

California Independent System Operator Corporation

Financial Statements

December 31, 2012 and 2011



California Independent System Operator Corporation

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December 31, 2012 and 2011

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Independent Auditor's Report

To Members of the Board of Governors
California Independent System Operator Corporation

We have audited the accompanying financial statements of the California Independent System Operator Corporation, which comprise the statements of net position as of December 31, 2012 and 2011, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the California Independent System Operator Corporation at December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

The accompanying management's discussion and analysis on pages 3 through 11 is required by accounting principles generally accepted in the United States of America to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in the appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

PricewaterhouseCoopers LLP

Sacramento, CA
April 4, 2013

California Independent System Operator Corporation

Management's Discussion and Analysis

The following discussion and analysis of the California Independent System Operator Corporation (the Company) provides an overview of the Company's financial activities for the years ended December 31, 2012 and 2011. This discussion and analysis should be read in conjunction with the Company's financial statements and accompanying notes, which follow this section.

Background

The Company is a nonprofit public benefit corporation incorporated in May 1997, and is responsible for the operation of the long-distance, high-voltage power lines that deliver electricity throughout most of California (the California grid) and to neighboring control areas and states, along with Canada and Mexico.

The Company's principal objective is to ensure the reliability of the California grid, while fostering a competitive wholesale marketplace for electrical generation and related services in California. The Company operates pursuant to tariffs filed with the Federal Energy Regulatory Commission.

The Company operates a day-ahead market for all twenty-four hours of the next operating day, and a real-time market for each operating hour. This market structure is the vehicle for providing open-access transmission service to users of the transmission grid, clearing energy bids and offers for short-term energy purchases and sales, performing economic dispatch to maintain continuous supply-demand balance and manage grid congestion, and procuring reserve capacity or ancillary services to maintain reliable operation under unexpected changes in grid conditions. The Company also performs a settlement and clearing function by charging and collecting payments from users of these services and paying providers of such services.

The Board of Governors (the Board) of the Company is appointed by the California Governor and subject to confirmation by the California State Senate. A full Board is comprised of five members.

Financial Reporting

The Company's accounting records are maintained in accordance with generally accepted accounting principles for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB) and, where not in conflict with GASB pronouncements, accounting principles prescribed by the Financial Accounting Standards Board (FASB).

Cash held by the Company on behalf of market participants is recorded in a restricted asset account with a corresponding liability due to market participants in the statements of net position. Except for the retention of restricted assets noted above, financial statements reflect a net reporting of market activities wherein the financial statements do not include the revenues and expenses, cash flows, and assets and liabilities associated with the market transactions it facilitates.

Revenue and Rates

The Company charges a Grid Management Charge (GMC) to market participants to recover the Company's operating costs, capital expenditures and debt service costs, and to provide for an operating reserve.

The GMC was restructured in 2012 and is comprised of the following three service categories: market services, system operations and congestion revenue rights services. In 2011 GMC rates were comprised of the following six service categories: core reliability services; energy transmission services; forward scheduling; congestion management; market usage; and settlements, metering and client relations.

California Independent System Operator Corporation

Management's Discussion and Analysis

The following table summarizes the pro forma bundled GMC rate based on the budgeted revenue requirement divided by the estimated control area transmission volume. As reflected below, the GMC rate has been stable for the past three years.

	2012	2011	2010
Revenue requirement in millions	\$ 194.8	\$ 189.8	\$ 195.1
Estimated transmission volume in millions of MWh	242.4	240.0	246.0
Pro forma GMC rate per MWh	0.804	0.791	0.793

Liquidity

The Company sets its annual revenue requirement at a level to cover three major expense groups: operations and maintenance budget, debt service, and capital projects budget. Those costs are offset by the miscellaneous revenue budget, which is primarily interest income and fees collected outside of the GMC.

Per the tariff, the operations and maintenance budget contains an operating reserve, which is based on 15% of the current year's operating and maintenance costs. Furthermore, the tariff requires the collection of a 25% debt service reserve based on the debt service to be paid during the year. The Company's operating and debt service reserves were fully funded in 2012 and 2011.

In July 2009, the Company issued \$200.0 million of fixed rate bonds primarily for the construction of the Company's new facility in Folsom, California. The construction of the new facility was completed near the end of 2010. The new facility was occupied in January 2011. The remaining proceeds of the 2009 bonds are being used to fund computer hardware and software systems, equipment, and other planned capital projects. As of December 31, 2012, \$13.1 million of these proceeds remain unspent for capital projects.

The Market

The Company continues to develop market enhancements to increase reliability, efficiency and provide accuracy of market results in the future. These enhancements increase the functionality and flexibility of the market system to meet the on-going needs of market participants.

California Independent System Operator Corporation

Management's Discussion and Analysis

Financial Highlights

Statements of Net Position, Statements of Revenues, Expenses and Changes in Net Position

The financial statements provide both short-term and long-term information about the Company's financial status. The statements of net position include all of the Company's assets and liabilities, using the accrual method of accounting, and identify any assets which are restricted as a result of bond covenants or external commitments. The statements of net position provide information about the nature and amount of resources and obligations at specific points in time.

The statements of revenues, expenses and changes in net position report all of the Company's revenues and expenses during the year. The statements of cash flows report the cash provided and used during the year by operating activities, as well as other cash sources such as investment income and debt financing, and other cash uses such as payments for bond principal and capital additions.

