

Memorandum

To: CAISO Board of Governors
From: Nancy Saracino, VP, General Counsel and Corporate Secretary
Date: August 29, 2008
Re: **Regulatory Update**

This memorandum does not require Board action.

Federal Energy Regulatory Commission (FERC) matters and related decisions of the court of appeals

Market redesign and technology upgrade (MRTU)

- **Market power mitigation measures for exceptional dispatches (ER08-1178)**

On June 27, 2008, the California Independent System Operator Corporation (CAISO) filed tariff amendments to mitigate bids of resources when manually dispatched outside of the MRTU software in circumstances where the resource could exercise market power. CAISO also proposed two mechanisms to compensate resources that do not have capacity contracts in the event of bid mitigation. During the first four months of MRTU, for each 30-day period, the resources will receive the higher of its default energy bid plus \$24.00 or the locational marginal price (LMP) at the resource's location, until the defined supplemental revenue cap is reached. Once the cap is reached, the resource would be eligible to receive the higher of its default energy bid or the LMP for the balance of the 30-day period. Beginning the fifth month of MRTU, for each 30-day period beginning on the first day of the fifth month, the resource will receive the higher of its bid, LMP or default energy bid, until the supplemental revenue cap is reached. Once the cap is reached, the resource would be eligible to receive the higher of its default energy bid or the LMP for the balance of the 30-day period. CAISO filed its answer to comments and protests on August 5, 2008.

Responsible attorney: Sidney Davies

- **Caps for start-up and minimum load costs (ER08-73)**

In its June 20 order, FERC accepted the CAISO proposal to limit market-based start-up and minimum load costs to 200% of actual costs for resources in local capacity areas, and to 400% of actual costs for resources not located in local capacity areas. FERC directed that the methodology for calculating the caps be modified in a compliance filing to be made within 30 days. On July 21, CAISO filed its

compliance filing and also filed a request for clarification and, in the alternative, rehearing regarding one aspect of the June 20 order. Specifically, the June 20 order directed CAISO to use a western regional forward natural gas price for calculating the caps, rather than the Henry Hub price proposed by CAISO. The CAISO request for clarification pointed out that there was no western regional transparent forward gas price and that the Henry Hub price, though priced in Louisiana, would allow generators to recover their costs. No party protested this aspect of the CAISO original proposal and no party filed in opposition to the CAISO rehearing request.

Responsible attorney: Sidney Davies

- **Order on underscheduling compliance filing (ER06-615)**

On July 17, 2008, FERC issued an order conditionally accepting the CAISO September 28, 2007 compliance filing. This filing responded to a FERC directive to include interim measures that mitigate potential economic incentives of load serving entities (LSEs) to underschedule (schedule less than a specified percentage of their demand), in the day-ahead market. These interim measures will be effective as of MRTU implementation, and will remain effective until CAISO implements convergence bidding no later than 12 months following MRTU start-up.

The CAISO proposal consists of the following features:

1. A bright line test to define persistent underscheduling;
2. An interim scheduling charge for LSEs that persistently underschedule; and
3. Confidential weekly reports to disclose scheduling performances.

The proposal originally included a “free pass” that would allow LSEs to underschedule more than 15 percent of demand for five percent of the trading hours each month without penalty. FERC accepted the proposal as filed except for the five percent free pass and directed CAISO to eliminate this provision in a compliance filing. CAISO submitted its compliance filing in on August 18.

Responsible attorney: Anna McKenna

- **Filings in response to FERC’s June 21 MRTU order (ER06-615)**

On July 21, CAISO submitted two filings in response to FERC’s June 20 order conditionally accepting CAISO’s August 3, 2007 filing. In this order, FERC generally accepted all the remaining tariff language filed on compliance, subject to some further minor compliance obligations, including tariff clarifications CAISO agreed to make on further compliance. In one filing, CAISO submitted a further compliance filing as directed. The second filing requested clarification or, in the alternative, rehearing, concerning a FERC directive regarding allocation of bid cost recovery payments to metered subsystems.

