

Memorandum

To: ISO Board of Governors

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

Date: July 6, 2011

Re: Regulatory Update

This memorandum does not require Board action.

Federal Energy Regulatory Commission and related Court of Appeals matters

Tariff amendment filings and orders

- **Tariff amendment to modify bid cost recovery rules (ER11-3149)**

On March 21, 2011, the ISO filed tariff amendments proposing to modify bid cost recovery rules to eliminate the incentive for parties to engage in a bidding practice that exploited bid cost recovery rules to generate increased payments. The ISO Board of Governors authorized the filing at its March 18 meeting. The ISO's bid cost recovery mechanism was created to ensure that where the ISO commits a resource, that resource will at least recover its bid costs, including start-up and minimum load costs. Where a resource's energy market revenues are insufficient to cover those costs, the bid cost recovery mechanism provides a resource with a make-whole payment. In March of 2011, the ISO observed a bidding practice that forced the ISO to schedule a resource in the day-ahead market at a high megawatt level but to dispatch the resource at a much lower level in the real-time market. This bidding practice resulted in significant overpayment of bid cost recovery of approximately \$57 million in total bid cost recovery payments from August 2010 through February 2011. The ISO proposed a tariff amendment to eliminate the opportunity for the bidding practice and requested expedited consideration of the proposed amendment. FERC issued an order on May 4, 2011 accepting the tariff amendment as just and reasonable with a March 26, 2011 effective date, as requested.

On June 3, 2011, the ISO filed a request for clarification of one statement in FERC's May 4 order relating to ISO authority to correct prices and charges when computational errors cause them to be inconsistent with the filed rate. On the same day, the ISO filed a limited waiver of certain requirements in Section 11.8 of its tariff, in order to permit the ISO to refrain from correcting the calculation of bid cost recovery payments during the period from April 2009 to July 2010. The ISO explained that it is exercising its existing authority to recalculate bid cost recovery payments during the period from August 2010 to March 2011, when a bidding practice exacerbated the impact of an error in the procedures used by the ISO to calculate bid cost recovery payments. The requested waiver would avoid the unnecessary burden to market participants of resettlements for the earlier

period when the financial impact of the error in calculating bid cost recovery payments was relatively smaller.

Responsible attorneys: Roger Collanton and Anna McKenna

- **Tariff amendment to address excessive bid cost recovery and exceptional dispatch payments (ER11-3856)**

On June 22, 2011 the ISO filed an amendment proposing: 1) modifications to the ISO's bid cost recovery rules to remedy the observed behavior that has resulted in excessive bid cost recovery payments beyond the expected outcome of a competitive market; and 2) to extend mitigated exceptional dispatch energy settlement rules to exceptional dispatches needed to access stranded ancillary services awards and residual unit commitment capacity. The ISO requested waiver of the sixty-day notice requirement under Section 35.11 of FERC's regulations asserting that the waiver is appropriate and necessary to enable the ISO to immediately eliminate incentives for market participants to engage in the identified bidding strategies that, if left unaddressed, may cause inappropriately high payments to resources. Since the early part of April, resources have engaged in a series of complex day-ahead and real-time bidding strategies that maximize bid cost recovery payments during targeted hours of the day-ahead market. The rule changes proposed in this filing address the newly identified bidding strategies through settlement rules that eliminate the potential for excessive bid cost recovery payments.

Additionally, this filing included certain rule changes to address observed market power issues associated with exceptional dispatches.

Responsible attorneys: Anna McKenna and Sidney Davies

- **Reliability Demand Response Resource Product (ER11-3616)**

On May 20, 2011, the ISO filed a tariff amendment to implement the reliability demand resource product approved by the ISO Board. This enhancement will enable retail emergency-triggered demand response programs, including interruptible, air conditioning, and agricultural pumping load programs, to be integrated into ISO markets and operations. The tariff revisions are the result of a comprehensive settlement agreement among the ISO, state investor-owned utilities, and other interested parties addressing how a large percentage of emergency-triggered demand response resources in California made available under state retail demand response programs will be integrated into the ISO's wholesale market design. Adding reliability demand response resources will increase demand response participation in the ISO markets and will facilitate integration into the ISO markets of a significant quantity of existing emergency-triggered retail demand programs and newly configured demand response resources that desire to be dispatched only under certain system conditions compatible with their operation.

