

Memorandum

To: ISO Board of Governors

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

Date: January 27, 2011

Re: Regulatory Update

This memorandum does not require Board action.

Federal Energy Regulatory Commission (FERC) and related Court of Appeals matters

Tariff amendment filings and orders

- **Revised transmission planning process (ER10-1401; ER10-2191; EL10-7)**

In May 2010, following a ten-month stakeholder process, the Board approved the revised transmission planning process (RTPP). The ISO filed the tariff amendment to implement the RTPP on June 4, 2010. On July 26, 2010, FERC suspended the effective date of the tariff revisions until January 3, 2011, or the date of an earlier decision, and held a technical conference on August 24, 2010. On December 16, 2010, FERC approved the ISO's RTPP proposal, requiring only minor changes on compliance to provide greater clarity on certain details in the tariff. The RTPP provisions became effective on December 20, 2010. Under the approved RTPP the ISO is able to:

1. Identify and approve transmission facilities needed to achieve state and federal public policy goals and directives, currently the goal of 33 percent renewable energy by 2020. This provision creates a new class of transmission upgrades, in addition to traditional reliability and economic categories.
2. Take into account the uncertainties regarding the timing and location of new renewable resources, to minimize the risk of subjecting ratepayers to the cost of under-utilized transmission, by:
 - a. Working closely with the CPUC to define a "most likely" generation scenario based on key generator development milestones, plus several high-potential alternative scenarios;
 - b. Using a "least regrets" approach to identify public policy upgrades that are low-risk of being under-utilized based on the scenarios and warrant immediate approval, plus less certain upgrades to be re-evaluated in the next planning cycle.

3. Formulate a statewide conceptual transmission plan in collaboration with non-ISO transmission providers in California (SMUD, LADWP and IID) and with input from other interested parties, that identifies potential transmission development for the state as a whole to achieve the stated public policy goals.
4. Better integrate the generation interconnection process, which has traditionally had its own process, timeline and cost allocation rules, into the RTPP to create a more comprehensive planning approach.
5. Develop a comprehensive annual transmission plan for the ISO area that utilizes steps 1-4 above and identifies all transmission projects needed in all categories: reliability, economic (e.g., reduction of congestion costs), public-policy, and generation interconnection.
6. Conduct an open solicitation in which both independent transmission companies and participating transmission owners may submit proposals and be approved to build and own public-policy and economic projects, while preserving traditional participating transmission owner rights and responsibilities to build reliability projects and interconnection upgrades.

Now that FERC has approved the RTPP, the ISO is working toward completion of its first annual comprehensive transmission plan under the new rules, including a full description of the transmission projects that will enable California to reach the 33 percent renewable energy target.

Responsible attorneys: Anthony Ivancovich and Judi Sanders

- **Generation interconnection process (ER11-1830)**

On December 16, 2010, the ISO received an order conditionally accepting the ISO's generation interconnection process tariff amendment. Under the revised process, which the Board approved at its September 9, 2010 meeting, the ISO will use a cluster process as the primary means for studying all generation projects seeking to interconnect to the ISO grid, regardless of size, thereby harmonizing the ISO's small and large interconnection processes. The ISO submitted its compliance filing on January 18, 2011, which addressed FERC's directive regarding requirements for customers who elect to downsize their project size after the Phase I interconnection studies to submit a financial security deposit. Specifically, FERC directed that the customer financial security deposit required to continue to Phase II be based on the cost of upgrades for the downsized project. The ISO is proposing to implement this directive by removing costs of discrete no-longer-needed upgrades as a result of the downsizing when those upgrades can be identified without the need to perform re-study. The tariff amendment implementing these generation interconnection process reforms is effective as of December 19, 2010.

Responsible attorney: Bill Di Capo

- **Proxy demand resource amendment (ER10- ER10-765)**

The Board approved the ISO's proxy demand resource proposal, which permits demand response to be provided by retail load subject to specific terms and conditions, on September 10, 2009. On January 4, 2011, FERC issued an order that accepted the ISO's proxy demand resource compliance filing submitted in September 2010. FERC's order also granted the ISO's request for rehearing of its July 2010 directive to verify that proxy demand resources are capable of providing ancillary services capacity for periods longer than an hour. In the January 4 order, FERC agreed with the ISO that this effort was no longer necessary because a longer-than-one-hour dispatch was unlikely to occur and due to other tariff changes that allow non-generator resource continuous energy requirements for, including proxy demand resource, for less than an hour.