Condensed Statements of Net Position (in millions)

	2012	2011	2010
Assets			
Current assets	\$ 421.6	\$ 491.8	\$ 479.0
Fixed assets, net	252.4	303.9	351.3
Other noncurrent assets	113.5	94.9	101.4
	<u>\$ 787.5</u>	<u>\$ 890.6</u>	<u>\$ 931.7</u>
Liabilities and Net Assets			
Current liabilities	\$ 392.1	\$ 420.9	\$ 385.9
Long-term debt, net of current portion	218.5	259.2	289.3
Other noncurrent liabilities	21.8	19.4	17.5
Net position	155.1	191.1	239.0
	<u>\$ 787.5</u>	<u>\$ 890.6</u>	<u>\$ 931.7</u>

Assets

Current Assets (in millions)

	2012	2011	2010
Cash and cash equivalents	\$ 376.2	\$ 450.2	\$ 382.5
Short-term investments	27.8	22.8	61.8
Accounts receivable and other assets	17.6	18.8	34.7
	<u>\$ 421.6</u>	<u>\$ 491.8</u>	<u>\$ 479.0</u>

2012 Compared to 2011

As of December 31, 2012, current assets amounted to \$421.6 million reflecting a decrease of \$70.2 million during the year. This decrease is largely due to the decrease in cash and cash equivalents of \$74.0 million caused by decreases in the collateral held for market participants and in deposits from market participants for generator interconnection studies.

California Independent System Operator Corporation

Management's Discussion and Analysis

2011 Compared to 2010

As of December 31, 2011, current assets amounted to \$491.8 million reflecting an increase of \$12.8 million during the year. This increase is largely due to increased cash and cash equivalents caused by increased collateral and market deposits. Accounts receivable and other assets decreased by \$15.9 million largely due to a continued shorter GMC collection period resulting from the implementation of weekly settlements, and lower generation interconnection project receivables.

Fixed Assets, net (in millions)

	2012	2011	2010
Net assets in service	\$ 247.8	\$ 297.6	\$ 232.7
Work-in-progress	<u>4.6</u>	<u>6.3</u>	<u>118.6</u>
	<u>\$ 252.4</u>	<u>\$ 303.9</u>	<u>\$ 351.3</u>

2012 Compared to 2011

Total fixed assets, net of accumulated depreciation, decreased in 2012 by \$51.5 million compared to 2011. The decrease is primarily due to the current year depreciation expense of \$73.6, offset by new assets placed in service of \$23.8 million. Work in-progress decreased by \$1.7 million compared to 2011 due to the completion of capital projects during the year.

2011 Compared to 2010

Total fixed assets, net of accumulated depreciation, decreased in 2011 by \$47.4 million compared to 2010. Net assets in service increased in 2011 compared to 2010 by \$64.9 million due to the placement in service of completed assets and the remaining two wings of the new headquarters of \$94.5 million, partially offset by higher depreciation expense. Work in-progress decreased by \$112.3 million compared to 2010 due to the placement in service of the remaining two wings of the new headquarters and other projects of \$126.8 million, partially offset by \$22.1 million in new projects.

Other Noncurrent Assets (in millions)

	2012	2011	2010
Long-term investments	\$ 107.6	\$ 90.0	\$ 94.5
Other assets	<u>5.9</u>	<u>4.9</u>	<u>6.9</u>
	<u>\$ 113.5</u>	<u>\$ 94.9</u>	<u>\$ 101.4</u>

2012 Compared to 2011

Other noncurrent assets increased by \$18.6 million in 2012. This change is largely attributable to increased investments amounting to \$17.6 million during the year due to transfers of cash and cash equivalents to long-term securities and to higher prepayment amounts at the end of 2012.

2011 Compared to 2010

Other noncurrent assets decreased by \$6.5 million in 2011. This change is largely attributable to decreased investments amounting to \$4.5 million during the year due to the use of bond funds for construction of the new building and to lower prepayment amounts at the end of 2011.

California Independent System Operator Corporation

Management's Discussion and Analysis

Liabilities

Current Liabilities (in millions)

	2012	2011	2010
Accounts payable and accrued expenses	\$ 15.3	\$ 18.6	\$ 24.5
Accrued salaries and compensated absences	27.1	25.9	26.2
Current portion of long-term debt	39.6	28.6	42.2
Due to market participants	307.2	347.2	292.2
Generator noncompliance fines refund obligation	2.9	0.6	0.8
	<u>\$ 392.1</u>	<u>\$ 420.9</u>	<u>\$ 385.9</u>

2012 Compared to 2011

Current liabilities at December 31, 2012, amounted to \$392.1 million, a decrease of \$28.8 million during the year. This decrease is primarily due to lower amounts of collateral held for market participants, reduced amounts of generator interconnection study deposits as a result of studies being completed, and the distribution of forfeited study deposits that were previously pending Federal Energy Regulatory Commission approval. These decreases were offset by a higher liability amount for the current portion of long-term debt of \$11.0 million.

2011 Compared to 2010

Current liabilities at December 31, 2011, amounted to \$420.9 million, an increase of \$35.0 million during the year. This increase is primarily due to increased amounts of collateral held for market participants as a result of increased market activity and because of forfeited study deposits held pending Federal Energy Regulatory Commission approval. This was offset by a lower liability amount for the current portion of long-term debt of \$13.6 million, and a reduction of \$5.9 million in accounts payable and accrued expenses because of reduced expenditures.

Long-Term Debt (in millions)

Summarized activity of long-term debt for the year ended December 31, 2012, is as follows:

	Beginning of Year	Payments	End of Year
CIEDB Revenue Bonds, Series 2008	\$ 84.6	\$ (25.1)	\$ 59.5
CIEDB Revenue Bonds, Series 2009	200.0	(3.5)	196.5
Total long-term debt	<u>\$ 284.6</u>	<u>\$ (28.6)</u>	<u>\$ 256.0</u>

California Independent System Operator Corporation

Management's Discussion and Analysis

Summarized activity of long-term debt for the year ended December 31, 2011, is as follows:

	Beginning of Year	Payments	End of Year
CIEDB Revenue Bonds, Series 2008	\$ 126.9	\$ (42.3)	\$ 84.6
CIEDB Revenue Bonds, Series 2009	200.0	-	200.0
Total long-term debt	<u>\$ 326.9</u>	<u>\$ (42.3)</u>	<u>\$ 284.6</u>

Debt service requirements below reflect scheduled maturities of long-term debt at December 31, 2012. Interest is calculated using the stated fixed rate of the bonds. As of December 31, 2012, the Company had an underlying rating of A from S&P, A1 by Moody's and A+ by Fitch. Fitch rates the Company's outstanding 2009 Series A bonds at AA- due to the additional support of the pledged deed of trust on the Company's primary building.

