



Memorandum

To: CAISO Board of Governors

From: Anthony Ivancovich, Assistant General Counsel
Sidney Davies, Assistant General Counsel

Date: April 12, 2007

Re: Regulatory Update

This is an update of key regulatory activities and requires no Board action.

FERC Matters and Related Decisions of the Court of Appeals

Market Redesign and Technology Upgrade (MRTU)

- **Ancillary Services Compliance Filing (ER06-615).** On March 21, 2007 the CAISO filed a compliance filing in accordance with Paragraphs 380 and 381 of the September 21, 2006 MRTU Order to add tariff detail on how the CAISO will procure Ancillary Services under MRTU. In addition, the compliance filing explained the procedures for market procurement of Ancillary Services and procurement of Ancillary Services from Reliability Must-Run resources.
- **Congestion Revenue Rights (CRR) Report (ER06-615).** On March 30, 2007, the CAISO submitted its report to FERC on the results of the CRR Dry Run conducted between July 2006 and January 2007, which consisted of a process through which the CAISO and market participants performed, on a non-binding market simulation basis, the complete sequence of activities for the allocation and auction of one-year Seasonal and Monthly CRRs based on the rules specified in the CAISO's February 9, 2006 MRTU Tariff. The CRR Dry Run results provide the Commission with information on the methodology used to conduct the dry run and to analyze the results of the dry run. The CAISO presented the results of the capacity portion of the CRRs that were allocated and auctioned as well as a financial analysis of these distributed non-financially binding CRRs. The financial analysis provides an indication of the potential exposure of market participants to congestion charges associated with Locational Marginal Prices. The CRR Dry Run Report is divided into a public report plus a confidential appendix. The public report does not provide any information on the results for any identified CRR Dry Run participant but aggregate the results, averaged across all market participants, and describes high level individual results in a manner that does not allow the individual market participants to be identified. The confidential appendix identifies and provides results for all market participants and has been filed with FERC under seal
- **Tariff Amendment to Facilitate Timely Implementation of MRTU (ER07- 475).** On March 9, 2007, the CAISO submitted certain amendments to the currently-effective ISO Tariff designed to facilitate timely implementation of MRTU. These amendments do not pertain to current ISO Market operations but are

designed to enable the CAISO to obtain the necessary information and authority to ensure that previously conditionally accepted aspects of the MRTU market concerning the treatment of Existing Transmission Contracts (ETCs), Transmission Ownership Rights (TORs), Converted Rights, and Congestion Revenue Rights (CRRs) are in place and ready to be implemented at the start of MRTU. Parties have filed interventions, protests and comments on March 30. The CAISO will be filing an answer to such pleadings on April 16, 2007.

- **Import Capability Assignment under MRTU (ER07-648-000).** In its September 21, 2006 order conditionally accepting the CAISO's MRTU Tariff, FERC directed that a technical conference be convened to further develop a process for assigning import capability as part of the MRTU's resource adequacy-related provisions. On March 22, 2007, the CAISO filed its "Import Capability Assignment Amendments" to its Tariff as the culmination of the technical conference and stakeholder process conducted in compliance with the directive included in the Commission's September 21st MRTU Order. The Board of Governors had previously approved the policy underpinnings for this tariff amendment at its March 7, 2007 meeting. The Import Capability Assignment Amendments embody the strong preference expressed by the CAISO and stakeholders to build from the process already approved by FERC as part of the existing Interim Reliability Requirements Program (IRRP) and is consistent with FERC's prior guidance to assign import capability first to existing resource commitments, to the maximum extent possible, and then to distribute the remaining import capability on a uniform basis using Load ratio share to all LSEs serving Load in the ISO Control Area. In addition, the tariff amendment included the following refinements:
 - "Capping" the import capability assigned to each LSE based on the greater of an LSE's load ratio share or specifically defined existing resource commitments. Under the existing IRRP, LSEs receive an assignment of import capability in each assignment step even if previously assigned import capability exceeded its share calculated on a Load ratio basis.
 - Placing all priority resource commitments on an equal footing regardless of the date the transactions commence delivery. (The existing IRRP did not contemplate granting a future assignment priority to resource commitments that did not deliver during the 2007 calendar year.)
 - Adding a process to assign un-requested, residual import capability on a "first come, first served" basis.
 - Enhancing the information collection and reporting provisions to facilitate oversight of secondary, bilateral transfers of import capability.

