

Memorandum

To: ISO Board of Governors

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

Date: December 6, 2012

Re: Regulatory Update

This memorandum does not require Board action.

Regulatory Highlights

- *ISO requests that FERC confirm that J.P. Morgan does not have consent rights under a separate tolling agreement between J.P. Morgan and AES over the executed reliability must-run agreement filed at FERC by the ISO and AES. This relates to the synchronous condenser project at Huntington Beach units 3 and 4, as authorized by the Board September 13-14, 2012*
- *FERC issues an order withdrawing J.P. Morgan market-based rate authority effective April 1, 2013*
- *FERC dismisses, without prejudice, J.P. Morgan's complaint case against the ISO challenging the ISO's exceptional dispatch mitigation decisions for their units in the April-June 2012 time period*
- *ISO files for settlement rule changes to recapture revenue derived from intertie circular scheduling practices that are already prohibited under the ISO tariff*
- *FERC conditionally accepts the ISO's tariff amendment to implement resource adequacy deliverability status to distributed generation resources from transmission capacity identified in the ISO's annual transmission plan*
- *FERC accepts the ISO's request to implement new compensation for regulation resources effective May 1, 2013*

Federal Energy Regulatory Commission and related Court of Appeals matters

Tariff amendments and orders

- **J.P. Morgan Ventures Energy Corp. v. California Independent System Operator Corporation (EL12-105)**

On December 5, 2012, FERC issued an order dismissing, without prejudice, J.P. Morgan's complaint case against the ISO challenging the ISO's exceptional dispatch mitigation decisions for J.P. Morgan's units in the April-June 2012 time period. FERC accepted the ISO's argument that the complaint is premature because the settlement dispute process is ongoing. FERC also rejected JP Morgan's argument that the ISO had not established that the disputes were "complex"—a designation that allows us up to 15 months to resolve the disputes under our tariff. Although FERC held that the disputes properly fall within the complex designation and therefore are subject to a 15-month period for resolution, it "encouraged" the ISO to resolve the disputes more expeditiously than that.

Responsible Attorney: Burton Gross

- **Order No. 755 - Compensation for regulation services (ER12- 1630)**

On April 27, 2012, the ISO filed a tariff amendment with FERC to comply with FERC's Order No. 755 directive to compensate regulation resources based on the actual service provided, including both a capacity payment that reflects the marginal unit's opportunity costs and a performance payment that reflects the quantity of regulation service actually provided in response to dispatch signals. The Board approved this tariff amendment at its March 2012 meeting. Given the complexity of the software enhancements, the ISO requested an effective date for its tariff revisions in the spring of 2013. On September 20, 2012, FERC issued an order accepting the ISO's tariff revisions, subject to conditions. These conditions include that the ISO submit a report on this market enhancement after collecting one year of operational data. FERC, however, directed the ISO to implement its tariff revisions on January 1, 2013. On October 19, 2012, the ISO submitted the following three filings in response to the Commission's order: (1) a compliance filing to submit tariff revisions to address additional conditions in the Commission's September 20 order; (2) a request for rehearing challenging FERC's directive that the ISO implement this market enhancement by January 1, 2013; and (3) a motion for an extension of time requesting an effective date of May 1, 2013 to coincide with our spring 2013 market release. On December 3, 2012, FERC granted the ISO's request for an extension to May 1, 2013.

Responsible Attorney: Andrew Ulmer

- **Scheduling priority for combined heat and power resources (ER12-2634)**

On November 30, 2012, FERC issued an order accepting the ISO's tariff amendment filed on September 21, 2012, to permit combined heat and power resources to: (1) establish a higher scheduling priority for capacity dedicated to industrial host requirements, and (2) retain the higher scheduling priority for qualifying facilities 20 MWs or less that remain subject to the Public Utility Regulatory Policies Act of 1978 (PURPA). These changes, approved by the Board at its May meeting, are driven by state and federal policies that require qualifying facilities to comply with the tariff and the PURPA mandatory purchase requirement for qualifying facilities greater than 20 MW. The amendments retain the higher scheduling priority for combined heat and power resources due to provide a higher level of protection against curtailments to minimize disruption of the industrial hosts' operations and to ensure the energy efficiency benefits of cogeneration