Responsible attorney: Anna McKenna

- **Congestion revenue rights amendments for 2008 (ER08-1059 *et al*)**

On July 29, FERC accepted CAISO's May 30 tariff amendment filing that proposed modifications to year two congestion revenue rights, processes and enhancements to the credit policies for congestion revenue rights, subject to minor modifications agreed to by CAISO in its answer to comments filed by parties to the proceeding. The congestion revenue rights "year two" changes include lowering the minimum denomination of such a right from 0.1 MW to 0.001 MW; alternative load forecasting option; and details concerning the 30-day outage reporting obligation for outages that affect congestion revenue rights. Enhancements to the credit policy include credit requirements to mitigate the risk posed by load serving entities that lose load to other load serving entities; an additional method to calculate the value of congestion revenue rights using historical data; clear tariff authority to require additional financial security in the event unanticipated market conditions that are not reflected in the congestion revenue rights auction prices or historical values increase the risk of a these rights; and enhanced affiliate disclosure requirements. CAISO filed its compliance filing reflecting the agreed-upon and FERC-directed modifications on August 28, 2008.

Responsible attorneys: Anna McKenna and Sidney Davies

- **Orders relating to congestion revenue rights amendments filed in 2007 (ER07-869 *et al*)**

On July 28, 2008, FERC issued an order denying requests for rehearing and clarification of FERC's July 6, 2007 order that conditionally accepted proposed tariff revisions concerning short-term congestion revenue rights and the implementation of long-term congestion revenue rights. On the same day, FERC issued an order accepting tariff provisions relating to both short-term and long-term congestion revenue rights, filed in compliance with FERC's final rule regarding long term congestion revenue rights. CAISO submitted its compliance filing on August 26, 2008.

Responsible attorney: Anna McKenna

- **Quarterly seams report for the second quarter of 2008**

On July 3, 2008, CAISO filed a joint quarterly report with the Western Area Power Administration and Turlock Irrigation District and a joint quarterly report with the Imperial Irrigation District. The report includes a summary of the joint discussions and also a summary of seams-related activities facilitated by the Western Electricity Coordinating Council for the second quarter of 2008.

Responsible Attorney: Anna McKenna

Petition for waiver of timing provisions of the large generator interconnection procedures (ER08-960)

On May 15, 2008, CAISO filed with FERC a petition for a one-time waiver of limited provisions of the existing CAISO tariff governing generator interconnection. The waiver petition requests temporary suspensions of interconnection study obligations and timelines with respect to specific pending and future interconnection requests to facilitate future implementation of the generator interconnection reform process (GIPR). The waiver petition proposes to divide pending interconnection requests into three groups – a "serial study group," which will continue to be processed first under the existing procedures and financial rules; "transition cluster" group, which will be subject to the temporary suspension and then studied

generally pursuant to the new GIPR requirements to be filed in a future tariff amendment; and the initial GIPR cluster to be processed entirely under the new GIPR provisions.

The CAISO's approach allows late stage projects, projects with power purchase agreements and projects utilizing new interconnection capacity, to be processed more rapidly under the existing rules to clear the back log of interconnection requests and sets the stage for the GIPR reforms, which will streamline the interconnection process for those IRs in the transition cluster and any future GIPR clusters. On July 14, 2008, FERC issued an order granting CAISO's waiver request. Two entities filed requests for rehearing or clarification asking that the GIPR criteria be modified. CAISO filed answers opposing any modification to the criteria.

Responsible attorneys: Sidney Davies and Mike Dozier

Generator interconnection process reform filing (ER08-1317)

On July 28, 2008, CAISO filed revisions to both the currently-effective CAISO tariff and the MRTU tariff to implement its GIPR proposal. The GIPR filing proposes revisions to CAISO's generator interconnection process, as embodied in its large generator interconnection procedures, large generator interconnection agreement, and related tariff provisions and *pro forma* agreements. CAISO has proposed the GIPR filing to achieve the following objectives:

- Clear the existing backlog of generator interconnection requests;
- Develop procedures and requirements that acceptably balance generation developer flexibility with increased generation developer commitments to promote a greater correlation between system needs and the level of requests for interconnection;
- Provide interconnection customers with significant network upgrade cost certainty;
- Provide interconnection customers with greater certainty in the timing of interconnection study outcomes;
- Reduce or eliminate the need for restudies;
- Better integrate CAISO's transmission planning process with the generation interconnection process; and
- Allow for the integration of state efforts to identify transmission needs for energy resource areas.