Responsible attorney: Bill Di Capo

- **Miscellaneous tariff clarifications (ER11-2574)**

The ISO submitted proposed tariff language to FERC on December 30, 2010 to clarify the meaning of existing tariff provisions, ensure consistency throughout the tariff as well as between the tariff and applicable business practices, and correct typographical and other inadvertent errors. Prior to making its filing, the ISO conducted a stakeholder process and ultimately incorporated a number of stakeholder proposals into the filing. The ISO has requested an effective date of February 28, 2010 for these tariff amendments.

Responsible attorney: Andrew Ulmer

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

On January 19, 2011, the ISO filed an answer to the protests lodged at FERC of the ISO's December 1, 2010 proposal to implement the permanent capacity procurement mechanism, which the Board approved on November 2, 2010. The capacity procurement mechanism is a successor to the interim capacity procurement mechanism, which became effective in tandem with the ISO's new market design on April 1, 2009 and has a two-year sunset date. The majority of protests and comments submitted in response to the ISO's proposed tariff amendments focused on two issues – the risk of retirement provision and the capacity procurement mechanism compensation rate based on going-forward costs. The risk-of-retirement designation would allow the ISO in any current resource adequacy compliance year, to procure capacity from a resource that is uneconomic and at risk retirement but that will be needed for reliability during the following resource adequacy compliance year. In response to the protests and comments, the ISO explained that the risk-of-retirement designation was necessary as a last resort to maintain reliability under significantly changing circumstances.

With respect to the compensation for capacity procurement mechanism designation, the ISO proposed to set the default rate at \$55/kW-year, based on the same going-forward fixed costs methodology that

FERC approved for the interim capacity procurement mechanism. Some parties argued that the going-forward fixed costs approach provided insufficient compensation to generators, while other parties argued that the ISO's proposal paid generators too much. The ISO's answer explained that the compensation methodology is just and reasonable because it is designed to procure short-term capacity to backstop resource adequacy procurement. It is not meant to incent new entry, nor is it designed to replicate the outcome of a competitive capacity market. The going-forward fixed costs methodology is constructed to ensure that designated resources will recover the costs associated with meeting the limited obligations a unit must meet when it accepts a capacity procurement mechanism designation.

Responsible attorneys: Beth Ann Burns and David Zlotlow

- **FERC accepts Order 719 compliance filing (ER09-1048)**

On January 20, 2011, FERC issued an order in response to the ISO's February 18, 2010 filing in compliance with FERC Order No. 719. Order 719 required independent system operators and regional transmission operators to modify their operations and FERC tariffs in several areas, including market monitoring. The ISO made its initial compliance filing on April 28, 2009. FERC issued an order on compliance on November 19, 2009, which required the ISO to make an additional compliance filing. The two most significant compliance obligations were for the ISO to: (1) clarify its market monitoring structure by stating whether the Market Surveillance Committee would be a formal FERC-approved market monitoring unit or would be a consulting body for the ISO Board and management; and (2) review Section 37 of the ISO tariff, which comprises the Rules of Conduct for Market Participants, to ensure that the ISO only has penalty authority for purely objective violations, with violations requiring subjective assessments to be reserved for FERC consideration. In its April 28 compliance filing, the ISO explained that the Market Surveillance Committee was a consulting body, rather than a formal market monitoring body, and the ISO also proposed amendments to Section 37 to remove subjective discretion from administering the Rules of Conduct. With minor additional compliance obligations, the January 20 order accepted the ISO's compliance filing with respect to the relationship between the ISO and the Market Surveillance Committee. FERC, however, largely rejected the ISO's proposed amendments to Section 37. In FERC's view, the ISO's proposed revisions to Section 37 still contained too much ISO discretion. The January 20 order gives the ISO 30 days to make further amendments to Section 37.