Responsible Attorney: Sidney Davies

- **Amendment to implement financial and credit enhancements (ER13-471)**

On November 29, 2012, the ISO filed tariff amendments to implement changes to the financial and credit policy provisions in its tariff to be effective February 1, 2013. The proposed tariff amendments will: (1) modify the progressive discipline for late invoice payments to reflect the ISO's move from semi-monthly to weekly invoicing; (2) clarify terminology associated with the receipt and remittance of payments; (3) eliminate unsecured credit limits for market participants with speculative-grade credit ratings; (4) eliminate certain forms of financial security that encumber the ISO's ability to call on credit support expeditiously in the event of a non-payment; and (5) add a new option for payments to and from the ISO – the Automated Clearing House ("ACH") payment service. The Board authorized these changes at its meeting held on November 1, 2012.

Responsible Attorneys: Sidney Davies and Virginia Johnson

- **Amendments to enable settlement rule for schedules sourcing and sinking in the same Balancing Authority Area (ER13-449)**

On November 21, 2012, the ISO filed tariff amendments to implement new settlement rules that would allow the ISO to recapture revenue derived from intertie circular scheduling practices that are already prohibited under the tariff. The filing also defines specifically what activity would trigger the new settlement rules and specifies several exceptions to those rules. Circular scheduling can generally be thought of as simultaneous import and export schedules that source and sink in the same balancing authority area. Such schedules do not produce an actual flow of power and can create operational and market complications for the ISO. Through the proposed tariff amendments, the ISO would resettle both the direct revenue earned from such schedules and any incremental congestion revenue rights revenue earned as a result of such schedules.

Responsible Attorney: David Zlotlow

- **Petition to distribute rules of conduct penalties (ER13-439)**

On November 20, 2012, the ISO filed for permission to distribute rules of conduct penalty proceeds from 2011. The ISO's Rules of Conduct (Section 37 of the tariff) grant the ISO authority to penalize market participants for violations of pre-defined rules. The tariff requires the ISO to place all penalty proceeds into a trust account and for each calendar year allocate those proceeds to market participants that had no violations in that year. The tariff requires the ISO to receive FERC permission before making such disbursement. The total penalty distribution for 2011 was \$19,000. Of that total, \$18,500 was for three different violations of the requirement to provide a timely explanation of a forced outage (section 37.4.3). The other \$500 comprised one violation of the general obligation to provide required information to the ISO (section 37.6.1).

Responsible Attorney: David Zlotlow

- **Replacement Requirement (ER12-2669)**

On November 19, 2012, FERC conditionally accepted the ISO's tariff amendment to better coordinate maintenance outages at resource adequacy resources, while ensuring that sufficient resource adequacy capacity will be operationally available to meet forecasted load and maintain grid reliability. The new tariff provisions establish a replacement requirement for load serving entities to the extent the ISO determines, under specified criteria, that capacity listed in their monthly resource adequacy plans must be replaced because the resource is scheduled for an approved maintenance outage during the month and will not be operationally available to the ISO. In addition, the new tariff provisions establish a replacement requirement for resource adequacy resources that allows them the flexibility to request a maintenance outage with replacement capacity, or as an opportunity outage without replacement capacity. FERC did not accept the ISO's tariff modifications to establish a new backstop mechanism for procuring resource adequacy maintenance outage backstop capacity on a daily basis as needed to maintain grid reliability. FERC determined that the ISO should instead use its existing capacity procurement mechanism authority to backstop maintenance outages if necessary.

Responsible Attorney: Beth Ann Burns

- **Order on resource adequacy for distributed generation resources (ER12-2643)**

On November 16, 2012, FERC issued an order conditionally accepting the ISO's tariff amendment to implement the ISO's proposal to provide resource adequacy deliverability status to distributed generation resources from transmission capacity identified in the ISO's annual transmission plan. Under the proposed new process, the annual transmission planning process identifies, through a new deliverability study, available transmission capacity to support deliverability status for distributed generation resources without requiring any additional delivery network upgrades to the ISO-controlled grid, and without adversely affecting the deliverability status of existing generation resources or proposed

generation in the interconnection queue. FERC made two alterations to the tariff amendment. First, it directed that potential deliverability that the ISO identifies for distributed generation should be allocated directly to load serving entities, instead of to local regulatory authorities who, in turn, allocate to their jurisdictional load serving entities. Second, FERC directed that deliverability be allocated to distributed generation interconnection customers on a first come, first served basis, based on the order in which they entered the utility's queues to interconnect to the state jurisdictional or FERC jurisdictional parts of the utility distribution system.