Responsible attorneys: Sidney Davies and Mike Dozier

Green borders unexecuted large generator interconnection agreement (ER07-1034)

Last year, CAISO and SCE filed an unexecuted large generator interconnection agreement with Green Borders Geothermal, LLC specifying the terms for the interconnection of Green Borders' proposed new 62 MW generating facility to the CAISO controlled grid. The only issue in dispute was related to the Southern California Edison (SCE) estimate of the costs of the transmission network upgrades associated with the interconnection at \$237,442,000. As a result of lengthy settlement negotiations, SCE agreed to restudy Green Borders' interconnection request using congestion management as an alternative to most of the network upgrades originally identified by SCE and CAISO's approval of related special protection systems modifications.

As a result of this restudy, Green Borders, SCE, and CAISO agreed on an alternative set of required facilities and their associated costs, and on July 31, 2008, SCE filed an offer of partial settlement that proposes an alternative set of network upgrades with an estimated cost of \$16,674,000 in conjunction with an increase in the estimated cost of the interconnection facilities for the project.

The partial settlement leaves one issue still remaining in dispute – whether telecommunication facilities located on the Green Borders side of the interconnection, deemed necessary to implement the special protection system and remedial actions schemes, should be considered network upgrades, interconnection customer's interconnection facilities, or participating transmission owner's interconnection facilities. On August 20, CAISO filed comments in support of the offer of partial settlement, taking the position that the telecommunications facilities remaining at issue should be classified as interconnection customer's interconnection facilities.

Responsible attorney: Mike Dozier

Geysers qualifying facility interconnection agreement dispute (ER08-1193)

On June 30, 2008, Pacific Gas & Electric Company (PG&E) filed revisions to its pre-existing generator interconnection agreement with Calpine, to add four Geysers qualifying facilities after expiration of their Public Utility Regulatory Policies Act power purchase agreements. On July 22, 2008, CAISO filed a protest, arguing that the Geysers units are required to comply with the CAISO tariff requirement to enter into a large generator interconnection agreement. At the same time, CAISO filed four unexecuted large generator interconnection agreements. On August 21, 2008, CAISO filed an answer to comments filed by PG&E in response to CAISO's protest.

Responsible attorneys: Sidney Davies and Mike Dozier

Tariff amendment changing outage reporting for generators (ER08-1053)

At its May meeting, the Board approved a tariff amendment that revises outage reporting requirements for generators. The amendment was filed with FERC on May 29, with a requested effective date of June 1. PG&E and SCE strongly supported the amendment as filed and no party opposed it. On July 23, 2008, FERC accepted the tariff amendment as filed, effective on June 1, as requested.

Responsible attorney: Dan Shonkwiler

Resource-specific system resource filing (ER08-1364)

On August 6, 2008, CAISO filed revisions to the MRTU Tariff to accommodate resource-specific system resources, including a new *pro forma* agreement to be executed by the owners of such resources.

Responsible attorney: Mike Dozier

Transmission control agreement amendment complaint filing (EL08-52)

On April 1, 2008, CAISO requested that FERC issue an order accepting CAISO's proposed revisions to the transmission control agreement to add Startrans as a new participating transmission owner for its Mead

transmission rights obtained from Vernon and to remove the listing of those transmission rights from the transmission control agreement as belonging to Vernon. On July 2, FERC issued an order accepting CAISO's proposed revisions effective as of April 23, 2008, the effective date of the transfer of the subject transmission rights. In the order, FERC accepted CAISO's positions in response to various concerns expressed by intervenors regarding the incorporation of Startrans as a new participating transmission owner. However, the order required CAISO to submit a compliance filing of a revised approach to CAISO's *TAC Rate* spreadsheet to provide additional information in response to intervenor comments. CAISO submitted this compliance filing on August 1.