Responsible attorneys: John Anders

- **Grid management charge (GMC) 2012 rate structure proposal**

The ISO submitted proposed tariff amendments to FERC on July 5, 2011 that will implement the new GMC rate design approved by the board at its May 2011 meeting. In this filing, the ISO

proposes to substantially reduce the number of GMC cost categories from seven under the current structure to three under the proposal. The ISO has also reduced the number of billing determinants that are used to develop the rates under the GMC formula. These changes are intended to provide greater transparency, predictability and simplicity, rate design principles which were of particular importance to stakeholders. The rate design proposal also includes four transactional and administrative fees, two of which are similar to fees currently being charged. Finally, the ISO proposes to “grandfather” a limited number of long term power supply contracts that meet specific tariff criteria from the application of the systems operation charge until such time as these contracts are renegotiated and GMC increases can be passed through to the power purchasers. The ISO proposes to implement the new GMC rate design on January 1, 2012.

Responsible attorney: Judi Sanders

- **Congestion revenue rights processes tariff amendments (ER11-3973)**

On June 23, 2011, the ISO filed amendments to its tariff to enable the ISO to model an anticipated level of unscheduled outages in its annual congestion revenue rights (CRRs) release processes. This enhancement will enable the ISO to better manage revenue adequacy of outstanding CRRs released through the annual processes. In addition, the ISO is proposing clarifications to existing tariff provisions that do not reflect changes to the CRR release rules and requirements but eliminate uncertainty or ambiguity in the ISO tariff. The proposal to model possible outages in the annual release processes was uncontested by stakeholders at the end of the stakeholder process preceding this filing.

Responsible attorneys: Anna McKenna and David Zlotlow

- **Energy self-schedule requirement for self-provided regulation (ER11-3510)**

On May 3, 2011, the ISO filed a tariff amendment to clarify a requirement that an energy self-schedule must be submitted by scheduling coordinators self-providing regulation ancillary services. The ISO experienced market performance degradation in January and February and determined the root cause was the submission of an economic bid with a submission to self-provide regulation. An economic bid is a price responsive bid. A self-schedule has no offer price and is priced at the market. It is incompatible with the market software and ISO policy for an economic bid to be submitted in conjunction with a submission to self-provide regulation. The ISO requested waiver of the 60-day notice requirement and an effective date of May 24, 2011 so that the rule change could be made effective as soon as the software change can be implemented. On May 27, FERC issued an order accepting the tariff amendment as filed effective as of May 24, 2011.

Responsible attorney: Sidney Davies

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

On June 21, FERC issued a letter order accepting the ISO’s CPM compliance filing, subject to the outcome of the remainder of the proceeding that is in settlement discussions. Acceptance of the compliance filing allows the following provisions to become effective: 1) explanation how the ISO applies the selection criteria in the tariff in order to identify the best suited resources to receive a CPM designation or exceptional dispatch; 2) clarification that the risk of retirement CPM designation

will be exercised only if all other available procurement measures fail to procure the resources needed for reliable operation; and 3) confirmation that the ISO will not unduly discriminate in favor of non-use limited resources in selecting resources to receive a CPM designation if use-limited resources are capable of performing the required service for the duration of the CPM designation or exceptional dispatch.

Responsible attorneys: Beth Ann Burns and David Zlotlow

- **Order 890 compliance (OA08-12)**

On May 26, 2011, FERC issued an order finding the ISO to be in full compliance with the directives in Order Nos. 890 and 890-A. Those orders required tariff modifications by transmission providers to ensure that transmission service is provided on a non-discriminatory basis and to that certain ancillary services, such as regulation and frequency response, may be provided by generating units, as well as other non-generating resources where appropriate. In the May 26 order, the Commission terminated a long-pending ISO compliance filing proceeding because recent ISO tariff amendments have resolved the issue whether non-generation resources are being treated on a comparable basis to generation resources.