The CAISO has requested an effective date of May 22, 2007 to enable the CAISO to timely complete the import capability assignment process for Resource Adequacy Plans covering periods in 2008. The methodology included in the Import Capability Assignment Amendments would be performed on annual basis, with results valid for the following calendar year.

Responsible Attorneys: Sidney Davies, Anna McKenna and Grant Rosenblum

Request for Tariff Waiver to Support Tehachapi Transmission: FERC Docket No. ER07-447-000

On January 19, 2007, the CAISO filed with FERC a request for a one-time waiver of the 180-day "Queue Cluster Window" limitation set forth in Section 4.2 of the CAISO's Large Generator Interconnection Procedures. The purpose of the waiver request was to provide the CAISO with the regulatory authorization to support the outcome of the CAISO's clustered system impact study that developed its preferred plan of service for the Tehachapi Transmission Project. By extending the Queue Cluster Window from 180 days to approximately 33 months, the CAISO was able to efficiently and cost effectively identify the transmission network upgrades necessary to interconnect approximately 4,350 megawatts of primarily wind generating facilities in the Tehachapi area. On March 20, 2007, FERC granted the waiver request. Thus, the order removes the "conditional" tag from the Board of Governor's January 2007 approval of the project. In granting the waiver, FERC rejected the protest of Calpine Corporation. FERC agreed with the CAISO that the circumstances of the clustered system impact study mitigate any potential harm to Calpine's ability to successfully develop its proposed Pastoria expansion.

Responsible Attorney: Grant Rosenblum

Long-Term Firm Transmission Rights (Order Nos. 681 and 681-A)

On March 12, 2007, the CAISO filed with FERC its Answer to protests and comments filed by market participants in response to the CAISO's January 29, 2007 filing requesting authority to provide long-term firm transmission rights at the start of its Market Redesign and Technology Upgrade (MRTU) in compliance with FERC's Final Rule regarding Long-Term Firm Transmission Rights in Organized Electricity Markets. The answer provides additional information on sixteen issues raised by interveners, and in that Answer the CAISO requests that FERC approve the January Filing as proposed. The CAISO also notes that there are two issues on which interveners commented and for which the stakeholder process is continuing. The issues involve the restriction on using Trading Hubs as a source for Long Term CRRs and the historical reference period to be used to verify sources for Long Term CRRs, the rules for which are scheduled to be filed in its upcoming CRR filing on May 2, 2007.

Responsible Attorney: Anna McKenna

Southern Cities v. CAISO Arbitration – Appeal to FERC (EL03-54-003)

On March 29, FERC issued an order that reinstates an arbitrator's award for the CAISO in a dispute over the proper settlement of certain charges. The dispute arose from the fact that for six weeks in February and March, 2000, some of the Reliability Must-Run (RMR) units in Southern California Edison's service territory were unavailable. The CAISO initially assessed the cost of dispatching other units to SCE as out-of-market (OOM) charges, but ultimately decided the dispatches were for Intra-Zonal Congestion Management and should be assessed to all load in south of Path 15 (SP15). The Southern Cities and Vernon disputed their share of these charges – approximately \$2 million – and pursued the matter through arbitration. In 2002, the arbitrator ruled against the Southern Cities, finding that the CAISO's settlement decision was correct. The Southern Cities appealed this ruling to FERC. FERC initially reversed the arbitrator, finding that the charges were for Voltage Support, but SCE continued to pursue the matter. In this most recent ruling, FERC agreed with SCE's argument that the charges were properly allocated among all Scheduling Coordinators in the zone, even if they were for Voltage Support, as FERC had concluded. Accordingly, FERC reinstated the arbitrator's ruling.