Responsible Attorneys: Bill Di Capo and Beth Ann Burns

- **Transmission Control Agreement (ER13-71)**

On November 6, 2012, FERC issued an order accepting the proposed changes to the ISO's Transmission Control Agreement as filed by the ISO on October 10, 2012. The ISO proposed changes to the Transmission Control Agreement between the ISO, the current participating transmission owners, to add two new participating transmission owners: Valley Electric and the City of Colton. The Board approved the Valley Electric and Colton applications to become new participating transmission owners during the September 13-14 meeting. The changes to add Valley Electric and Colton include updates to the table of contents, signature pages, and appendices to reflect their entitlement to the transmission facilities being transferred to ISO operational control. Another change in the body of the agreement was submitted to address a matter left unresolved by the most recent amendment of the Transmission Control Agreement. Also, Southern California Edison took this opportunity to reflect termination of an existing contract that had been an encumbrance on the ISO-controlled grid

Responsible Attorney: John Anders

- **Generator project downsizing tariff amendment (ER13-218)**

On October 29, 2012 the ISO filed its generator downsizing tariff amendment relating to the proposal approved by the Board at the September 13-14 meeting. The amendment provides a new one-time opportunity for all customers in the ISO's interconnection queue, that entered the queue prior to cluster five, to downsize the megawatt size of their projects. A downsizing generator must pay for certain administrative costs in addition to the costs of any increase in network upgrades to itself or an affected interconnected customer that is affected by the downsizing: study costs for a downsizing engineering study; and costs to amend interconnection agreements for itself or an affected generator. On November 19, the ISO received two limited protests on the proposal to which the ISO responded on November 30 indicating that: (1) cost caps are appropriate because transmission owners also benefit in addressing network upgrade downsizing in a one-time only effort instead of multiple requests at any time; and (2) the ISO agreed that cost coverage should extend to the utility distribution customers. In response to a request for an alternative downsizing option, the ISO responded that this matter was beyond the scope of the present proceeding which considers only the tariff proposal. The ISO has asked FERC for an effective date of

January 1 so that it can implement a January 4 deadline date for interconnection customers to submit downsizing requests.

Responsible Attorney: Bill Di Capo

- **Central counterparty amendment (ER12-1856)**

On October 22, 2012, PacifiCorp and Portland General Electric asked FERC to reconsider its order of August 31, 2012, which accepted the ISO's filing in compliance with Order No. 741 by amending the tariff to make the ISO a central counterparty to market transactions. The motions for reconsideration focused on the effects of the tariff amendment on state greenhouse gas regulation, and asked FERC to reconsider two aspects of the amendment: a rule that scheduling coordinators may not list the ISO as the "purchasing-selling entity on e-tags" and a provision stating that ISO market transactions are deemed to occur in the State of California. The ISO filed an answer on November 6, 2012, explaining that the motions should be denied as untimely requests for rehearing because no relevant circumstances had changed, and that FERC acted properly in accepting the tariff amendments.

Responsible Attorney: Dan Shonkwiler

- **Tariff Amendment regarding information requests from the CFTC (ER13-404)**

On November 16, 2012, the ISO filed a tariff amendment with FERC that would allow the ISO to provide confidential or commercially sensitive data to the Commodity Futures Trading Commission on the same basis that it currently provides such data to FERC. Specifically, the ISO would not be required to notify the affected market participants of the request. This tariff amendment, which was approved by the Board on November 1, is necessary to obtain an exemption from the CFTC's regulatory oversight.