Responsible attorney: Mike Dozier

MMC Energy Inc. v. CAISO (EL08-46-000)

MMC Energy filed a complaint on March 13, 2008 alleging that CAISO unlawfully prohibited its generating units from participating in the spinning reserve ancillary services market. It also alleged that during 2006 and 2007 it was wrongfully subjected to "no-pay" adjustments for both spinning and non-spinning reserves services in the total amount of \$552,000. CAISO denied the allegations. On June 6, 2008, FERC issued its order on the complaint ruling in CAISO's favor on the key issue of whether MMC has been providing spinning reserves when such reserve consists of small internal combusting generator synchronized to the grid aggregated with a combustion turbine unit that is not running. FERC determined that this configuration did not provide spinning reserve as defined by the CAISO tariff. FERC also found that there are issues of fact to be decided related to whether CAISO was obligated to pay MMC prior to a September, 2006 market notice in which CAISO "clarified and applied the requirements for providing spinning reserve services". FERC set the remainder of the no-pay issues for hearing, but held the order in abeyance pending a settlement process. Both CAISO and MMC filed requests for rehearing.

The CAISO request for rehearing contends that FERC in awarding MMC \$240,000 of 2006 no-pay charges conflated two distinct issues in the case: (1) CAISO's misapplication of its tariff to allow MMC to have only internal combustion engine on-line for spinning reserve and (2) its assessment of "no-pay" charges for reasons unrelated to this operational configuration, e.g. undispachable energy, undelivered energy, unavailable capacity, and/or unconnected capacity during the period of an award. CAISO pointed out that, aside for the no-pay charges, it paid MMC for its spinning reserve product in 2006. MMC's request for rehearing challenges virtually every issue on which FERC ruled against MMC. In addition, MMC argues that FERC failed to address the right of MMC to seek damages against CAISO for its alleged misrepresentation. MMC also asked FERC to clarify its order regarding MMC's entitlement to compensation for the services it provided as "spinning reserve" even if they were not true spinning reserve as defined under the tariff.

Responsible attorney: Paul Dobson

Accounting for post-employee benefits (AC08-54)

On June 30, 2008, CAISO sought rehearing of a FERC order about how to account for post-employment benefits other than pensions. FERC's policy has been to allow utilities to recover the costs of these benefits as a component of cost-based rates provided the costs are determined on an accrual basis consistent with financial accounting standards. CAISO, however, prepares its financial statements in conformance with government accounting standards, rather than financial accounting standards, and

thus requested a waiver to apply the analogous government accounting standards. The Commission's Chief Financial Accountant denied this waiver in an order issued May 30. The request for rehearing argues that the May 30 denied CAISO's request erroneously for three reasons. First, it erred in finding the government accounting standards to be inconsistent with FERC's policy statement, which expressly recognizes that other accounting standards could be used in appropriate circumstances. Second, it erred in finding that use of government accounting standards would result in an increase in CAISO's grid management charge. Third, it erred in finding that use of government accounting standards would significantly complicate the review or comparability of financial information with other independent system operators and regional transmission organizations.

Responsible attorney: Dan Shonkwiler

Appeal re: large generator interconnection process (D.C. Cir. 05-1401)

On July 22, 2008, the United States Court of Appeals for the District of Columbia Circuit rejected an appeal that challenged certain aspects of the large generator interconnection process, particularly FERC's directive that interconnection studies be centralized by the transmission provider, which in our case is CAISO. PG&E, which petitioned for review of FERC's orders, argued that the orders did not make the findings necessary to terminate the investor owned utilities' role in these studies, *i.e.* a finding that the old process was unjust or unreasonable. The court did not reach the merits of PG&E's arguments, though, because it found that PG&E failed to appeal the correct orders. The court held that this appeal was too late, and amounted to an improper collateral attack on the orders that established the centralized study process.

Responsible attorney: Dan Shonkwiler

CPUC matters

Rulemaking re: policies and protocols for demand response (R07-01-041)

The California Public Utilities Commission (CPUC) has opened a new Phase 3 to consider how to restructure demand response resources from CAISO stage 2 emergency-triggered resources (which trigger to prevent firm load shedding) to resources that participate directly in CAISO's day-ahead and real time markets, as operating reserve or as energy (in the form of curtailable demand). Pursuant to a prior ruling, the utilities were required to file their requests for approval of demand response programs for the next program cycle (years 2009-2011). In general, these filings proposed to maintain significant MW amounts of stage 2 emergency-triggered demand response resources. In response to these filings, the CPUC issued a ruling requesting CAISO to file comments concerning the appropriate statewide MW level of emergency-triggered demand response resources. In its June 25, 2008 comments, CAISO recommended that a range of 500-to1000 MW (representing 1% to 2% of the CAISO peak system load) may be useful to protect the system from emergency conditions. Significantly, CAISO's recommended figures are 500 to 700 MW lower than what the utilities had proposed for the 2009-2011 program cycle. CAISO's comments also argued that these emergency triggered resources should no longer count as resource adequacy resources (as they do now under counting rules).