Responsible Attorney: Dan Shonkwiler

La Paloma Complaint (EL05-54)

On March 9, FERC denied a motion for rehearing in which the La Paloma Generating Company sought to revive a complaint that the CAISO had improperly failed to hand over \$6.4 million of collateral. FERC's order tracks the position taken by the CAISO throughout the litigation, and reaffirms the CAISO's understanding of its security requirements for Scheduling Coordinators. La Paloma's complaint essentially boiled down to a claim that the rights to the financial security posted by La Paloma's Scheduling Coordinator (SC) actually belong to La Paloma (not the SC), and that the CAISO could not hold those funds to secure obligations of the SC (such as refunds from the electricity crisis era, that were unrelated to La Paloma transactions). In May 2005, FERC granted the CAISO's motion to summarily dismiss the complaint and La Paloma sought rehearing. In addition, La Paloma also argued its case by filing a motion in the refund case and sending a separate letter. The CAISO responded to each these additional pleadings.

The March 9 order, which unanimously denied rehearing, tracks the position taken by the CAISO. It reaffirms that, because the Scheduling Coordinator is the financially responsible party under the CAISO tariff, the collateral that it posted covers all of its obligations, not simply those arising from La Paloma's transactions. The order also found that, because the CAISO tariff requires the CAISO to retain the collateral, the situation was distinguishable from other matters in which FERC had declined to require collateral to secure payment of refunds.

Responsible Attorneys: Dan Shonkwiler and Stacie Ford

Vernon TRR Appeal (FERC EL00-105; Ninth Circuit 06-74506)

On May 14, 2007, the DC Circuit will hear oral argument in an appeal concerning FERC's authority to review a Transmission Revenue Requirement (TRR) submitted by city or other non-jurisdictional entity for recovery through the CAISO's Transmission Access Charge (TAC). This appeal is brought by the City of Vernon, which joined the CAISO as a Participating Transmission Owner (PTO) in 2001. Earlier in the proceeding, the Court of Appeals, ruled that, although FERC does not have jurisdiction over Vernon's rates, it may review Vernon's TRR to ensure the reasonableness of the CAISO's TAC rates. Since then, FERC required Vernon to file a revised TRR with certain modifications and disallowances made by the ALJ. Vernon has appealed this order, arguing that notwithstanding FERC's authority to review its TRR, FERC lacks the authority to require it to pay refunds.

The CAISO, together with PG&E, SCE and the Electricity Oversight Board, submitted a brief in support of FERC. The brief focuses on a clause that was added to the Transmission Control Agreement when Vernon became a PTO in which it agreed to "make all refunds [and] adjustments . . . to implement any FERC order" "whether or not it is subject to the rate jurisdiction of the FERC." The brief argues that FERC has authority to issue orders that affect this contractual commitment, regardless whether it has authority under the FPA to *enforce* Vernon's obligation to pay. The brief also argues that certain points raised by Vernon were resolved in an earlier appeal. A brief in support of Vernon was submitted by NCPA, the American Public Power Association, and the National Rural Electric Cooperative Association.

Responsible Attorney: Dan Shonkwiler

TAC Appeal (FERC ER00-2019; Ninth Circuit 06-74506)

The CAISO obtained approval for the current design for the Transmission Access Charge (TAC) through a lengthy process that began with stakeholder meetings in 1999, and continued through FERC's denial of requests for rehearing in 2005. Three parties have appealed the Commission's orders approving the CAISO's TAC to the United States Court of Appeals in San Francisco. The Department of Water Resources, State Water Contractors and Metropolitan Water District argue that FERC should have required the CAISO to use time-sensitive rates instead of a single volumetric (flat) rate. The

CASO, joined by a broad coalition of intervenors, filed a brief supporting FERC on March 21. This brief summarizes the ample evidence that supported FERC's approval of the current design. It also makes the points that, considered as a whole, the CAISO's transmission rates are not flat. Rather, the TAC is only one of two charges through which TRRs are recovered, the other being congestion charges which vary based on the usage of the grid. In addition, the brief argues that there is no Commission precedent that requires time of use rates. No oral argument date has been set.