Responsible Attorney: Dan Shonkwiler

Regulatory contracts

- **Order on Western Antelope Dry Ranch and Western Antelope Blue Sky small generator interconnection agreements (ER12-2207 and ER12-2209)**

On November 15, 2012, FERC issued an order regarding two unexecuted small generator interconnection agreements filed at the interconnection customer's request. The two interconnection agreements relate to parallel solar projects that have the same project sponsor – Silverado Power. Dry Ranch is a 10 MW solar PV project, and Blue Sky Ranch is a 20 MW solar PV project; both projects are located in the Western Antelope, east of Kern River area of Southern California Edison's electrical system. The ISO is processing the projects under parallel interconnection requests, and the two agreements contain essentially the same terms. The order addressed two pertinent issues. First, FERC

rejected as premature the inclusion of contract language to address the potential that certain ISO grid network upgrades might be reclassified as distribution network upgrades if this portion of the grid is transferred from ISO to utility operational control. Similarly, FERC rejected a request that the contracts be exempted from future classification, but determined that because it is not yet clear whether the reclassification will take place, terms relating to changes in customer repayment upon a reclassification should be removed from the contract. Second, FERC agreed that certain protective relays and telecommunication equipment were properly classified as interconnection (direct assignment) facilities which the customer must pay for without reimbursement in response to a challenge that the facilities should be classified as network upgrades.

Responsible Attorney: Bill Di Capo

- **Reliability Must-Run Agreement for Huntington Beach Units 3 and 4 (ER13-351)**

On November 9, 2012, the ISO and AES Huntington Beach jointly filed at FERC an executed reliability must-run agreement for units 3 and 4, as authorized by the Board at its September 13-14, 2012 meeting. During the summer of 2012, Huntington Beach units 3 and 4 were brought out of retirement to meet local reliability needs in light of the unavailability of SONGS. The units lost their air permits as of October 21, 2012. The agreement provides for the conversion of the existing generating units 3 and 4 into synchronous condensers to be available for the summer of 2013 to provide voltage support in anticipation of the continued unavailability of SONGS. The ISO, AES and the responsible utilities, SCE and SDG&E, agreed on all rates, terms and conditions. The agreement, however, reflects conditions precedent that must be satisfied before it can become effective. One of the conditions precedent concerns J. P. Morgan's consent rights under a separate tolling agreement between J.P. Morgan and AES. The ISO filed at FERC a request for declaratory order, summarized later in this report in "Other FERC Matters", to resolve the consent issue.

Responsible Attorney: Sidney Davies

- **Adjacent Balancing Authority Operating Agreement (ER13-224)**

On October 30, 2012, the ISO filed an Adjacent Balancing Authority Operating Agreement between the ISO and Nevada Power Company ("NEVP"), doing business as NV Energy. In addition, the ISO provided notice of the termination of the existing Interconnected Control Area Operating Agreement between the ISO and NEVP. This filing revises these contractual arrangements to reflect the planned transition of Valley Electric Association, Inc. from the NEVP balancing authority area to the ISO balancing authority area, effective January 3, 2012. Changes in the ISO balancing authority area necessarily require an amendment to the agreements with adjacent balancing authorities. These changes were contemplated in the Transition Agreement between the ISO and Valley Electric and are now being implemented with respect to NEVP. This matter remains pending before FERC.

Responsible Attorney: John Anders

- **Interconnected Balancing Authority Area Operating Agreement (ER13-168)**

On October 22, 2012, the ISO filed an amendment to the Interconnected Balancing Authority Area Operating Agreement between the ISO and the Western Area Power Administration – Desert Southwest Region (“Western-DSR”). This filing revised this contractual arrangement to reflect the planned transition of Valley Electric Association, Inc. (“Valley Electric”) from the Nevada Power Company, doing business as NV Energy, balancing authority area to the ISO balancing authority area. Changes in the ISO balancing authority area necessarily require an amendment to the agreements with adjacent balancing authorities. These changes were contemplated in the Transition Agreement between the ISO and Valley Electric and are now being implemented with respect to Western - DSR. This matter remains pending before FERC.

Responsible Attorney: John Anders

Rulemakings and inquiries

- **Coordination between Natural Gas and Electricity Markets (AD12-12)**

On November 15, 2012, FERC issued an order regarding coordination between natural and electricity markets based on regional technical conferences held during the summer of 2012. The order directs FERC staff to conduct additional technical conferences to examine: (1) information sharing practices, including rules for disclosure of non-public information under the standards of conduct; and (2) whether scheduling practices of natural gas and electricity markets require changes and, if so, what changes will achieve the most efficient scheduling systems for both industries. The order also directs ISOs and RTOs to appear before FERC on May 16, 2013 and October 17, 2013 to share experiences coordinating with natural gas markets and ensuring adequate fuel supplies over the winter and spring, and the summer and fall, respectively. Finally, the order directs FERC staff to prepare quarterly reports on coordination activities between natural gas and electricity markets during 2013 and 2014.