	Principal	Interest	Total
Debt service requirements (in millions)			
2013	\$ 39.6	\$ 13.2	\$ 52.8
2014	27.1	11.6	38.7
2015	3.8	10.9	14.7
2016	4.0	10.7	14.7
2017	4.1	10.6	14.7
2018-2039	177.4	142.4	319.8
	<u>\$ 256.0</u>	<u>\$ 199.4</u>	<u>\$ 455.4</u>

2012 Compared to 2011

At December 31, 2012 the Company had \$256.0 million of outstanding bonds issued through the California Infrastructure and Economic Development Bank (CIEDB). The decrease in long-term debt is attributable to scheduled debt payments on the 2009 and 2008 series bonds in the amount of \$28.6 million in 2012.

2011 Compared to 2010

At December 31, 2011 the Company had \$284.6 million of outstanding bonds issued through the California Infrastructure and Economic Development Bank (CIEDB). The decrease in long-term debt is attributable to scheduled debt payments on the 2008 series bonds in the amount of \$42.3 million in 2011.

Other Noncurrent Liabilities (in millions)

	2012	2011	2010
Employee retirement plan obligations	\$ 21.8	\$ 19.4	\$ 17.5
	<u>\$ 21.8</u>	<u>\$ 19.4</u>	<u>\$ 17.5</u>

2012 Compared to 2011

Other noncurrent liabilities amounted to \$21.8 million at December 31, 2012, an increase of \$2.4 million during the year as a result of net increases in employee retirement plan obligations attributable to the excess of plan costs over current year funding.

California Independent System Operator Corporation

Management's Discussion and Analysis

2011 Compared to 2010

Other noncurrent liabilities amounted to \$19.4 million at December 31, 2011, an increase of \$1.9 million during the year as a result of increases in employee retirement plan obligations attributable to the excess of plan costs over current year funding.

Net Position (in millions):

	2012	2011	2010
Net investment in capital assets	\$ 35.6	\$ 72.9	\$ 95.9
Unrestricted	<u>119.5</u>	<u>118.2</u>	<u>143.1</u>
Total	<u>\$ 155.1</u>	<u>\$ 191.1</u>	<u>\$ 239.0</u>

2012 Compared to 2011

Net investment in capital assets at December 31, 2012, totaled \$35.6 million, a decrease of \$37.3 million during the year. This change is attributable to the decrease in unspent debt proceeds and debt service payments. The unrestricted component of the net position amounted to \$119.5 million at December 31, 2012, a slight increase of \$1.3 million during the year.

2011 Compared to 2010

Net investment in capital assets at December 31, 2011, totaled \$72.9 million, a decrease of \$23.0 million during the year. This change is attributable to the decrease in unspent debt proceeds. Unrestricted component of the net position amounted to \$118.2 million at December 31, 2011, a decrease of \$24.9 million during the year. The decrease is primarily due to the change in net assets partially offset by the changes in net investment in capital assets.

Changes in Net Position

Condensed Statement of Revenues, Expenses and Changes in Net Position (in millions):

	2012	2011	2010
Operating revenues	\$ 209.0	\$ 194.6	\$ 211.9
Operating expenses	<u>232.5</u>	<u>231.2</u>	<u>215.6</u>
Operating loss	(23.5)	(36.6)	(3.7)
Other income (expenses), net	<u>(12.5)</u>	<u>(11.3)</u>	<u>(3.8)</u>
	<u>\$ (36.0)</u>	<u>\$ (47.9)</u>	<u>\$ (7.5)</u>

Operating Revenues

2012 Compared to 2011

Total operating revenues increased during the year by \$14.4 million. This is primarily due to an \$8.8 million increase in the GMC due to slightly higher volumes and average GMC rates. Additionally, higher revenues from generator interconnection studies were recognized in 2012 as a result of increased activity with studies conducted by transmission owners.

California Independent System Operator Corporation Management's Discussion and Analysis

2011 Compared to 2010

Total operating revenues decreased during the year by \$17.3 million. This is primarily due to a \$15.7 million decrease in the GMC, the Company's primary operating revenue. The decrease is the result of an overall lower revenue requirement in 2011 compared to 2010, and collections of GMC revenues in 2010 being higher than the revenue requirement for that year, which did not recur in 2011.

Operating Expenses and Percentages (dollars in millions):

	2012	2011	2010
Salaries and related benefits	\$ 105.4	\$ 105.1	\$ 102.9
Communication and technology costs	20.0	20.3	18.8
Legal and consulting costs	23.1	15.9	16.2
Other: leases, facilities and other administrative costs	10.7	13.9	16.8
Lease termination and loss on retirement of assets	(.3)	6.6	-
Depreciation and amortization	73.6	69.4	60.9
	<u>\$ 232.5</u>	<u>\$ 231.2</u>	<u>\$ 215.6</u>
Salaries and related benefits	45 %	45 %	48 %
Communication and technology costs	9	9	9
Legal and consulting costs	10	7	7
Other: leases, facilities and other administrative costs	5	6	8
Lease termination and loss on retirement of assets	0	3	0
Depreciation and amortization	31	30	28
	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

2012 Compared to 2011

Operating expenses were \$1.3 million higher for the year ended December 31, 2012, as compared to the year ended December 31, 2011. This increase is comprised of \$7.2 million in higher legal and consulting costs as a result of increased expense reimbursements for generator interconnection studies and \$4.2 million of increased depreciation related to hardware and software placed in service. The increases were partially offset by the non-recurring lease termination charge of \$6.6 million in 2011, which did not occur in 2012, and a \$3.2 million decrease in lease, facilities and other administrative costs.