Responsible attorney: David Zlotlow

Regulatory contracts filings and orders

- **Palo Verde II (Blythe Solar Power Project) interconnection agreement (ER11-2318) and Palen interconnection agreement (ER11-2451)**

These two non-conforming interconnection agreements have been entered into by the ISO, Southern California Edison Company, and affiliates of the Solar Millennium solar developer and relate to solar

thermal projects in the Interstate I-10 corridor region, near Blythe. These projects are targeted to receive federal stimulus cash grant funding. Blythe Solar Power Project is a proposed 1000MW facility and Palen is a proposed 500MW facility; each project is planned to be built in multiple phases. The non-conforming provisions relate to two subjects. The first subject pertains to SCE's agreement to up-front fund network upgrades for the interconnection of these projects, conditioned upon SCE receiving FERC approval to recover any costs of "abandoned plant" from transmission ratepayers. The second subject relates to a "partial termination" provision added to each agreement because the necessary delivery network upgrades which SCE will fund will not be fully completed until 2017. The provision permits the interconnection customer to terminate the interconnection agreement with respect to later planned phases of the project. In order to exercise partial termination, the customer must pay a partial termination charge which is secured by providing the ISO, in advance, a partial termination financial security. If partial termination is exercised, the partial termination charge is applied for the benefit of ISO rate payers as a credit against SCE's transmission revenue requirement. The ISO filed the two non-conforming interconnection agreements on December 9, 2010.

Responsible attorney: Bill DiCapo

- **Granite Wind Interconnection Agreement (ER11-2369)**

On January 20, 2011, FERC issued an order conditionally approving the Granite Wind interconnection agreement and the requested November 24, 2010 effective date. The 60 MW Granite Mountain wind project is targeted to receive federal cash grant stimulus funding and connects to certain proposed South of Kramer transmission upgrades in Southern California Edison's service territory. SCE has agreed to up-front fund Granite Wind's network upgrades, conditioned upon its receipt of abandoned plant recovery, which is pending FERC approval. The FERC order accepting the interconnection agreement is subject to the outcome of SCE's incentives filing.

Responsible attorney: Bill Di Capo

- **Mojave Solar 1 Project (Docket ER11-2368), Coram Brodie Wind Project (Docket ER11-2386) and AV Solar Ranch Project (Docket ER11-2572)**

In December 2010, the ISO filed three additional non-conforming interconnection agreements for approval by FERC. Because each of the projects developers is seeking federal stimulus cash grant funding, the interconnection customers requested that the ISO complete execution of their interconnection agreements and filing of the non-conforming interconnection agreements by December 2010. The non-conforming provisions of these agreements relate to Southern California Edison's agreement to up-front fund network upgrades, conditioned upon SCE's receipt of abandoned plant approval in the incentives filing that SCE filed with FERC in December 2010.

Responsible attorney: Bill Di Capo

- **Potrero reliability must-run agreement (ER11-2218)**

On November 30, 2010, Mirant, now known as GenOn, filed revisions to its reliability must run agreement for the Potrero power plant for the 2011 contract year. The agreement includes a new provision that allows the ISO to provide notice of termination during the contract year. All of the terms and conditions were negotiated and agreed to among the affected entities, which include Pacific Gas and Electric Company and the CPUC in addition to GenOn and the ISO. By letter dated December 21, 2010, the ISO provided GenOn with notice of termination effective January 1, 2011. Pursuant to the amendments, the termination of the agreement will be effective as of midnight of February 28, 2011. On January 19, 2011, FERC issued an order accepting the reliability must-run amendments. On January 25, 2011, GenOn filed notice of cancellation of its reliability must-run rate schedule effective February 28, 2011.

Responsible attorney: Sidney Davies

Report filings

- **Monthly convergence bidding status report (ER10-300)**

On December 30, the ISO filed reports on the status of convergence bidding. FERC directed the ISO to file monthly status reports to track progress toward the ISO's implementation of convergence bidding by February 2011. The target date for convergence bidding implementation is February 1, 2011, and the initiative is currently on track to meet this target.