Responsible Attorney: Andrew Ulmer

Reports filed

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

A market disruption is an action or event that causes a failure of an ISO market, related to system operation issues or system emergencies. The ISO reports these market disruptions to FERC on a monthly basis. On November 15, the ISO submitted its monthly report of market disruptions that occurred from September 16 through October 15.

Responsible Attorney: Anna McKenna

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

The ISO submits two types of monthly exceptional dispatch reports to FERC. On November 15, 2012, the ISO submitted transactional data including incremental and decremental MW volume, duration and location for exceptional dispatches occurring during the month of September 2012. On October 30 and November 30, the ISO submitted MW hour data and cost data for exceptional dispatches occurring during the months of July and August 2012, respectively. An exceptional dispatch is a dispatch or a commitment issued by the ISO to a resource outside the operation of the ISO market to address operational needs that cannot be address by the ISO market.

Responsible Attorney: Sidney Davies

Other FERC matters

- **Order to Show Cause re J.P. Morgan (EL12-103)**

On November 14, 2012, FERC issued an Order Suspending Market-Based Rate Authority. The order rejected J.P. Morgan's arguments and ruled that the market-based rate authority of the relevant J.P. Morgan entity (J.P. Morgan Ventures Energy Corp.) would be suspended for a period of six months, beginning on April 1, 2013. The order further provided general guidance for how J.P. Morgan would be able to continue to operate and schedule generation that it controls during the period when the suspension is in effect, and explained that the delay in the effective date of the suspension was adopted in order to allow the ISO to take any necessary steps to maintain system reliability during the suspension period. On September 20, 2012, FERC had previously issued an Order to Show Cause as to why J.P. Morgan should not be found to have violated FERC's market behavior rules. The Order to Show Cause preliminarily found that J.P. Morgan may have submitted misleading information to FERC, the ISO, and the ISO's Department of Market Monitoring in connection with a complaint J.P. Morgan had previously filed with FERC challenging a monetary penalty the ISO had imposed for J.P. Morgan's failure to timely respond to DMM data requests that had been issued as part of an investigation into alleged improper bidding behavior. The Order to Show Cause contemplated suspension of J.P. Morgan's market-based rate authority as a potential remedy for the alleged misconduct. On October 17, 2012, the ISO filed a motion to intervene and comments in the proceeding. In its pleading, the ISO stressed the importance of complying with FERC's market behavior rules and supported FERC's decision to institute the proceeding. The ISO further stated its support for serious sanctions, up to and potentially including suspension of market-based rate authority or similar sanctions, if FERC concludes that material misrepresentations have occurred. On October 17, 2012, J.P. Morgan filed its answer to the Order to Show Cause. J.P. Morgan acknowledged that the pleadings identified by FERC in the Order to Show Cause contained "mistakes" but argued against suspension or other penalties primarily because the errors were not knowing or intentional and occurred despite its exercise of "adequate – albeit imperfect – due diligence."

Responsible Attorneys: Burton Gross and Anna McKenna

- **Request for declaratory order concerning J. P. Morgan (EL13-21)**

As noted earlier, the ISO filed a reliability must-run contract with AES Huntington Beach that includes a condition precedent that requires resolution of J.P. Morgan's consent rights. As of the date of this report, J.P. Morgan has not consented, waived its right to consent, or acknowledged that it has no right to consent. Because the issue must be resolved in a timely fashion to ensure that the conversion of the Huntington Beach units 3 and 4 into synchronous condensers can be completed by the summer of 2013, the ISO filed a request for declaratory order with FERC declaring that J.P. Morgan does not have any right to consent to the synchronous condenser project or to the reliability must-run agreement under any agreement it has with AES. The ISO requested FERC to issue an order on or before January 7, 2013.