Responsible attorney: Beth Ann Burns

- **Interconnection requirements for asynchronous generating resources (ER10-1706)**

The ISO filed a tariff amendment on July 2, 2010 to revise the interconnection requirements applicable to large asynchronous generating facilities seeking to interconnect to the ISO grid. Among other requirements, the tariff amendments would require wind and solar photovoltaic resources to have the capability to curtail their output in increments of 5MWs or less. On August 31, 2010, FERC issued an order accepting in part and rejecting in part the ISO's tariff amendments. The ISO's proposed active power management requirements were among the requirements FERC rejected. The ISO filed a request for rehearing of FERC's order, which remains pending. On June 15, 2011, the ISO filed a motion to lodge in the record of this proceeding a separate FERC order issued in May 2011 that authorized Southwest Power Pool (SPP) to impose active power management requirements on wind resources seeking to interconnect to its transmission system. The ISO asked FERC to consider its decision to allow SPP to impose active power management requirements on wind resources in the context of the ISO's pending rehearing request and grant the ISO similar relief.

Responsible attorneys: Andrew Ulmer and Grant Rosenblum

Rulemakings and related proceedings

- **Demand response compensation final rule (FERC Order 745) (RM10-17)**

On March 15, 2011 FERC issued a final order that establishes a standard compensation and cost allocation methodology for demand resources that participate in ISO and RTO markets. On April 14, 2011, the ISO filed a timely motion for clarification that the ISO's default load adjustment mechanism associated with the ISO's proxy demand resource product previously filed and approved was not impacted by the order and, in the alternative, requested rehearing. In the

meantime, the ISO is required to comply with Order 745 and must file modifications to its tariff by July 22, 2011 and has been engaged in a stakeholder process to develop the “net benefits test” mandated by the Order 745. In addition, on June 17, 2011, the ISO filed a motion to lodge the final supporting opinions from the Market Surveillance Committee with respect to the “net benefits test” that were included as initial drafts in the ISO’s request for rehearing. These matters remain pending before the Commission.

Responsible attorneys: Sidney Davies and John Anders

- **Credit reform final orders (ER11-3973)**

On June 30, 2011, the ISO filed its compliance filing in response to FERC’s series of credit reform orders. In this filing, the ISO proposed revisions to the existing settlements cycle to: (1) include billing and payment periods of no more than seven days each; (2) limit unsecured credit to \$50 million; (3) eliminating unsecured credit in connection with congestion revenue rights markets; (4) minimum criteria for market participation; (5) clarify the definition of “material adverse change” to trigger demands for additional collateral; and (6) modify the cure period for collateral calls from three days to two. The proposed effective date is October 1, 2011. The ISO will be submitting a further compliance filing to address use of netting and set-offs on September 30, 2011.

Responsible attorneys: Grace Arupo, Beth Ann Burns and Sidney Davies

- **Availability of e-tag information to FERC staff (Docket No. RM11-12)**

The ISO and the ISO’s Department of Market Monitoring (DMM) submitted comments in response to the April 21, 2011 notice of proposed rulemaking issued by FERC regarding the availability of e-tag information to FERC staff. The ISO and DMM both support FERC’s proposal to require the applicable Electric Reliability Organization to make e-tag information available to FERC staff and urge FERC to also require the Electric Reliability Organization to provide this information directly to the relevant independent system operators or regional transmission organizations.