Responsible Attorney: Dan Shonkwiler

Refund Case (EL00-95) and Related Civil Litigation

The CAISO has completed the FERC-ordered rerun to reflect the mitigated prices. The case is now in the "financial adjustment" phase, during which the CAISO is processing certain offsets that FERC has ordered to reflect suppliers' costs – emissions permits, fuel costs, and overall entity costs – as well as interest calculations. This work will lead to an initial compliance filing with the results of the refund calculations and, down the road, a second compliance filing that accounts for the settlements reached by various parties and forms the basis for the ultimate financial clearing.

Looming in the background since September 2005 has been a Ninth Circuit ruling (*BPA v. FERC*) that the Commission does not have authority to order municipalities and other governmental entities to pay refunds. This ruling has not affected the FERC proceedings because the case remained at the court pending rehearing, and was not final. In the meantime, the California Parties filed suit in federal court to collect refunds from the governmental suppliers, as suggested by the Court of Appeals' decision. On March 16, however, the United States District Court in Sacramento, which was hearing the suit against all but two of the suppliers, ruled that it does not have jurisdiction because the suits lack a federal subject matter. This order leaves the California Parties free to re-file the suits in state court.

As a result of separate developments, the Ninth Circuit opinion could soon affect the proceedings at FERC and possibly the CAISO's calculations. In March, the court denied the California Parties' request for rehearing and also their request to stay the decision until the Supreme Court decides whether to accept an appeal. A remand to FERC is therefore imminent. In anticipation, the California Parties filed a motion on April 2 asking FERC to continue the case with minimal changes, direct the ISO and PX to complete their calculations, and wait until the end of the proceeding – and until further developments in the civil litigation – to address any issues that may arise from the governmental entities' immunity from FERC jurisdiction.

Finally, the CAISO continues to file monthly status reports, which have been well received. The March report announced the CAISO's intention to expand the interest calculations, which previously included only refunds and unpaid invoices, to cover all background adjustments during the refund period.

Responsible Attorney: Dan Shonkwiler

California ISO Bond Offering (ES07-20)

On February 9, 2007, the CAISO filed an application pursuant to Section 204 of the Federal Power Act ("FPA"), 16 U.S.C. Sec. 824(c) (2000), requesting that the Commission authorize CAISO's proposed \$60 Million Dollar bond offering. The purposes of the bond issuance are to provide funding for projected capital expenditures through 2007 and certain "carryover" project expenditures in early 2008, namely costs associated with CAISO's Market Redesign and Technology Upgrade. The bond funds would also provide funding for the establishment of a debt service reserve fund ("DSRF").

Approximately, \$6 million of the total bond offering would be used to establish the DSRF, which would be available to pay debt services in the event of financial difficulties affecting the CAISO. On March 30, 2007, the Commission issued an order approving the CAISO's FPA Section 204 application and authorizing CAISO to issue the bond for the purposes set forth above in an amount not to exceed \$60 Million.

Responsible Attorney: Grace Arupo

Mandatory Reliability Standards for the Bulk-Power System FERC Docket RM06-16-000 (Order 693)

On March 16, 2007, FERC issued its Final Rule on the mandatory reliability standards for the bulk power system. Specifically, pursuant to section 215 of the Federal Power Act (FPA), FERC approved 83 of 107 proposed reliability standards, six of the eight proposed regional differences, and the Glossary of Terms Used in Reliability Standards developed by the Electric Reliability Organization (ERO). FERC determined that it was in the public interest to make these rules mandatory and enforceable, but also found that many of the standards require significant improvement, specifically with respect to implementing provisions of the April, 2004 Blackout Report. Consequently, NERC was ordered to submit improvements to 56 of the 83 standards. The remaining 24 standards not approved in the Final Rule remain pending until further information is provided.