Responsible Attorneys: Burton Gross and Sidney Davies

California Public Utilities Commission matters

- **Long Term Procurement Process - CPUC Docket R.12-03-014**

Track 1 of the CPUC long term procurement process involves an analysis of the need for local capacity in the LA Basin and Big Creek/Ventura local areas, based on the ISO's once-through cooling studies. The ISO presented opening and reply testimony in Track 1, supporting not only the once-through cooling study methodology but the study assumptions regarding uncommitted amounts of demand response, energy efficiency and other non-generation resource alternatives. On September 24 and October 12 the ISO submitted initial and reply briefs, respectively. In addition, the ISO has actively participated in workshops addressing the resource procurement process that will be initiated once the CPUC has directed Southern California Edison to procure resources needed in these areas. A decision in Track 1 is anticipated by early 2013.

Responsible Attorney: Judi Sanders

- **Demand Response Direct Participation – CPUC Docket R.07-01-041**

At the November 29 CPUC meeting, the Commissioners accepted an October 25, 2012 proposed decision in the Phase 4 direct participation phase of this proceeding. The decision directs that direct participation of demand response in the ISO market be commenced. The decision also adopts a proposed standardized electric tariff, known as Rule 24, which establishes rules governing utility customer load participation in "demand response programs that directly bid into the wholesale market." These rules govern interaction between third party demand response providers and utility customers who participate in programs. The decision evaluated certain issues on which CPUC action has been pending in light of FERC's Orders No. 745 and No. 745A—orders which set out a rule that demand response compensation in the wholesale market must be no less than locational market price for demand response bids made at or above a net benefits test

price threshold. The decision prohibits utility load from being bid to the wholesale market at prices below the net benefits test price threshold. The ISO filed comments supporting the proposed decision on November 14 and November 19.

Responsible Attorney: Bill Di Capo

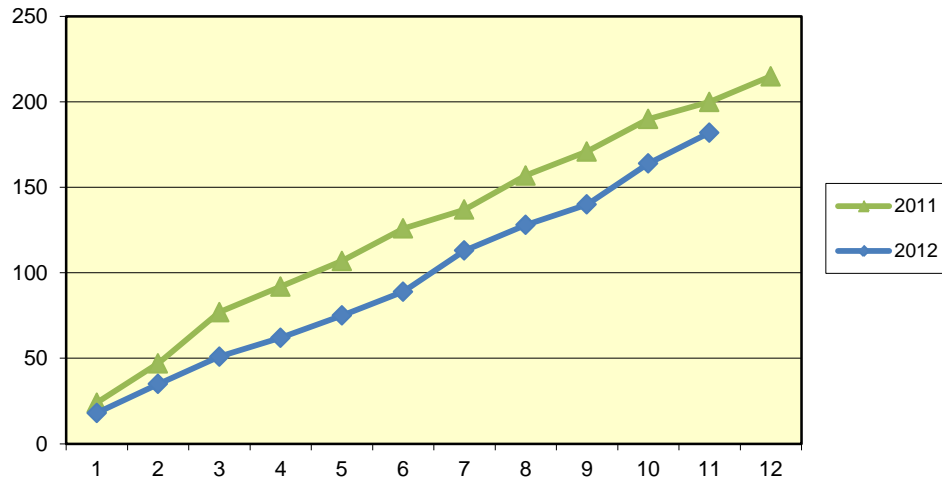
**San Diego Gas & Electric Company Request for Power Purchase Agreement
Approval – CPUC Docket A.11-05-023**

In this proceeding, SDG&E sought approval of three power purchase tolling agreements (PPTAs) totaling approximately 450 MW. According to SDG&E, the need for the PPTAs was driven by the upcoming retirement of the Encina generating facility, a coastal unit subject to the state's once-through cooling requirements. The OTC compliance date for the Encina facility is in late 2017. The ISO participated actively in the proceeding and presented its OTC study results that showed a need for up to 650 MW in the San Diego local capacity area starting as early as 2018. As was the case in the long term procurement proceeding discussed above, the ISO's uncommitted energy efficiency and demand response modeling assumptions were hotly contested by interveners in the proceeding. On November 20, 2012, proposed decisions were issued by the Administrative Law Judge and the Assigned Commissioner. Both decisions accepted the ISO's OTC study methodology but made adjustments of over 300 MW to the ISO's local capacity need determinations for uncommitted energy efficiency, demand response and uncommitted combined heat and power. The proposed decision issued by the Administrative Law Judge rejected all three PPTAs because the estimated commercial online dates for the facilities were ahead of the late 2017 need date established by the OTC study. The proposed decision issued by the Assigned Commissioner approved one of the three PPTAs, a contract with the Escondido Energy Center for 45 MW. Comments on the proposed decisions are due on December 10 and reply comments on December 17.