Responsible attorney: Sidney Davies

- **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 in connection with the implementation of its new market design. On December 15, 2010 and January 13, 2011, the ISO submitted its monthly market disruption reports that occurred from October 16, 2010 through December 15, 2010. 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 monthly exceptional dispatch reports to FERC in connection with exceptional dispatches under its new market design. On December 15, 2010 and January 13, 2010, the ISO

submitted transactional data including incremental and decremental MW volume, duration and location for exceptional dispatches occurring during the months of October and November, 2010, respectively. On December 30, 2010, the ISO submitted MW hour data and cost data for exceptional dispatches occurring during the months of September 2010.

Responsible attorney: Sidney Davies

- **Negotiated default energy bids informational filing (ER06-615)**

On January 7, 2011, the ISO filed an informational report with a confidential attachment providing information concerning nine new negotiated default energy bids that were implemented in December 2010. Default energy bids are used in the automated market power mitigation processes in the ISO market.

Responsible attorney: Sidney Davies

- **Annual demand response report (ER06-615)**

On January 14, 2011, the ISO filed public and confidential version of its annual demand response report. Due to the limited number of participants currently providing demand response, the information is confidential. The ISO expects additional participation from demand response resources, such as proxy demand response resources, in 2011.

Responsible attorney: Sidney Davies

Other FERC matters

- **Petition for limited waiver of ISO tariff regarding interconnection financial postings (ER11-2503)**

On December 23, 2010, the ISO filed a petition for a limited waiver of the requirement that generator interconnection customers make their second posting of financial security 180 days after publication of the final Phase II interconnection study report. The purpose of the waiver is to extend the timing of the posting requirement for seven transition cluster interconnection customers that relied on erroneous information provided by the ISO to the effect that the 180 day period would be calculated from the date of subsequent revisions to their final Phase II study reports. The requested waiver would allow the ISO to adjust the second financial security posting due date for these interconnection requests based on these customers' expectations and avoid the potential harm that would be caused in the absence of a tariff waiver. The waiver request noted that no other interconnection customers in the transition cluster would be affected by granting this limited waiver, and that the ISO had consulted with PG&E, the only participating transmission owner to

which this financial security is due, and was authorized to represent that PG&E supported the petition.

Responsible attorney: John Anders

- **Complaint regarding the second financial security posting (EL11-14)**

On December 30, 2010, interconnection customer AES Wind filed a complaint at FERC alleging that its Phase II study report was not final and therefore the second installment of interconnection financial security had not yet been triggered and was not due on January 8, 2011 as indicated by the ISO, but rather, would be due on a future date 180 days after the final study is issued – an event that had yet to occur. On January 3, 2011 FERC issued a notice shortening the time to comment. On January 7, the ISO filed an answer, and on January 8 AES Wind filed a motion to withdraw the complaint. In essence, the ISO and SCE agreed that the Phase II study report for the AES Wind Red Mountain Ridge project was not final and would not be final until the appropriate cost responsibility for the location constrained resource interconnection facilities has been finally determined and AES Wind can be allocated its proportionate share. This is the first application of cost responsibility for a location constrained resource interconnection facility in a Phase II study report. The 180-day clock will not begin to run until the final Phase II study report has been issued by the ISO.

Responsible attorney: John Anders

- **Calpine Sutter tariff waiver filing (ER11-2085)**

On November 10, 2010, Calpine requested that FERC grant a waiver of provisions of the ISO tariff related to its Sutter Energy Project. Calpine requested that FERC allow it to withdraw its interconnection request for its Sutter Energy Center project from the ISO's interconnection queue and receive full recovery of its initial posting of interconnection financial security. Calpine's interconnection request for Sutter is a particularly unusual circumstance due to the following factors: (1) Sutter is already in commercial operation, (2) Sutter was at one time within the ISO balancing authority area, (3) the interconnection request seeks to reconnect Sutter within the ISO balancing authority area, (4) the results of the ISO's interconnection studies require further studies through the WECC path rating process, and (5) Calpine is exposed to significant cost uncertainty for potential network upgrades that may be required by affected systems as a result of the WECC path rating process, which the ISO's interconnection studies cannot quantify with a great deal of accuracy in advance of the determination of those costs by the affected systems. On December 1, 2010, the ISO filed comments stating that while the ISO does not believe that the interconnection financial security posting requirements set forth in the tariff should be waived in all cases where affected system costs are not identified by the time of posting, the ISO does not object to Calpine's request based upon the facts and unique circumstances of this request, subject to the following clarification. The ISO requested that FERC make clear in any order granting Calpine's request for a limited waiver of the tariff that the

waiver is only available if the aggregate amount of upgrade costs for all affected systems and WECC path mitigation, combined, exceeds the cost estimates set forth in the ISO's phase I interconnection study report by at least \$1 million. On December 16, 2010, the ISO submitted an answer to comments filed by Western Area Power Administration. Western urged FERC to initiate an investigation as to whether the ISO's pilot pseudo-tie program should be incorporated in the tariff. The ISO's answer urged FERC to reject Western's recommendation.

