracino, Vice President, General Counsel & Chief Administrative Officer

Date: March 15, 2012

Re: Regulatory Update

This memorandum does not require Board action.

Regulatory Highlights

- **Local market power mitigation and dynamic competitive path assessment (ER12-423)**

On November 16, 2011, the ISO filed a tariff amendment to comply with FERC's directive to use demand bids, rather than forecast demand, to determine which bids to mitigate for local market power within three years of implementation of the ISO's nodal market. In addition, the tariff amendment included two improvements approved by the Board at its July 14, 2011 meeting. Specifically, the ISO proposed to implement:

(1) a more accurate and efficient method to determine mitigation through the use of a single pre-market run to determine which bids to mitigate (compared with the current process that uses two pre-market runs); and (2) a dynamic competitive path assessment that will also improve the accuracy of mitigation. The ISO is proposing to implement the new mitigation method in both the day-ahead and hour-ahead mitigation runs in April 2012. The dynamic competitive path assessment will be implemented only in the day-ahead market as of April 2012. The current static competitive path assessment will continue to be used in the hour-ahead mitigation run until a future tariff amendment is implemented that will introduce real-time bid mitigation every 15 minutes and implement the dynamic competitive path assessment in the hour-ahead and the 15 minute real-time market processes. This second phase is targeted for implementation as part of the fall 2012 release. By order dated March 1, 2012, FERC accepted the ISO's tariff amendment in its entirety. FERC also directed the ISO's Market Surveillance Committee to evaluate the use of the three pivotal-supplier test and to consider whether an alternative screening approach might be warranted under the new mitigation approach and to file a report by May 1, 2013. FERC had previously directed the Market Surveillance Committee to undertake a similar evaluation with respect to the market power mitigation mechanism currently in place, which concluded that the three pivotal-supplier test was appropriate.

Responsible attorney: Sidney Davies

- **ISO complaint to amend the transmission control agreement (EL11-40)**

On February 29, 2012, the ISO filed a complaint with FERC to amend the transmission control agreement. The transmission control agreement is an agreement among the ISO and all participating transmission owners. At its December 2011 meeting, the Board approved the addition of Citizens Sunrise Transmission as a new participating transmission owner with respect to its interest in the Sunrise Powerlink transmission expansion project. For several months prior to this approval, the ISO had been in negotiations with the existing participating transmission owners to amend the transmission control agreement in several respects in addition to the addition of Citizens Sunrise Transmission. The parties ultimately reached an impasse with respect to the ISO's proposal to revise the standard for a determination of liability or indemnity from an ordinary negligence standard to a gross negligence standard as had been previously approved by FERC with respect to the standard set forth in the tariff. Without these proposed revisions, the ISO could be faced with significant uncertainty and potentially conflicting standards in circumstances regarding its liability and its entitlement to indemnity where the provisions of either the tariff or the transmission control agreement could be applicable. The ISO and the other parties to the transmission control agreement agreed upon all revisions with the exception of the liability standard, with most participating transmission owners agreeing to the change in liability standard. Accordingly, the ISO filed a complaint to seek FERC acceptance of the proposed changes and adjudication of the legal standard.

Responsible attorney: John Anders

Federal Energy Regulatory Commission and related Court of Appeals matters

Tariff amendments and orders

- **Penalty allocation procedures (ER12-760)**

On January 4, 2012, the ISO filed a tariff amendment to establish the procedures for the ISO to follow when seeking FERC approval to allocate to one or more market participants the cost of any penalty imposed on the ISO. The amendment proposed to establish a direct allocation process for cases where the ISO seeks approval to allocate the cost of a reliability standards penalty to a particular market participant or participants found responsible for the underlying violation, as well as an indirect allocation process for cases where the ISO seeks approval to allocate to market participants in general the cost of a reliability standards penalty that is not attributable to a particular market participant or the cost of any other penalty imposed by FERC or another regulatory body. No protests were filed in response to the ISO's filing. One market participant filed a set of comments proposing to revise the title of the proposed tariff subsection in a manner that would limit application of the indirect allocation procedure to reliability standards penalties. The ISO filed an answer to this comment on January 27, 2012, arguing that the change should not

be adopted. On March 2, 2012, FERC issued an order accepting in part and rejecting in part the ISO's proposed amendment. FERC approved both the direct and indirect allocation procedures for reliability standards penalties, but ruled that the amendment procedures for seeking FERC approval of an indirect allocation should be limited to reliability-related penalties. The approved provisions were made effective March 5, 2012. FERC also directed the ISO to file a compliance filing within 30 days to update the procedure for seeking FERC approval of an indirect allocation so that the procedure is limited to reliability-related penalties.