2011 Compared to 2010

Operating expenses were \$15.6 million higher for the year ended December 31, 2011, as compared to the year ended December 31, 2010. This increase is comprised of \$8.5 million of increased depreciation related to hardware and software placed in service and a full year of depreciation of the Company's new headquarters. Other increases were \$6.6 million of lease termination and loss on retirement of assets primarily related to the unrecoverable lease and termination costs of the abandoned facilities.

Total labor costs increased in 2011 by \$2.2 million due mostly to annual performance-based merit increases. Communications and technology costs increased by \$1.5 million due to required additional software maintenance contracts. These increases were offset by decreases in all other operating expenditures in the amount of \$3.2 million in 2011.

California Independent System Operator Corporation Management's Discussion and Analysis

Other Income (Expense), Net (in millions):

	2012	2011	2010
Interest income	\$ 3.0	\$ 2.9	\$ 5.9
Interest expense	(15.5)	(14.5)	(10.7)
Interest expense recovery	-	0.3	1.0
Total	<u>\$ (12.5)</u>	<u>\$ (11.3)</u>	<u>\$ (3.8)</u>

2012 Compared to 2011

Interest income increased by \$0.1 million at December 31, 2012, compared to December 31, 2011, due to higher fund balances available for investments. Interest expense increased by \$1.0 million primarily due to the recognition of \$2.2 million in additional interest associated with the refunds of generator noncompliance fines, partially offset by \$1.2 million in lower interest expenses on long-term debt.

2011 Compared to 2010

Interest income decreased by \$3.0 million at December 31, 2011, compared to December 31, 2010, due to lower fund balances available for investments and lower interest rates. Interest expense increased by \$3.8 million primarily due to lower capitalized interest as a result of the completion of the Company's new headquarters facility in late 2010.

California Independent System Operator Corporation
Statements of Net Position
December 31, 2012 and 2011

(in thousands of dollars)

	2012	2011
Assets		
Current assets		
Cash and cash equivalents, including restricted amounts	\$ 376,211	\$ 450,166
Accounts receivable	11,792	11,965
Short-term investments, including restricted amounts	27,839	22,790
Other current assets	5,720	6,835
Total current assets	<u>421,562</u>	<u>491,756</u>
Noncurrent assets		
Long-term investments, including restricted amounts	107,587	90,074
Fixed assets, net	252,406	303,868
Other assets	5,922	4,856
Total noncurrent assets	<u>365,915</u>	<u>398,798</u>
Total assets	<u>\$ 787,477</u>	<u>\$ 890,554</u>
Liabilities and Net Position		
Current liabilities		
Accounts payable and accrued expenses	\$ 15,286	\$ 18,541
Accrued salaries and compensated absences	27,132	25,919
Current portion of long-term debt	39,580	28,585
Due to market participants	307,210	347,208
Generator noncompliance fines refund obligation	2,851	638
Total current liabilities	<u>392,059</u>	<u>420,891</u>
Noncurrent liabilities		
Long-term debt, net of current portion	218,550	259,201
Employee retirement plan obligations	21,758	19,343
Total noncurrent liabilities	<u>240,308</u>	<u>278,544</u>
Total liabilities	<u>632,367</u>	<u>699,435</u>
Commitments and contingencies		
Net position		
Net investment in capital assets	35,634	72,887
Unrestricted	119,476	118,232
Total net position	<u>155,110</u>	<u>191,119</u>
Total liabilities and net position	<u>\$ 787,477</u>	<u>\$ 890,554</u>

The accompanying notes are an integral part of these financial statements.

California Independent System Operator Corporation
Statements of Revenues, Expenses and Changes in Net Position
Years Ended December 31, 2012 and 2011

(in thousands of dollars)

	2012	2011
Operating revenues		
GMC revenue	\$ 195,150	\$ 186,390
Other revenues	13,902	8,189
Total operating revenues	<u>209,052</u>	<u>194,579</u>
Operating expenses		
Salaries and related benefits	105,383	105,126
Equipment leases and facility costs	4,519	7,270
Communications, technology and temporary staffing contracts	20,043	20,292
Legal and consulting services	23,116	15,854
Training, travel and professional dues	2,720	2,631
Insurance, administrative and other expenses	3,457	4,005
Lease termination and loss on retirement of assets	(289)	6,632
Depreciation and amortization	73,563	69,360
Total operating expenses	<u>232,512</u>	<u>231,170</u>
Loss from operations	<u>(23,460)</u>	<u>(36,591)</u>
Other income (expense)		
Interest income	2,960	2,940
Interest expense	(15,509)	(14,513)
Interest expense recovery	-	254
Total other expense, net	<u>(12,549)</u>	<u>(11,319)</u>
Change in net position	<u>(36,009)</u>	<u>(47,910)</u>
Net position		
Beginning of year	<u>191,119</u>	<u>239,029</u>
End of year	<u>\$ 155,110</u>	<u>\$ 191,119</u>

The accompanying notes are an integral part of these financial statements.

California Independent System Operator Corporation
Statements of Cash Flows
Years Ended December 31, 2012 and 2011

(in thousands of dollars)

	2012	2011
Cash flows from operating activities		
Receipts from scheduling coordinators for GMC	\$ 195,877	\$ 196,187
Other receipts	13,348	11,872
Payments to employees and to others for related benefits	(102,090)	(103,430)
Payment of generator noncompliance fines refund obligation	-	-
Payments to vendors/others	(56,418)	(49,524)
Receipts from market participants	293,139	371,655
Payments to market participants	<u>(333,137)</u>	<u>(316,615)</u>
Net cash provided by operating activities	<u>10,719</u>	<u>110,145</u>
Cash flows from capital and related financing activities		
Purchases and development of fixed assets	(21,996)	(30,411)
Repayment of bonds	(28,585)	(42,250)
Interest on debt	<u>(14,870)</u>	<u>(16,608)</u>
Net cash used in capital financing activities	<u>(65,451)</u>	<u>(89,269)</u>
Cash flows from investing activities		
Purchases of investments	(73,069)	(44,047)
Sales and maturities of investments	50,506	87,525
Interest received	<u>3,340</u>	<u>3,264</u>
Net cash (used in) provided by investing activities	<u>(19,223)</u>	<u>46,742</u>
Net increase (decrease) in cash and cash equivalents, restricted and unrestricted	(73,955)	67,618
Cash and cash equivalents, restricted and unrestricted		
Beginning of year	<u>450,166</u>	<u>382,548</u>
End of year	<u>\$ 376,211</u>	<u>\$ 450,166</u>

The accompanying notes are an integral part of these financial statements.