Responsible attorney: Bill Di Capo

Advice letter filings of qualifying facility standard contract (PG&E Advice Letter 3197-E-A, SCE Advice Letter 2200-E-A, SDG&E Advice Letter 1958-E-A)

On April 4, 2008, CPUC staff issued a notice requiring PG&E, SCE, and SDG&E (the IOUs) to prepare a single proposed new form of standard contract for sales from qualifying facilities to the IOUs in accordance with the Public Utility Regulatory Policies Act in response to CPUC D.07-09-040. The IOUs submitted a revised version of their proposed form of contract on July 11, 2008. CAISO filed comments supporting the proposed standard contract on July 31.

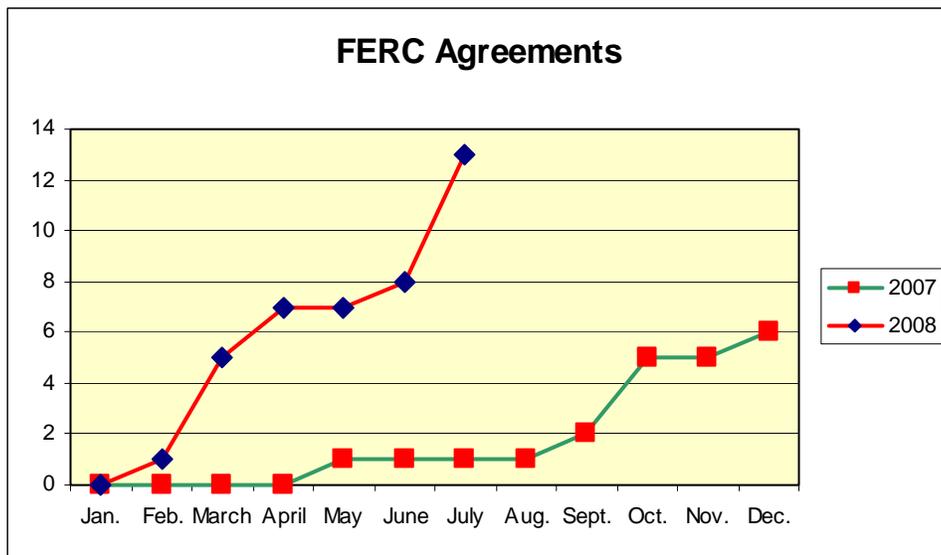
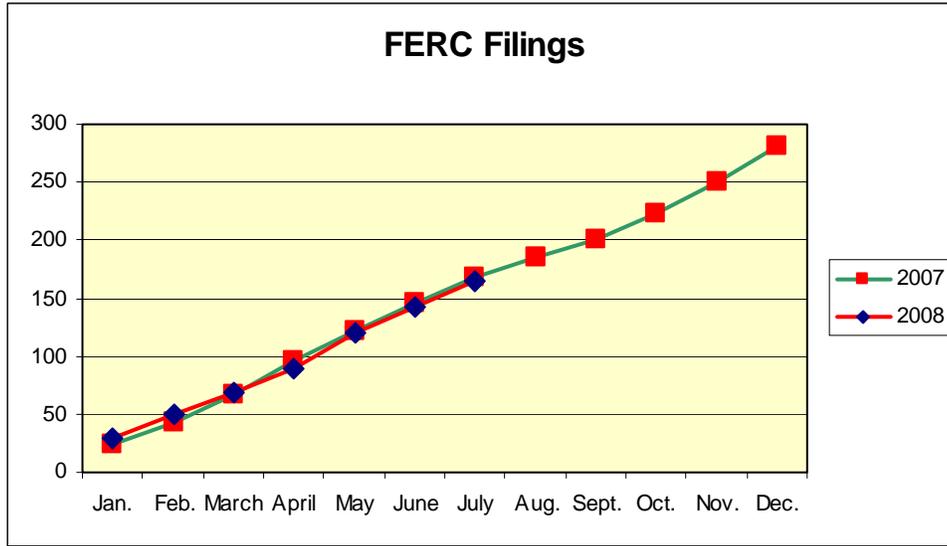
Responsible attorneys: Sidney Davies and Mike Dozier