Order 693 is over 500 pages long, and addresses items of general applicability and contains detailed discussions of each reliability standard. The CAISO jointly filed comments with the ISO/RTO Council, and filed individual comments as well regarding a few of the standards. The CAISO did not have specific concerns with most of the reliability standards proposed by NERC. Most commenters, including the CAISO, requested that the FERC reconsider its decision to reject a trial period for the implementation of the mandatory standards. Despite this broad support for a trial period, FERC again rejected the notion of a formal trial period. However, in recognition of the concerns raised by the parties, FERC directed the ERO and the Regional Entities to focus their resources on the most serious violations during an initial period through December 31, 2007. FERC stated that "this approach will allow the ERO, Regional Entities and other entities time to ensure that the compliance monitoring and enforcement processes work as intended and that all entities have time to implement new processes". Thus, while the Final Rule will go into effect on June 4, 2007, it appears that owners, users and operators of the Bulk-Power System will have some leeway to sort out duties and responsibilities within each standard and ensure the compliance mechanisms are in place.

Responsible Attorney: Judi Sanders

CPUC Matters

Rulemaking Regarding Policies and Protocols For Demand Response and Alignment with CAISO Market Design Protocols (R.07-01-041)

The California Public Utilities Commission demand response ("DR") rulemaking has four major goals: (1) establish a comprehensive set of protocols to estimate the load impacts of DR; (2) establish methodologies to determine cost-effectiveness of DR programs; (3) set DR goals for 2008 and beyond, and developing rules for goal attainment; and (4) consider modifications to DR programs to support CAISO efforts to incorporate DR into market design protocols.

A pre-hearing conference was held in this proceeding on March 13, 2007, at which the parties discussed a proposed process for further action, and the Administrative Law Judge circulated a possible schedule. Parties at the conference expressed a preference for workshops in lieu of evidentiary hearings. The ALJ's possible schedule envisioned a joint strawperson proposal being developed by the IOUs, followed by a workshop and party comments, with a proposed

decision being issued in January 2008. To date, the ALJ has not issued a scoping memo following the prehearing conference.

Responsible Attorney: Bill Di Capo

Sunrise Powerlink proceeding (A.06-08-010/05-12-014)

On March 1, 2007 the CAISO served a second portion of its Initial Testimony in the Sunrise Powerlink CPCN proceeding (an Errata to the testimony was submitted on March 23, 2007). The testimony is sponsored by a panel of witnesses consisting of Armie Perez, Ren Orans (outside consultant) and Robert Sparks. The first two phases of the CAISO testimony have focused on the development of the CAISO's base (reference) case and the following: (1) modeling the base case with the Sunrise project; (2) modeling the base case plus South Bay re-powering; and (3) modeling the base case plus the LEAPS and Greenpath North projects. A testimony workshop was held in San Diego on March 27, 2007, at which the CAISO explained its study processes and assumptions. Another round of CAISO testimony will be filed on April 20, 2007, and in this final phase of the initial testimony, the CAISO will summarize the results of other Sunrise alternative scenarios studies that have been requested by the interveners in the CPUC proceeding.

Responsible Attorney: Judi Sanders

Rulemaking Regarding Greenhouse Gas Implementation Standards (R.06-04-009)

Phase 1 of this proceeding concluded with the Commission's issuance of D.07-01-09 (Interim Opinion on Phase 1 Issues; Greenhouse Gas Emissions Performance Standard), wherein the CPUC established interim Emissions Performance Standard (EPS), pursuant to the Legislature's directive under SB 1368.

The CPUC is conducting Phase 2 of the proceeding collaboratively with the CEC. This phase is intended to serve as the forum for the CEC and CPUC to develop joint recommendations for Greenhouse Gas ("GHG") emissions limits that will be delivered to the California Air Resources Board (CARB) for its consideration because CARB has been given primary responsibility for developing GHG inventory and limitations levels pursuant to Assembly Bill 32. In Phase 2, the CPUC and CEC intend to jointly develop guidelines for a load-based GHG emissions cap. The CPUC has also noted that it will consult with CAISO, "which also has important expertise in this area." In this regard, assigned Commissioner Peevey has noted that "I do not anticipate that these organizations will participate as parties in this rulemaking, but, rather, that CPUC staff will coordinate regularly with their counterparts at the other agencies."