California Independent System Operator Corporation
Statements of Cash Flows
Years Ended December 31, 2012 and 2011

(in thousands of dollars)

	2012	2011
Supplemental information		
Cash paid for interest for bonds	\$ 14,870	\$ 16,608
Reconciliation of loss from operations to net cash provided by operating activities		
Loss from operations	\$ (23,460)	\$ (36,591)
Adjustments to reconcile loss from operations to net cash provided by operating activities		
Depreciation and amortization	73,563	69,360
Lease termination and loss on retirement of assets	(289)	6,632
Changes in operating assets and liabilities		
Accounts receivable and other assets	(561)	16,959
Accounts payable and other accrued expenses	1,464	(1,255)
Due to market participants	(39,998)	55,040
Net cash provided by operating activities	<u>\$ 10,719</u>	<u>\$ 110,145</u>
Supplemental disclosure of noncash financing and investing activities		
Amortization of bond premium	\$ 1,071	\$ 1,491
Amortization of bond issuance costs and loss of refunding	(404)	(479)
Generator fines interest included in interest expense	(2,213)	-
Generator fines interest expense recovery	-	254
Change in purchases and development of fixed assets included in accounts payable and accrued expenses	236	(8,667)

The accompanying notes are an integral part of these financial statements.

California Independent System Operator Corporation

Notes to Financial Statements

December 31, 2012 and 2011

1. Organization and Operations

The Company, a nonprofit public benefit corporation incorporated in May 1997, is responsible for the operation of the long-distance, high-voltage power lines that deliver electricity throughout most of California (the California grid) and to neighboring control areas and states, along with Canada and Mexico. The Company charges a Grid Management Charge ("GMC") to market participants to recover the Company's costs and to provide an operating reserve. The Company's principal objective is to ensure the reliability of the California grid, while fostering a competitive wholesale marketplace for electrical generation and related services in California. The Company operates pursuant to tariffs filed with the Federal Energy Regulatory Commission.

The Company operates a day-ahead market for all twenty-four hours of the next operating day, and a real-time market for each operating hour. The Company also performs a settlement and clearing function by charging and collecting payments from users of these services and paying providers of such services. Cash held by the Company on behalf of market participants is recorded in a restricted asset account with a corresponding liability due market participants in the statements of net position. Except for the retention of restricted assets noted above, the Company's financial statements reflect a net reporting of market activities wherein the financial statements do not include the revenues and expenses, cash flows, and assets and liabilities associated with the market transactions it facilitates. GMC revenues have a priority claim against any market-related receipts. Any market defaults are allocated to market participants.

The Board of the Company is appointed by the California Governor and is subject to confirmation by the California State Senate. A full Board is comprised of five members.

2. Summary of Significant Accounting Policies

Method of Accounting

The accompanying financial statements have been prepared on an accrual basis of accounting in accordance with accounting principles for proprietary funds as prescribed by the Government Accounting Standards Board ("GASB"), and where not in conflict with GASB pronouncements, accounting principles prescribed by the Financial Accounting Standards Board ("FASB"). The Company uses the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Net Presentation of Market Activity

Effective September 2012, the Company's tariff was amended to reflect a change in the legal status of its position in facilitating market transactions. The tariff change established the Company as being a central counterparty to the transactions that it financially settles, with certain limited exceptions. The Company adopted this change in response to FERC Order No. 741, which was promulgated, among other reasons, to clarify the Company's standing to pursue collection of defaulted amounts in the event a market participant files for bankruptcy.

While the tariff change modified the Company's legal rights and obligations with respect to market transactions by making the Company a buyer to every seller and a seller to every buyer, the responsibilities of market participants for supplying electricity and other services to their customers have not been modified. The Company's market participants continue to be primary obligors with respect to those obligations. In addition, the allocation of market defaults among market participants has not changed. Market participants continue to bear the credit risk associated with any financial defaults by other market participants. Accordingly, the Company's financial

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statements continue to reflect a net reporting of market activities and exclude the revenues and expenses, cash flows, and assets and liabilities associated with the market transactions the Company facilitates.

Use of Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could materially differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents, restricted and unrestricted, include cash in bank accounts, money market funds, and other highly liquid investments with original maturities of three months or less. Cash and cash equivalents are unrestricted unless specifically restricted by bond indentures or the tariff.

Accounts Receivable and Revenue Recognition

The GMC is based on rates filed with Federal Energy Regulatory Commission and is designed to recover the Company's operating costs, capital expenditures, debt service costs, and to provide for an operating reserve. The GMC billings are recognized as revenue, based on estimated meter data submitted by market participants and therefore may be subject to adjustment when final invoices are issued.

The GMC was restructured in 2012 and is comprised of the following three service categories: market services, system operations and congestion revenue rights services. In 2011, GMC rates were comprised of the following service categories: core reliability services; energy transmission services; forward scheduling; congestion management; market usage; and settlements, metering and client relations.

The operating reserve is calculated separately for each GMC service category and accumulates until the reserve becomes fully funded (at 15 percent of budgeted annual operating costs for each rate service category). At December 31, 2012, the operating reserve for each service category was fully funded. In accordance with the tariff, any surplus operating reserve balance is applied as a reduction in revenue requirements in the following year. The tariff requires GMC rates to be adjusted not more than once per quarter. Rate adjustments are based on the greater of a 2% difference in projected volumes used to set rates or \$1.0 million in estimated annual GMC revenues. During 2012 and 2011, adjustments were made to certain GMC rates pursuant to these provisions.