Responsible attorney: David Zlotlow

Regulatory contracts filings and orders

- **Transition of balancing authority responsibilities from SMUD to the Balancing Authority of Northern California (ER11-3387 and ER11-3388)**

On June 7, 2011 the Commission issued a letter order accepting two new agreements necessary to transition balancing authority responsibilities from SMUD to the Balancing Authority of Northern California (BANC) effective as of May 1, 2011. BANC is a joint powers agency comprised of the Modesto Irrigation District, City of Redding, City of Roseville, and SMUD, which operates as a separate public agency effective as of May 1, 2011. A primary purpose of BANC is to assume the NERC balancing authority registration from SMUD, thereby giving each of the BANC participants a stake in the administration of the balancing authority, including a percentage share of liability for BANC’s compliance with the reliability standards applicable to its registration as a balancing authority.

Responsible attorney: John Anders

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 in connection with the implementation of its new market design. On May 16 and June 15, 2011 the ISO submitted its monthly market disruption reports that occurred from March 16 through April 15, 2011. 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 May 13 and June 15, 2011, the ISO submitted transactional data including incremental and decremental MW volume, duration and location for exceptional dispatches occurring during the months of May and April, 2011, respectively. On April 29, May 27 and June 30, the ISO submitted MW hour data and cost data for exceptional dispatches occurring during the months of January, February and March 2011, respectively. In addition, on June 14, 2011, the ISO submitted its 120-day exceptional dispatch report. In this report, the ISO summarizes its efforts to reduce reliance on, and the number of, exceptional dispatches.

Responsible attorney: Sidney Davies

Other FERC matters

- **Southern California Edison Eldorado-Ivanpah incentive rate filing (EL10-1)**

On May 16, 2011, SCE submitted a new filing in this proceeding asking FERC to issue an order confirming that SCE has satisfied the condition in FERC's October 29, 2010 order permitting SCE to recover 100% of abandoned plant costs from transmission ratepayers and incorporate 100% of construction work in progress in its transmission rate base for the full build-out of the Eldorado-Ivanpah transmission project on the basis of the CPUC's approval of the full build-out. On May 31, 2011, the ISO filed comments pointing out that any confirmation by FERC at this time of SCE's ability to recover abandoned plant costs and other rate incentives for the second circuit of the transmission line and the third transformer bank at Ivanpah substation would be in advance of the ISO's approval of those elements of SCE's project through identification of those elements as needed network upgrades in executed generator interconnection agreements, which is the condition previously proposed by the ISO for this guarantee of cost recovery.

Responsible attorney: Mike Dozier

- **Investor-owned utilities' application to terminate their mandatory purchase obligation from qualifying facilities larger than 20 MW (QM11-2)**

On June 16, 2011, FERC issued an order granting the application of Pacific Gas and Electric Company, San Diego Gas & Electric Company, and Southern California Edison Company to terminate their purchase obligation under the Public Utility Regulatory Policies Act of 1978 for qualifying facilities larger than 20 MW. On March 18, 2011, the applicants filed their application requesting that FERC approve termination of their obligation under PURPA to enter into new contracts or new obligations to purchase electric energy and capacity from qualifying facilities with net capacity in excess of 20 MW as part of the terms of the settlement agreement recently entered into among the applicants, cogeneration and combined heat and power qualifying facility representatives, and statewide consumer and ratepayer groups. On April 15, 2011, the ISO filed comments supporting this application, consistent with the ISO's support of the underlying settlement agreement. The termination of the mandatory purchase obligation is effective on the later of either (1) the date that the CPUC decision approving the settlement agreement is final and non-appealable or (2) the date FERC's approval is final and non-appealable.

Responsible attorneys: Mike Dozier and Sidney Davies

California Public Utilities Commission matters

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

On June 14, 2011, the CPUC's administrative law judge issued a proposed decision that would grant the joint petition of California Municipal Utilities Association and the parties to the global settlement of qualifying facilities issues for modification of CPUC Decision 10-12-035 approving the settlement agreement. The proposed decision would revise D.10-12-035 to include statements that CMUA's issues regarding cost allocation to "municipal departing load" have been resolved. CMUA and the parties to the global settlement filed the joint petition for modification of D.10-12-035 on April 1, 2011. The petition asked the CPUC to revise the decision to include statements that CMUA's issues regarding cost allocation to "municipal departing load" have been resolved – and to deny CMUA's application for rehearing of the decision. On April 18, 2011, representatives of community choice aggregators and direct access customers filed a response that did not object to the petition so long as no stranded costs are passed on to them and indicating that a similar "vintaged" cost allocation approach as agreed with CMUA might be acceptable to them.