The Commissioner Peevey also signaled to CPUC jurisdictional LSE's that the CPUC would not be delegating all of its prerogatives to CARB. He has noted that "I remind the regulated LSEs that they will be expected to comply with any GHG emissions regulations adopted by the CPUC in addition to any GHG emissions regulations that CARB may adopt to fulfill the requirements of AB 32."

The schedule for phase 2 is organized around six programmatic elements:

- (1) reporting requirements;
- (2) development of the 1990 electricity sector baseline and current entity-specific GHG emissions levels;
- (3) GHG emissions reduction measures and annual emissions caps;
- (4) Flexible compliance mechanisms
- (5) Entity-specific allowance allocation, and
- (6) Modeling to support policy design and evaluation of costs.

In February, the CPUC set out schedules for addressing each of these elements and established tentative milestones for workshops, straw proposals, party comments, as well as a staff report targeted for January 2008. To date, there has been some schedule slip. Initial workshops to for development of a load cap will take place in April and May. CAISO will participate in these workshops.

Responsible Attorney: Bill Di Capo

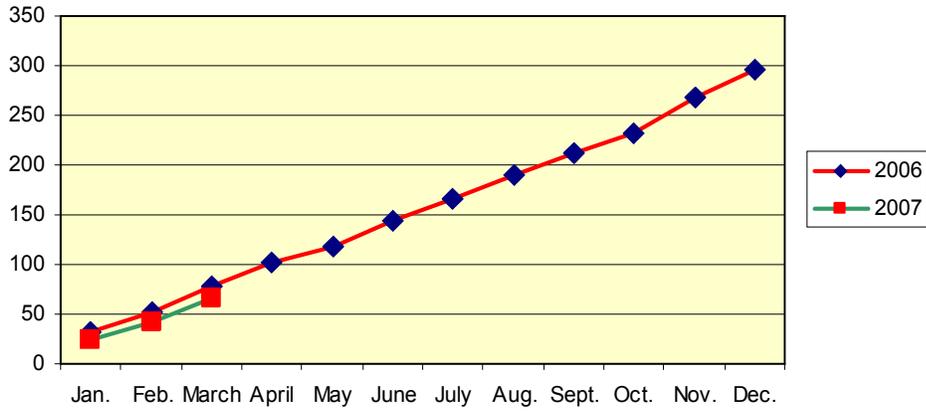
Resource Adequacy Phase 2, Track 2 (R. 05-12-013)

On March 30, 2007, the CAISO filed comments on certain issues set for consideration in Track 2 of Phase 2 of the CPUC's Resource Adequacy proceeding. The CAISO's comments focused on the features it believes are necessary elements of a successful long-term Resource Adequacy ("RA") program. The CAISO stated that the two attributes most critical to promoting the long-term success of any RA mechanism were providing incentives necessary to attract sufficient investment in California's electricity infrastructure and designing the RA program to be compatible with the CAISO's MRTU market design and systems. The CAISO also stressed that a long-term RA program must (1) ensure the availability of the right mix of resources to meet operational, locational and environmental requirements, (2) enable imports to continue to contribute to reliability in California, (3) provide clear and strong incentives (and penalties) to encourage resources to provide energy and ancillary services when the system needs them, (4) prevent the exercise of market power, and (5) rely primarily on load serving entities to secure sufficient resources to meet projected demands plus an appropriate planning reserve.