Responsible attorneys: Mike Dozier and Bill Di Capo

- **Critical Path, LLC and Clear Power, LLC complaint (EL11-11)**

On December 14, 2010, Critical Path, LLC and Clear Power, LLC filed a complaint against the ISO regarding several transmission projects that they submitted through the 2009 transmission planning request window. They allege that the ISO was required by its previous tariff to study the projects during the cycle in which they were submitted and under the tariff provisions in effect at the time of submission. They argue that deferring consideration of the projects to a subsequent planning cycle required a tariff waiver and any tariff provisions permitting deferral of request window projects was unjust and discriminatory. In its January 11, 2011 answer to the complaint, the ISO explained that under the previous transmission planning tariff provisions the evaluation period for large economic projects could span multiple periods. Therefore, it was within the ISO's discretion to determine in which planning cycle it would evaluate project proposals submitted in the 2008 and 2009 request windows, as long as the ISO did not act discriminatorily or arbitrarily. Accordingly, the ISO was not under any tariff requirement to seek a tariff waiver. Moreover, at the time the projects were submitted, the complainants had notice, through the revised transmission planning process (RTPP) stakeholder initiative, that the ISO was considering revisions to its planning process. Therefore, these parties had no expectation that the previous planning process would necessarily apply to their projects. Finally, under the recently-approved tariff provisions implementing the RTPP, the ISO will evaluate all proposals submitted in the 2008 and 2009 transmission planning request windows under RTPP tariff during the current 2010-2011 planning cycle. This process is currently underway and the results of the ISO's evaluation will be detailed in the 2010-2011 comprehensive transmission plan.

Responsible attorneys: Anthony Ivancovich and Judi Sanders

- **Transmission Technology Solutions/Western Grid Development complaint (No. EL11-8)**

On January 10, 2010, the ISO filed an answer to a complaint filed by Transmission Technology Solutions (TTS) and Western Grid Development (WGD). The complaint alleged that the ISO failed to comply with the requirements of the transmission planning process set forth in former section 24 of the tariff (as in effect at the time of the complaint) in evaluating transmission project proposals submitted by the complainants for consideration in the ISO's 2008-2009 and 2009-2010 transmission planning cycles. In its answer, the ISO demonstrated how its evaluation of the TTS and WGD proposals was fully consistent with the applicable tariff requirements, and the ISO had approved the most cost-

effective solutions for resolving the reliability needs identified by the ISO that were the subject of the TTS and WGD project proposals. The ISO pointed out how TTS' and WGD's claims were based on incorrect interpretations of ISO documents, factual inaccuracies, and a flawed cost comparison analysis. Moreover, the remedies requested by the complainants would require the ISO to violate provisions concerning the responsibility for construction of reliability-driven transmission projects that have been in the tariff since the ISO commenced operations and which were recently affirmed by FERC. In that regard, under the terms of the tariff applicable to the ISO's evaluation of the TTS and WGD projects, even assuming, for purposes of argument, that the TTS and WGD projects were needed, TTS and WGD would not be permitted to build and own these projects under the applicable terms of the tariff because, among other things, only participating transmission owners (PTO) with a PTO service territory are permitted to build reliability projects. TTS and WGD are not PTOs with a PTO service territory. For these and other reasons, the ISO urged the Commission to deny the complaint without further proceedings.