Rulemaking to consider annual revisions to local procurement obligations and refinements to the resource adequacy program (Docket R.08-01-025)

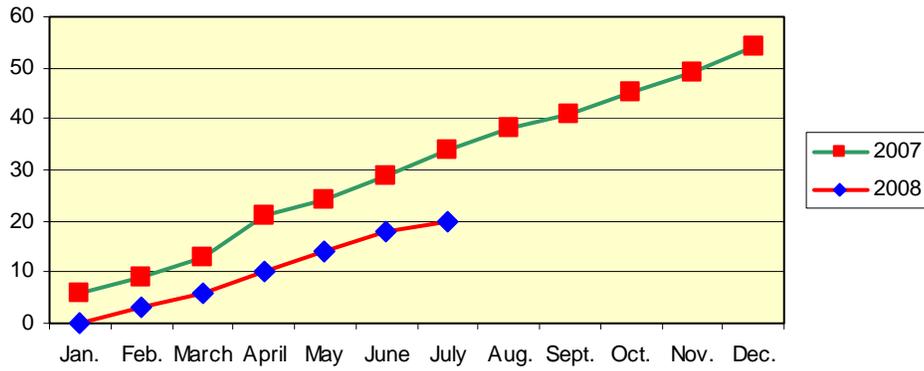
On May 17, 2008, the presiding Administrative Law Judge issued a proposed decision in the above-reference docket that adopted CAISO's recommendations on local capacity procurement obligations for CPUC jurisdictional load serving entities for 2009. More controversial issues relating to the resource adequacy program, including the formula for calculating the capacity value for various intermittent resources, were deferred to a later phase of the same proceeding. On June 16, 2008, CAISO submitted comments generally supporting the proposed decision. However, the decision included language implying that the need for coordination between CAISO reliability must-run designation and contracting process and the resource adequacy procurement schedule would terminate upon implementation of MRTU. CAISO submitted comments clarifying that this was incorrect and that existing coordination procedures should remain in place even after MRTU becomes effective. CAISO further submitted reply comments on June 23, 2008. The reply comments responded exclusively to issues raised by PG&E on resource adequacy program refinement matters. On June 26, 2008, the CPUC adopted the proposed decision and thereby established local capacity obligations for its jurisdictional load serving entities for 2009. (CPUC Decision 08-06-031.) The decision also generally adopted the modifications suggested by CAISO with respect to reliability must-run and resource adequacy coordination and the counting of new resources, while rejecting those matters opposed by CAISO.

Responsible attorney: Sidney Davies

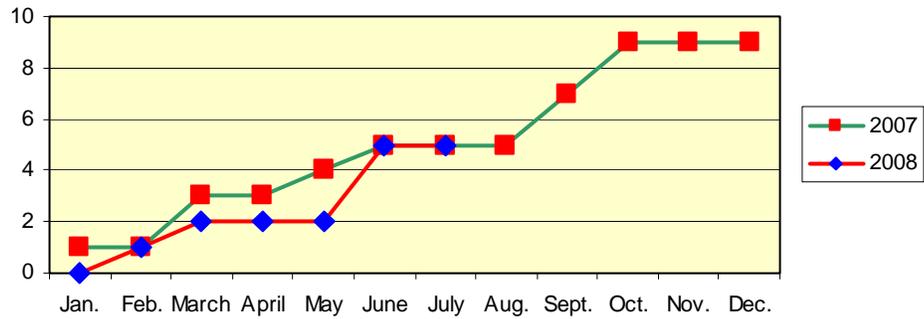
FILINGS THROUGH JULY 2008



CPUC/Other Commission Filings



Court Filings



Total Filings