The CPUC previously issued Decision 11-03-051, dated March 24, 2011, on applications for rehearing of D.10-12-035. D.11-03-051 made minor clarifications to and otherwise denied all applications for rehearing of D.10-12-035, except that it granted a request by CMUA for abeyance of its rehearing application. D.10-12-035 notes that the settlement will not be effective until FERC approves a waiver of the utilities' mandatory obligations to purchase power from qualifying facilities under the Public Utility Regulatory Policies Act of 1978 (which approval FERC provided on June 16, 2011 in docket number QM11-2, described above) 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.

Responsible attorneys: Mike Dozier and Sidney Davies

- **33% renewable integration study testimony in long term procurement plan (R. 10-05-006)**

On July 1, 2011 the ISO submitted testimony in the CPUC long term procurement plan docket supporting the final results of its 33% renewable integration study that modeled the renewable portfolio scenarios developed by the CPUC. Preliminary results from these studies had been provided to parties at the end of April, 2011. The ISO will conduct a workshop to discuss the testimony on July 11, 2011 at the CPUC offices and will participate in hearings beginning on August 11, 2011. It is anticipated that the CPUC will issue an order by the end of 2011.

Responsible attorney: Judi Sanders

- **2012 local capacity requirements (R.09-10-032)**

On May 23, 2011, the administrative law judge in the CPUC's resource adequacy proceeding for compliance year 2012 issued a proposed decision consistent with the proposals made by the ISO, including the adoption of the local capacity requirements study the ISO performed to establish local procurement obligations for 2012. In addressing other proposals, however, the proposed decision recommended terminating a requirement of the resource adequacy program that places an obligation on load serving entities to provide capacity to the ISO as replacement for a resource adequacy capacity that isn't available because the resource is on a planned maintenance outage. The ISO filed comments in the proceeding urging the CPUC to retain the replacement obligation until the ISO has a successor methodology or alternative measures in effect to account for the resources adequacy capacity on planned maintenance outage. On June 23, 2011, the CPUC issued a revision that retains the replacement obligation for 2012.

Responsible attorney: Beth Ann Burns

- **Fire Safety Rulemaking (Rulemaking 08-11-005)**

During 2010, the CPUC held a series of workshops to address proposed rules relating to the safety of electric utility and communications infrastructure provider facilities. Among other issues, workshop participants discussed whether the CPUC should extend inspection and maintenance rules for distribution facilities to electric transmission facilities under the ISO's operational control. The ISO participated in these workshops to describe its inspection and maintenance program that includes performance standards to ensure high quality, safe, and reliable electric service. The standards adopted by the ISO are set forth in Appendix C of the Transmission Control Agreement that is part of the ISO's tariff, which is subject to FERC jurisdiction. On June 10, 2011, the assigned commissioner issued a proposed decision adopting a consensus proposal to amend CPUC General Order 165 to require utilities to prepare and follow procedures for conducting inspections and maintenance activities for transmission lines and maintain records of inspection and maintenance activities. These proposed changes, however, do not prescribe specific inspection and maintenance activities or conflict with the Transmission Control Agreement or the ISO's currently adopted inspection and maintenance standards that govern electric transmission facilities under the ISO's operational control. The ISO has filed comments stating it does not object to the revisions to General Order 165 adopted in the proposed decision.