Generator Interconnection Studies

The Company is responsible for conducting generator interconnection studies at the request of project sponsors who are developing generating plants to become connected to the transmission grid operated by the Company. The project sponsors are required to make a deposit before any studies are performed. At any time, the project sponsors may withdraw from the studies.

In accordance with the tariff, the Company charges the project sponsors the actual costs of the studies. Related study costs include both internal costs and external costs and are recorded, when incurred, as operating expenses. As costs are incurred, the Company recognizes revenue for the same amount, which is recorded as a component of other revenues. The Company applies the

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deposits against the related receivable as costs are incurred. Certain deposits related to projects abandoned by the project sponsors are retained by the Company and distributed to market participants following approval by the Federal Energy Regulatory Commission. These distributions do not result in revenues or expenses recognized by the Company.

Generator Noncompliance Fines

From December 8, 2000 through June 30, 2001, the Company assessed noncompliance fines on participating generators that failed to fully comply with dispatch instructions when the Company was seeking to prevent an imminent or threatened system emergency. In accordance with the tariff, these fines are retained by the Company. The Company recorded the net realizable amount of such fines as revenue when the underlying noncompliance event occurred. However, this amount has changed over time in response to developments in the still ongoing litigation over the California electricity crisis. The Company adjusts such amounts in recognition of these developments, which affect the ultimate recognition of the fines charged and payments of the liability.

Investments

Investments include government and federal agency securities, corporate bonds, a guaranteed investment contract, and a forward delivery agreement with maturities of more than three months. Investments are carried at fair value except for the guaranteed investment contract and the forward delivery agreement. The guaranteed investment contract and the forward delivery agreement are nonparticipating investment contracts that cannot be negotiated or transferred and their redemption terms do not consider market rates. As a result, these investments are carried at cost. Income on investments and the gain or loss on the fair value of investments is recorded as a component of interest income.

Fixed Assets

Fixed assets are recorded at cost. Depreciation is computed using the straight-line method over the assets' estimated useful lives. Most of the Company's investment in fixed assets consists of the headquarters building and related assets which are being depreciated over twenty to thirty years and information systems, which are being depreciated over three to five years. The cost of improvements to or replacement of fixed assets is capitalized. Interest incurred during development is capitalized. When assets are retired or otherwise disposed of, the cost and related depreciation are removed from the accounts and any resulting gain or loss is reflected in the Company's statement of changes in revenues, expenses and changes in net position for the period. Repairs and maintenance costs are expensed when incurred. The Company capitalizes direct costs of salaries and certain indirect costs incurred to develop or obtain software for internal use. Costs incurred related to software development during the preliminary stage of a project and training and maintenance costs are expensed as incurred. Costs related to abandoned projects are expensed when the decision to abandon is made.

Other Assets

Other assets consist primarily of debt issuance costs that are amortized over the life of the bonds using the bonds outstanding method (which approximates the effective interest method). Other assets also include certain employee retirement plan trust accounts.

Compensated Absences

The Company accrues vacation leave when the employee becomes eligible for the benefit. The Company does not record sick leave or other leave as a liability since there are no cash payments for sick leave or other leave made when employees terminate or retire. At December 31, 2012 and 2011, the total accrued liability for vacation was \$7.3 million and \$7.0 million, respectively.

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Income Taxes

The Company is exempt from federal income tax under Section 501(c) (3) of the U.S. Internal Revenue Service (IRS) Code and is exempt from California State franchise income taxes.

Net Position

The Company classifies its net position into three components:

- **Net Investment in capital assets** - This component consists of capital assets, net of accumulated depreciation reduced by the outstanding debt balances, net of unamortized debt expenses.
- **Restricted** - This component consists of net assets with constraints placed on their use. Constraints include those imposed by debt covenants (excluding amounts considered in net capital, above) and by the Company's tariff and agreements with external parties.
- **Unrestricted** - This component consists of net assets that do not meet the definition of "invested in capital, net of related debt" or "restricted".

The Company had no restricted component of the net position at December 31, 2012 or 2011.

Concentration of Credit Risk

Financial instruments that subject the Company to credit risk consist primarily of accounts receivable relating to GMC billings due from market participants and cash and cash equivalents and investments.

All of the Company's receivables are due from entities in the energy industry, including utilities, generation owners and other electricity market participants. For the years ended December 31, 2012 and 2011, approximately 56 percent and 58 percent, respectively, of GMC revenues were from two market participants.

GMC revenues have a priority claim against any market-related receipts, which means that even if an entity defaults on an invoice containing a GMC charge, the Company receives the full GMC so long as sufficient funds were received on other market invoices.

The Company's concentration of credit risk related to cash and cash equivalents, and investments is described in Note 3.

Implementation of New GASB Accounting Guidance

In June 2011, the GASB issued Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position, effective for the Company's fiscal year beginning January 1, 2012. This Statement modifies the presentation of deferred inflows and deferred outflows in the financial statements and changes the labeling of "net assets", as previously presented to "net position" under the new standard. Implementation of Statement No. 63 had no effect on the Company's net position or changes in net position for the years ended December 31, 2012.

Additionally, GASB Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements, was adopted by the Company during the year ended December 31, 2012. This Statement incorporates into GASB's authoritative literature certain accounting and financial reporting guidance that is included in Financial Accounting Standards Board Statements and Interpretations, Accounting Principles

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Board Opinions and Accounting Research Bulletins of the American Institute of Certified Public Accountants' Committee on Accounting Procedures that were issued on or before November 30, 1989. Implementation of Statement No. 62 had no effect on the Company's financial statements for the years ended December 31, 2012.

Subsequent Events

The Company evaluates events or transactions that occur after December 31, 2012 but before financial statements are issued for potential recognition or disclosure in the financial statements. The Company has evaluated all subsequent events through April 4, 2013, the date the financial statements were issued, and no items were noted that need to be disclosed.