Responsible attorney: Burton Gross

- **Reliability demand response resource tariff amendment (ER11-3616)**

On February 16, 2012, FERC issued an order rejecting the ISO's proposed tariff amendment to allow reliability demand response resources to participate in the ISO markets. Reliability demand response resources include retail emergency-triggered demand response programs, interruptible, air conditioning, and pumping load programs. The ISO filed the reliability demand response resource proposal on May 20, 2011 to implement a settlement agreement among the ISO, state investor-owned utilities, and other interested parties. This settlement agreement was reached after several years of discussions among interested stakeholders and was approved by the CPUC. In the meantime, on March 15, 2011, FERC issued a final rule (Order 745) attempting to establish a standardized approach for compensation and cost allocation for certain demand resources in ISO and RTO markets. The ISO's approach to reliability demand response resource participation included application of the same default load adjustment mechanism that the FERC had previously approved with respect to proxy demand resources as compliant with FERC Order 719. FERC subsequently found that the default load adjustment mechanism was not consistent with its more recent Order 745. For this same reason, FERC rejected the ISO's proposal with respect to reliability demand response resources without prejudice (i.e., the ISO can resubmit the proposal without application of the default load adjustment mechanism). Separately, the ISO has sought rehearing of FERC's order regarding the ISO's filing in response to Order 745 on January 17, 2012. In addition, the ISO filed a petition with the Court of Appeals for the District of Columbia Circuit on December 27, 2011 of FERC's Order 745 and Order 745-A. At this time the ISO has not determined whether to resubmit a modified version of the reliability demand response resource proposal

Responsible attorneys: John Anders and Sidney Davies

- **Capacity procurement mechanism (ER11-2256)**

On December 23, 2011, the ISO filed an offer of settlement that resolves all of the outstanding issues related to the tariff amendment and FERC order that address implementation of the capacity procurement mechanism and retention of market mitigation measures applicable to exceptional dispatches. The fixed rate for the capacity

procurement mechanism will increase from \$55.00/ kW-year to \$67.50/kW-year for two years and to \$70.88/kW-year for an additional two years, and the settlement provisions will be in effect for four years. The offer of settlement was unopposed, and no protests or comments have been filed. By order dated February 16, 2012, FERC approved the settlement in its entirety.

Responsible attorney: Beth Ann Burns

- **Interconnection requirements for asynchronous generating facilities (ER10-1706 and D.C. Circuit case no. 12-1027)**

The ISO filed a tariff amendment on July 2, 2010 to revise interconnection requirements applicable to large asynchronous generating facilities seeking to interconnect to the ISO grid. Among other requirements, the tariff amendment required wind and solar photovoltaic interconnection customers to provide reactive power capability and maintain automatic voltage regulation controls. The proposed amendment also required these resources to have the capability to curtail their output in increments of five MWs or less. On August 31, 2010, FERC issued an order accepting in part and rejecting in part the ISO's filing. The ISO's proposed reactive power, voltage control and power management requirements were among the requirements FERC rejected. The ISO filed a request for rehearing of FERC's order. On November 17, 2011, FERC denied the ISO's request for rehearing but directed FERC staff to hold a technical conference to examine whether to reconsider or modify the reactive power provisions set forth in FERC Order No. 661-A that apply to wind resources. Currently, these provisions only allow a system operator to require a wind resource to provide reactive support based on a need demonstrated by an interconnection system impact study. FERC has scheduled a technical conference on April 17, 2012. On January 13, 2012, the ISO filed a petition for review of FERC's orders with the United States Court of Appeals for the District of Columbia Circuit (Case No. 12-1027). The Court will hold the ISO's petition in abeyance until after the April 17 technical conference.

Responsible attorneys: Andrew Ulmer and Dan Shonkwiler

Report filings

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

A market disruption is an action or event that causes a failure of an ISO market, related to system operation issues or system emergencies. The ISO reports these market disruptions to FERC on a monthly basis. On February 15, 2012, the ISO submitted its monthly report of market disruptions that occurred from December 16, 2011 through January 15, 2012. Section 7.7.15 of the tariff authorizes the ISO to take one or more of a number of specified actions in the event of a market disruption, to prevent a market disruption, or to minimize the extent of a market disruption.