Responsible attorney: Anthony Ivancovich

- **Southern California Edison incentive rate filing for four transmission projects (EL11-10)**

On December 9, 2010, SCE submitted a filing requesting recovery of any costs of abandoned plant and other rate incentives for the proposed (1) expansion of Colorado River substation, (2) expansion of Whirlwind substation, (3) south of Kramer transmission project, and (4) west of Devers transmission project. On January 10, 2011, the ISO submitted comments proposing that FERC condition approval of any recovery by SCE of costs of abandoned plant on the incorporation of those facilities as network upgrades for generator interconnection projects in interconnection agreements executed by the ISO.

Responsible attorney: Mike Dozier

- **Appeal regarding integrated balancing authority areas (D.C. Circuit Case No. 09-1213)**

On December 10, 2010, the United States Court of Appeals for the D.C. Circuit ruled on appeals that challenged the FERC orders approving the ISO's proposal to address integrated balancing authority areas and to identify proxy hubs for pricing interchange transactions with the Sacramento and Turlock balancing authority areas. The Court denied the appeals, which had been brought by SMUD, TANC and other municipal utilities, and ruled in favor of FERC and the ISO. Specifically, the Appeals Court found that the proposal was within FERC's authority to approve, that it was not unduly discriminatory, that it did not violate existing contracts, and that the proxy prices were not arbitrary. The ISO's proposal was approved by the Board in May 2008, filed with FERC the following month, and approved by FERC in September 2008, with rehearing denied in July 2009. In a recent filing with the Court, Turlock Irrigation District has indicated that it plans to ask the United States Supreme Court to review the decision.

Responsible attorneys: Roger Collanton, Dan Shonkwiler and Andrew Ulmer

California Public Utilities Commission (CPUC) matters

- **Demand Response Rulemaking (R.01-01-041)**

On November 8, 2010 the CPUC issued a ruling soliciting further input from parties on consumer protection, financial settlement and communication, and other issues associated with direct participation by retail customers in the ISO market as a proxy demand resource. This next step was contemplated in the June 4, 2010 final decision in Phase 4 of this proceeding, which authorized limited pilot activity but specifically deferred full participation until after resolution of these issues. In comments filed on December 8 and December 13, the ISO made several key points, supported by detailed examples. Most importantly the ISO reinforced the point that financial settlement issues should be resolved at the retail level and not the wholesale level, unless the ISO is directed otherwise by FERC in a final ruling in RM10-17 (the FERC notice of rulemaking on demand response compensation). This is consistent with prior positions taken by the CPUC. The ISO also commented that any solution should be efficient and support a robust third party demand response paradigm. The CPUC ruling also noticed a three-day workshop to discuss these issues on January 19-21, which the ISO is attending.

Responsible attorneys: Bill Di Capo and John Anders

- **Rulemaking proceedings regarding qualifying facility policy (R.04-04-003, etc.)**

On October 8, 2010, PG&E, SCE, SDG&E, the CPUC Division of Ratepayer Advocates, TURN, and representatives of qualifying facilities (QFs) filed a proposed settlement intended to resolve issues among the utilities, QFs, and ratepayer advocates in multiple CPUC proceedings. The settlement includes four proposed versions of standard power purchase agreements between the utilities and QFs, all of which would require QFs to comply with the tariff as advocated by the ISO in these proceedings. In addition, the settlement includes a separate letter agreement between the utilities and the ISO in which the ISO agrees to provide temporary exemptions, which the ISO may grant under its tariff, from its revenue metering and telemetry requirements for QFs that are transitioning from a grandfathered existing power purchase agreement to a new standard power purchase agreement. On October 25, 2010, the ISO filed comments supporting the proposed settlement. On November 16, 2010, the administrative law judge issued a proposed decision that would approve the settlement. On December 6, 2010, the ISO filed comments supporting the proposed decision. On December 21, 2010, the CPUC issued a decision approving the settlement as filed. The decision notes that the settlement will not be effective until FERC approves a waiver of the utilities' mandatory obligations to purchase power from QFs under Section 210(m) of the Public Utility Regulatory Policies Act of 1978 and requires the utilities to file a motion for closure of the proceedings on the settlement once the conditions of the effectiveness of the settlement have been met. On January 18 and 20, other parties filed applications for rehearing of provisions of the decision unrelated to those regarding which the ISO submitted comments.

Responsible attorneys: Mike Dozier and Sidney Davies

**Regulatory Filings
Cumulative 2010 Charts**