3. Cash and Cash Equivalents and Investments

Investment Policy and Credit Risk

The Company's investment policy restricts investments to securities issued by, or explicitly guaranteed by, the United States Government, debt obligations issued by government sponsored enterprises and supranational agencies, municipal and state obligations, corporate debt obligations, bank obligations, repurchase and other types of investment agreements, fixed income mutual funds, and money market funds. The Company's investment policy includes restrictions for investments relating to maximum amounts invested as a percentage of the total portfolio, maximum maturities, and minimum credit ratings.

To mitigate the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment, the Company limits purchases of investments to those rated at the time of purchase by at least two of the following nationally recognized statistical rating organizations: Standard & Poor's, Moody's, and Fitch. The investment must have a minimum rating of at least A-1 (or equivalent) for short-term obligations such as commercial paper and at least A- (or equivalent) for longer term obligations like corporate medium-term notes. In the event of split ratings, the lowest rating is considered the overall credit rating.

Concentration of Credit Risk

This is the risk of loss associated with the percentage of an entity's investment in a single issuer. The Company's investment policy limits investments in any single issuer to no more than 5% of the portfolio, with exceptions relating to US government obligations, pooled investments such as money market funds, and investments procured in connection with Company bond offerings. As of December 31, 2012, other than investments in US government obligations and money market funds, the Company had no investments in any one issuer representing more than 5% of total cash and cash equivalents and investments.

Custodial Credit Risk

Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Company will not be able to recover the value of its deposits, investments or collateral securities that are in the possession of an outside party.

The Company may maintain balances in bank accounts exceeding the FDIC insured level of \$250,000. In the event of a bank default, the Company's deposits may not be returned. The Company had noninterest-bearing bank deposits in amounts of \$61.3 million and \$34.5 million at December 31, 2012 and 2011, respectively. These deposits qualified for FDIC insurance coverage under Section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA") through December 31, 2012.

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All other investments purchased by the Company, by policy, are held in custodial accounts by third-party custodians and are registered in the Company's name, thereby minimizing any custodial credit risk.

Interest Rate Risk

Changes in interest rates may adversely affect the fair value of the Company's investments and its cash flows. The nature of the Company's investment needs and cash flows requires the majority of its investments to have maturities of one year or less. The investment policy further limits the maximum maturity of any investment to five years with the exception of bond reserve funds which are invested in accordance with the terms of the related bond indenture. The fair value of the resulting short-term investment portfolio is therefore, less affected by rising interest rates. The cash flows from short-term portfolios can be more affected by declining interest rates as maturing investments are reinvested at lower interest rates.

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Summary of Balances

At December 31, 2012, the Company's cash, cash equivalents and investments consist of the following (in thousands):

Description	Credit Rating*	Remaining Maturities (in Years)			Total
		Less than 1	1 - 5	More than 5	
Cash and cash equivalents - unrestricted					
Deposits		\$ 60,759	\$ -	\$ -	\$ 60,759
Money Market Funds	AAAm	-	-	-	-
Money Market Funds	AAA	-	-	-	-
		<u>60,759</u>	<u>-</u>	<u>-</u>	<u>60,759</u>
Cash and cash equivalents - restricted					
Deposits		4,762	-	-	4,762
Money Market Funds	AAAm	302,326	-	-	302,326
Money Market Funds	AAA	8,364	-	-	8,364
		<u>315,452</u>	<u>-</u>	<u>-</u>	<u>315,452</u>
Total cash and cash equivalents		<u>376,211</u>	<u>-</u>	<u>-</u>	<u>376,211</u>
Short term investments - unrestricted					
Government-sponsored Enterprises	AA+	4,033	-	-	4,033
U.S Treasury	AA+	5,008	-	-	5,008
Corporate Notes	AA+	2,535	-	-	2,535
Corporate Notes	A	3,565	-	-	3,565
Corporate Notes	A-	614	-	-	614
Corporate Notes	AA-	3,051	-	-	3,051
		<u>18,806</u>	<u>-</u>	<u>-</u>	<u>18,806</u>
Short term investments - restricted					
U.S. Treasury	AA+	5,008	-	-	5,008
Government-sponsored Enterprises	AA+	4,025	-	-	4,025
		<u>9,033</u>	<u>-</u>	<u>-</u>	<u>9,033</u>
Total short-term Investments		<u>27,839</u>	<u>-</u>	<u>-</u>	<u>27,839</u>
Long-term investments - unrestricted					
Affinity Insurance Ltd.	N/A	-	-	37	37
U.S. Treasury	AA+	-	22,816	-	22,816
Government-sponsored Enterprises	AA+	-	21,772	-	21,772
Municipal Bonds	AA+	-	2,303	-	2,303
Municipal Bonds	AA-	-	1,575	-	1,575
Corporate Notes	AAA	-	2,637	-	2,637
Corporate Notes	AA+	-	1,033	-	1,033
Corporate Notes	AA-	-	6,415	-	6,415
Corporate Notes	A+	-	2,311	-	2,311
Corporate Notes	A	-	6,587	-	6,587
Corporate Notes	A-	-	4,053	-	4,053
Corporate Notes	BBB+	-	1,577	-	1,577
Long-term investments - restricted					
Guaranteed Investment Contract	Unrated	-	19,697	-	19,697
Forward Delivery Agreement	Unrated	-	-	14,774	14,774
Total long-term Investments		<u>-</u>	<u>92,776</u>	<u>14,811</u>	<u>107,587</u>
Total cash, cash equivalents and investments		<u>\$ 404,050</u>	<u>\$ 92,776</u>	<u>\$ 14,811</u>	<u>\$ 511,637</u>

* Represents S&P rating.