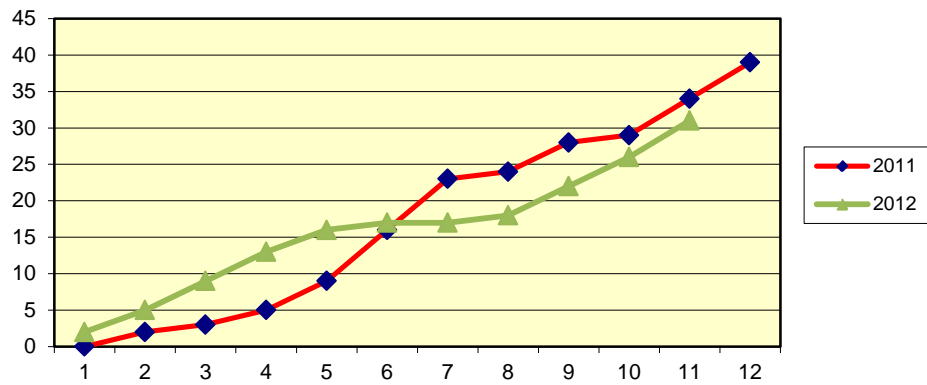
Responsible Attorney: Judi Sanders

Regulatory Filings Through November 2012

FERC Filings

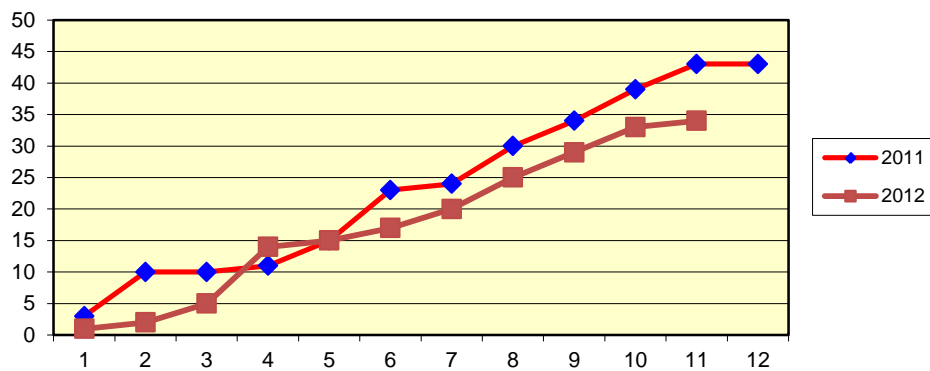


FERC Agreements

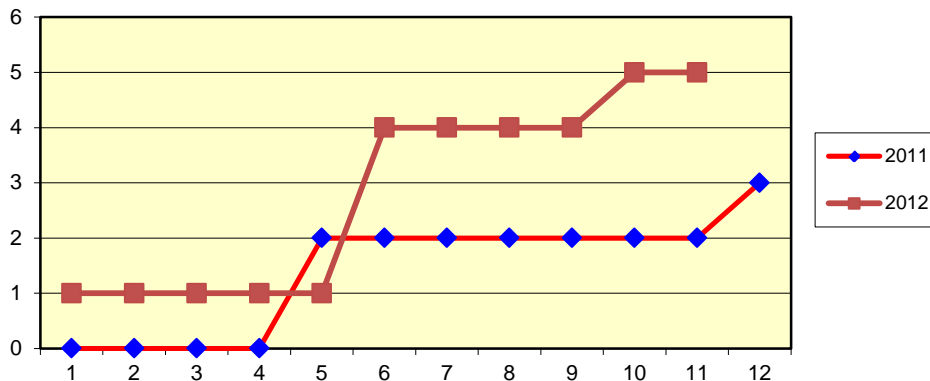


Regulatory Filings Through November 2012

CPUC/Other Commission Filings



Court Filings



Regulatory Filings Through November 2012