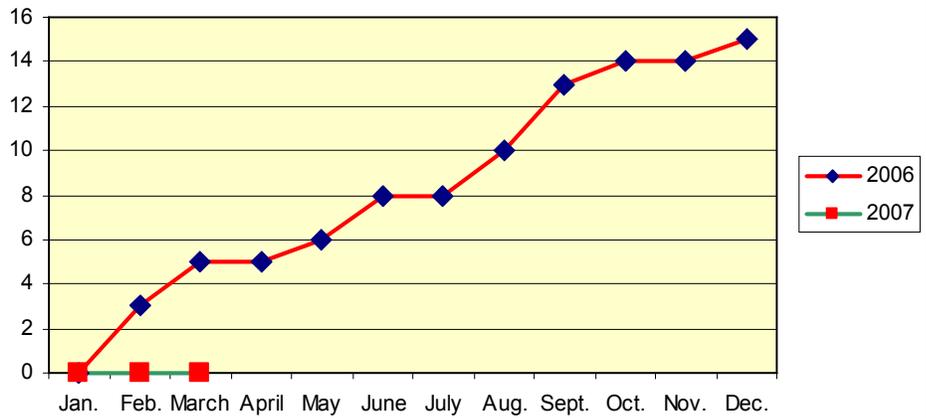
With respect to the Track 2 issue of what, if any, form of capacity market should be adopted, the CAISO stressed that any capacity market rules would likely require a high degree of integration with CAISO market and grid operations. Accordingly, the CAISO indicated that it plans to conduct a stakeholder process in 2007 to evaluate, research and develop a conceptual capacity market design that would enable the CAISO to efficiently and reliably operate CAISO market and the grid in the event a centralized capacity market option is pursued. The CAISO noted that its efforts would be carefully coordinated with those of the CPUC. The CAISO stated that if a capacity market is ultimately pursued, the CAISO would develop a detailed design in 2008 through a stakeholder process and file the appropriate tariff language with FERC.

Responsible Attorneys: Anthony Ivancovich and Grant Rosenblum

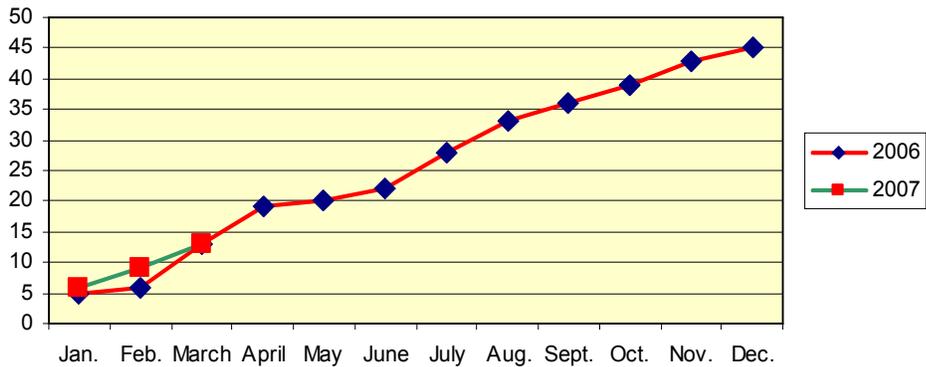
FERC Filings



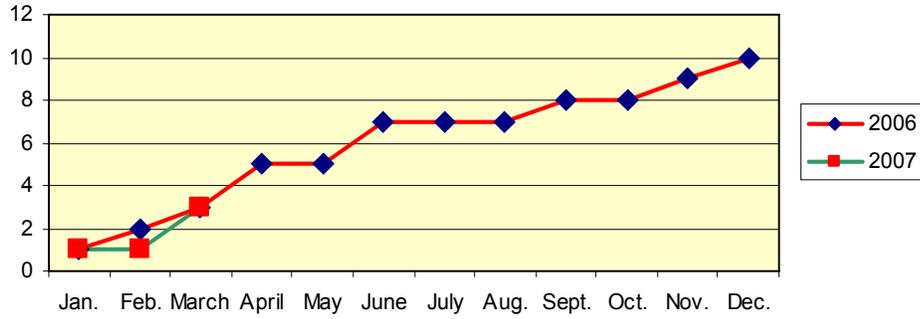
FERC Agreements



CPUC/Other Commission Filings



Court Filings



Total Filings