Responsible attorney: Anna McKenna

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

The ISO submits two types of monthly exceptional dispatch reports to FERC. On February 15, 2012, the ISO submitted transactional data including incremental and decremental MW volume, duration and location for exceptional dispatches occurring during the month of December, 2011. On February 29, 2012, the ISO submitted MW hour data and cost data for exceptional dispatches occurring during the month of November, 2011. An exceptional dispatch is a dispatch or a commitment issued by the ISO to a resource outside of the operation of the ISO market to address operational needs that cannot be address by the ISO market.

Responsible attorney: Sidney Davies

Other FERC matters

- **Pacific Gas and Electric Company waiver request (ER12-1009)**

On February 6, 2012, PG&E filed with FERC a request for a one-time waiver of a previously applicable penalty provision in the tariff that would otherwise result in the ISO assessing a \$5.77 million penalty on PG&E. PG&E requested that FERC instead require the ISO to assess a \$845,000 penalty, which is what the penalty would be based on the provision that currently exists in the tariff, rather than on the provision as it existed at the time of the conduct giving rise to the penalty occurred. The penalty arises from errors in reported meter data. On August 1, 2011, the ISO filed a tariff amendment with FERC to change the penalty provision at issue because the old provision was “overly burdensome” and a less punitive sanction would still establish appropriate incentives for market participants to timely report meter data. In its comments filed on February 22, 2012, the ISO acknowledges the reasons for the change in the tariff provision and agreed that in PG&E’s specific circumstances there was a reasonable basis for FERC to conclude that a penalty amount less than \$5.77 million would be justified.

Responsible attorney: David Zlotlow

California Public Utilities Commission matters

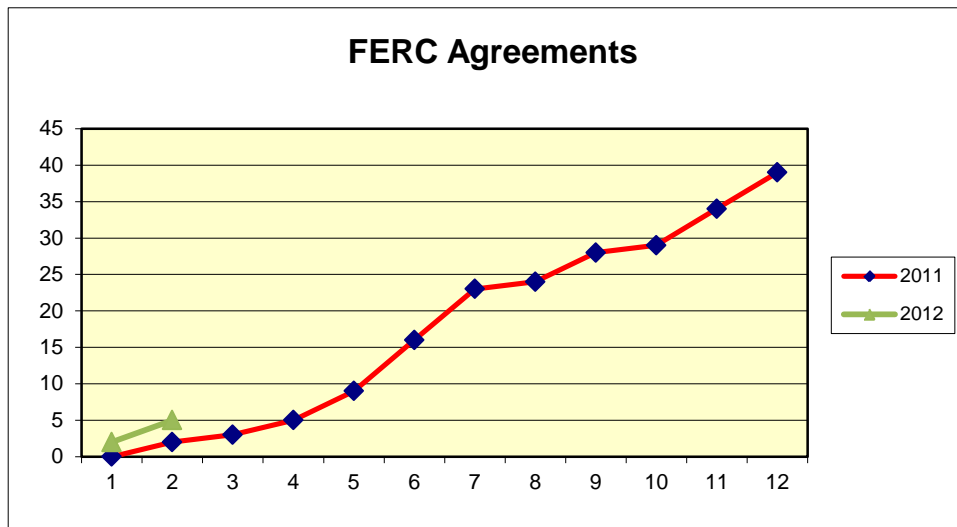
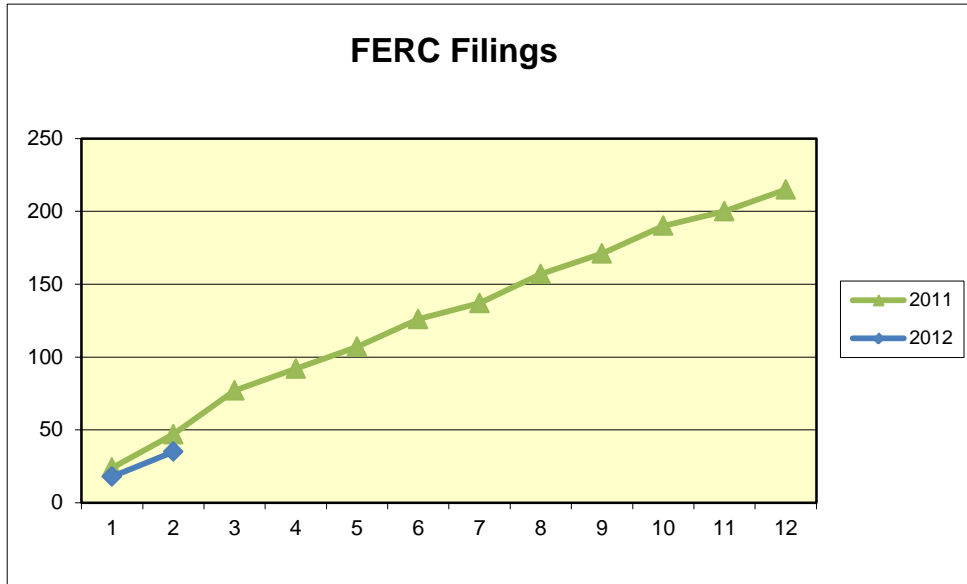
- **Rulemaking on procurement policies and plans (R.10-05-006)**