Responsible attorney: Andrew Ulmer

- **PG&E, SDG&E and SCE demand response programs 2012-2014 (A11.03-001, A11-03-002 and A11-03-003)**

The ISO submitted testimony commenting on the IOU demand response applications in these consolidated proceedings that review and approve the IOU tri-annual budget cycle for demand response programs and budgets. In its testimony, the ISO supported SCE's approach not to count, for resource adequacy purposes, demand response programs which are not structured as price responsive programs. The ISO also recommended that the CPUC consider a competitive solicitation mechanism as a metric against which to evaluate the proposed IOU budget amounts and the timeframe for IOU efforts to configure certain demand response programs to integrate into the ISO's market as proxy demand resources. Evidentiary hearings are set in this proceeding for July 19-22, 2011.

Responsible attorney: Bill Di Capo

Appellate Matters

- **Integrated Balancing Authority Area (IBAA) appeal (No. 10-1124)**

On June 13, 2011, the long-running litigation over the ISO's IBAA proposal came to an end when the U.S. Supreme Court denied a petition from Turlock Irrigation District to review FERC's jurisdiction over the proposal. The IBAA proposal, which went into effect with the ISO's new market, applied special rules to establish prices for imports and exports from certain neighboring transmission systems, in order to avoid potential reliability problems and incentives for gaming. FERC approved the IBAA proposal and, last December, the United States Court of Appeals denied petitions for review of FERC's orders. The Turlock Irrigation District then asked the U.S. Supreme Court to review one aspect of the Court of Appeals' decision. Turlock argued that the Court of Appeals had allowed FERC to regulate the sales of municipal utilities, contrary to the Federal Power Act's express restriction that FERC may not regulate the rates of municipal utilities. Whether the IBAA proposal contravened this provision turns on whether it regulates rates for sales of energy by municipal utilities, as Turlock argued, or the ISO's rates for transmission, as the Court of Appeals had ruled. The U.S. government filed a brief opposing Turlock's petition. Its brief addressed this key issue mainly by repeating the Court of Appeals' ruling. Accordingly, the ISO submitted a short brief of its own that explained why the IBAA affected the ISO's rates for transmission, rather than sales of energy by municipal utilities. Consistent with its practice, the Supreme Court did not explain why it declined to hear the case.

Responsible Attorneys: Roger Collanton, Andrew Ulmer and Dan Shonkwiler

Other regulatory filings

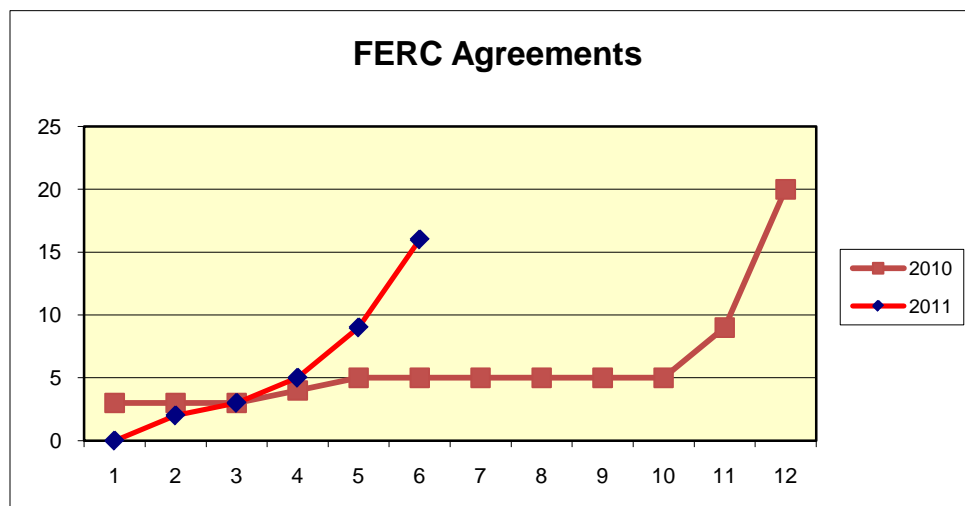
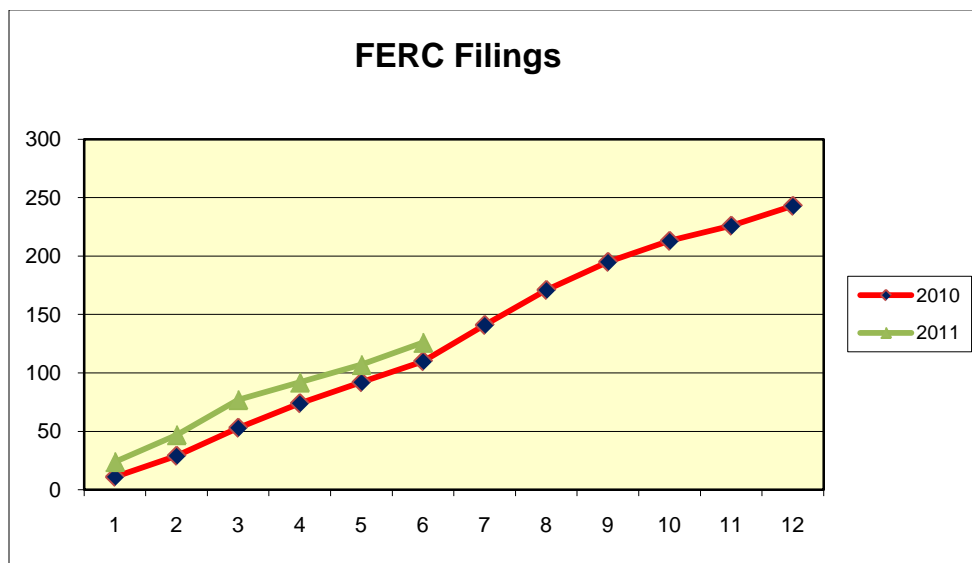
- **Statewide policy on the use of coastal and estuarine water for power plant cooling**