The ISO has been an active participant in track 1 of the CPUC’s long term procurement proceeding that addresses the need for additional non-renewable resources over a ten year horizon. In particular, the ISO is in the process of conducting operational studies to determine the level of resources needed to integrate the large number of renewable resources that will be interconnected to the grid by 2020 for the purposes of meeting the state’s ambitious 33% renewable portfolio standard requirements. In August, 2011, the ISO entered into a settlement agreement with most of the other parties that, among other things, addressed the status of the ISO’s renewable integration studies to date and recommended that these studies continue into calendar year 2012 so that the ISO could consider the results of its once-through cooling studies and present additional study results

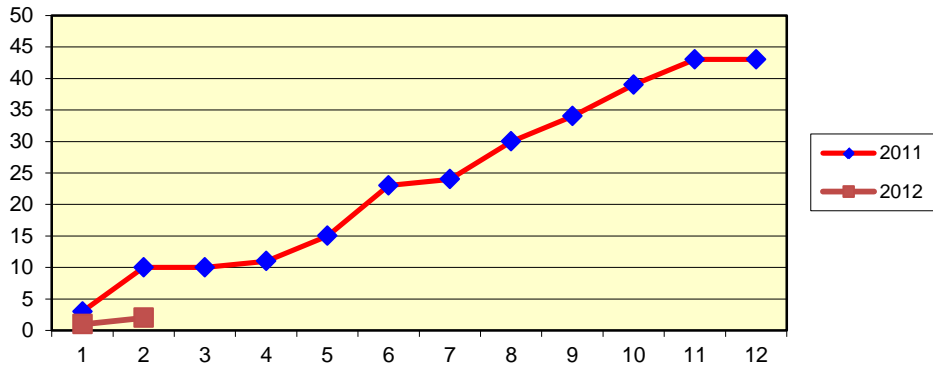
through an evidentiary process. The parties urged the CPUC to issue a determination regarding the ISO's continued studies by December 31, 2012. On February 21, 2012, the presiding administrative law judge issued a proposed decision that approved the settlement agreement but took no further action regarding a procedural schedule for the ISO's continued studies. The ISO will file comments on the proposed decision suggesting a schedule and modified language that more accurately represents the settlement agreement and the results of the ISO's studies. The ISO will stress the urgency of a timely decision, no later than year end 2012, to address the local area capacity needs anticipated to occur as early as 2018.

Responsible attorney: Judi Sanders

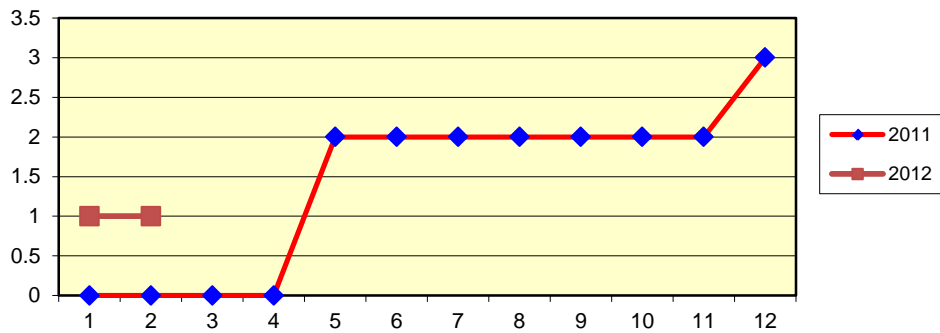
Regulatory Filings Through February 2012



CPUC/Other Commission Filings



Court Filings



Total Filings