In May 2010, the State Water Resources Control Board adopted a policy on the use of coastal and estuarine water for power plant cooling (once-through cooling). As defined by the policy, the water

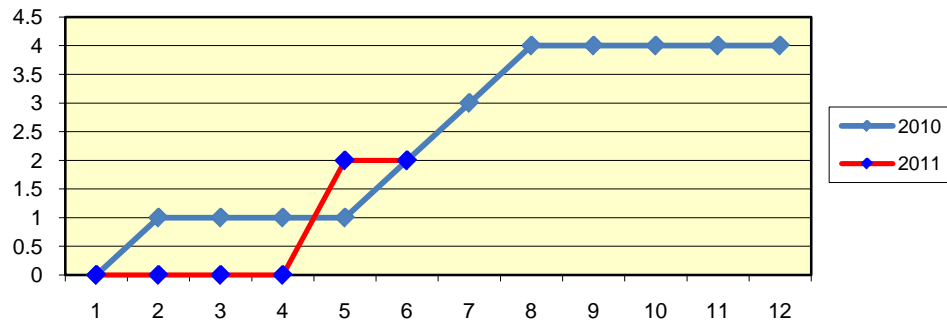
board will require power plants to adopt the best technology available to cool power plants with coastal or estuarine waters so as to reduce the level of impingement and entrainment of marine life in accordance with a specific schedule. Under the policy, affected generators submitted implementation plans on April 1, 2011. The ISO is working in collaboration with various state agencies as part of the statewide advisory committee on cooling water intake structures to review those implementation plans in order to advise the Water Board whether they are feasible from an electric reliability perspective. In connection with LADWP's implementation plan, the water board is considering a proposed amendment to the once through cooling policy that would accelerate the compliance schedule for three LADWP generating units and extend the compliance schedule beyond 2020 for the remainder of LADWP's generating units subject to the policy. The amendment would also require generators using once through cooling beyond 2020 to commit to eliminate use of once through cooling at those units and implement additional mitigation measures. The water board is scheduled to consider the amendment at its July 19, 2011 meeting.

Responsible attorney: Andrew Ulmer

**Regulatory Filings
2011 Cumulative Charts through June**



Court Filings



CPUC/Other Commission Filings