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At December 31, 2011, the Company's cash, cash equivalents and investments consist of the following (in thousands):

Description	Credit Rating*	Remaining Maturities (in Years)			Total
		Less than 1	1 - 5	More than 5	
Cash and cash equivalents - unrestricted					
Deposits		\$ 31,132	\$ -	\$ -	\$ 31,132
Money Market Funds	AAAm	55,839	-	-	55,839
Money Market Funds	AAA	103	-	-	103
		<u>87,074</u>	<u>-</u>	<u>-</u>	<u>87,074</u>
Cash and cash equivalents - restricted					
Deposits		108	-	-	108
Money Market Funds	AAAm	290,510	-	-	290,510
Money Market Funds	AAA	72,474	-	-	72,474
		<u>363,092</u>	<u>-</u>	<u>-</u>	<u>363,092</u>
Total cash and cash equivalents		<u>450,166</u>	<u>-</u>	<u>-</u>	<u>450,166</u>
Short term investments - unrestricted					
U.S Treasury	AA+	2,018	-	-	2,018
Corporate Notes	AA	1,003	-	-	1,003
Corporate Notes	A+	3,623	-	-	3,623
Corporate Notes	A	520	-	-	520
Corporate Notes	AA-	3,002	-	-	3,002
		<u>10,166</u>	<u>-</u>	<u>-</u>	<u>10,166</u>
Short term investments - restricted					
U.S. Treasury	AA+	5,241	-	-	5,241
Government-sponsored Enterprises	AA+	7,383	-	-	7,383
		<u>12,624</u>	<u>-</u>	<u>-</u>	<u>12,624</u>
Total short-term Investments		<u>22,790</u>	<u>-</u>	<u>-</u>	<u>22,790</u>
Long-term investments - unrestricted					
Affinity Insurance Ltd.	N/A	-	-	37	37
U.S. Treasury	AA+	-	6,588	-	6,588
Government-sponsored Enterprises	AA+	-	8,072	-	8,072
Municipal Bonds	AA+	-	2,332	-	2,332
Corporate Notes	AAA	-	2,690	-	2,690
Corporate Notes	AA+	-	2,621	-	2,621
Corporate Notes	AA	-	2,633	-	2,633
Corporate Notes	AA-	-	3,237	-	3,237
Corporate Notes	A+	-	2,215	-	2,215
Corporate Notes	A	-	10,965	-	10,965
Corporate Notes	A-	-	5,927	-	5,927
Corporate Notes	BBB+	-	3,235	-	3,235
Long-term investments - restricted					
U.S. Treasury	AA+	-	5,067	-	5,067
Guaranteed Investment Contract	Unrated	-	19,697	-	19,697
Forward Delivery Agreement	Unrated	-	-	14,758	14,758
Total long-term Investments		<u>-</u>	<u>75,279</u>	<u>14,795</u>	<u>90,074</u>
Total cash, cash equivalents and investments		<u>\$ 472,956</u>	<u>\$ 75,279</u>	<u>\$ 14,795</u>	<u>\$ 563,030</u>

* Represents lowest rating (Fitch, Moody's or S&P), presented on the S&P scale.

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The Company's cash, cash equivalents and investments at December 31 consist of unrestricted and restricted funds as follows (in thousands):

	2012	2011
Unrestricted funds, operating account	\$ 152,681	\$ 147,793
Restricted funds		
Market participants	307,210	347,208
Capital expenditures	17,274	31,267
Debt service	34,472	36,762
	<u>\$ 511,637</u>	<u>\$ 563,030</u>

Cash and cash equivalents restricted for market participants consist of the following at December 31 (in thousands):

	2012	2011
Security deposits	\$ 123,007	\$ 173,774
Market funds pending settlement	95,189	61,772
Pass-through fees due to others	12,890	10,810
Generator interconnection study deposits	60,250	81,166
Forfeited deposits pending distribution	15,874	19,686
Total amounts restricted for market participants	<u>\$ 307,210</u>	<u>\$ 347,208</u>

Cash, cash equivalents and investments restricted for market participants consist of amounts held by the Company to be remitted to market participants or others on their behalf. Security deposits are amounts received from market participants who are required to post collateral for their transactions in the Company's markets. Market funds pending settlement consist of amounts collected during the settlement and clearing function that will pass through to market participants in subsequent periods. Pass-through fees due to others consist of amounts collected from market participants that will be paid to market participants for summer reliability, startup costs and emission costs. Generator interconnection study deposits are amounts collected for future studies. Forfeited deposits consist of generator interconnection study amounts forfeited by project sponsors that are pending Federal Energy Regulatory Commission approval for distribution.

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4. Fixed Assets

Changes in the Company's fixed assets for the year ended December 31, 2012, are as follows (in thousands):

	2011	Additions and Transfers In	Deletions and Transfers Out	2012
Nondepreciable fixed assets				
Land	\$ 9,098	\$ -	\$ -	\$ 9,098
Work-in-progress	6,279	22,288	(23,924)	4,643
	<u>15,377</u>	<u>22,288</u>	<u>(23,924)</u>	<u>13,741</u>
Depreciable fixed assets				
Regional transmission operator software	355,977	20,393	(12,710)	363,660
Regional transmission operator hardware	32,711	2,484	(65)	35,130
Communication equipment	7,831	559	-	8,390
ISO Facilities (HQ and Alhambra)	156,413	104	(12,774)	143,743
Furniture, fixtures and other	14,639	197	(63)	14,773
	<u>567,571</u>	<u>23,737</u>	<u>(25,612)</u>	<u>565,696</u>
Less: Accumulated depreciation	<u>(279,080)</u>	<u>(73,563)</u>	<u>25,612</u>	<u>(327,031)</u>
	<u>288,491</u>	<u>(49,826)</u>	<u>-</u>	<u>238,665</u>
Total fixed assets, net	<u>\$ 303,868</u>	<u>\$ (27,538)</u>	<u>\$ (23,924)</u>	<u>\$ 252,406</u>

Changes in the Company's fixed assets for the year ended December 31, 2011, are as follows (in thousands):

	2010	Additions and Transfers In	Deletions and Transfers Out	2011
Nondepreciable fixed assets				
Land	\$ 7,617	\$ 1,481	\$ -	\$ 9,098
Work-in-progress	110,946	22,137	(126,804)	6,279
	<u>118,563</u>	<u>23,618</u>	<u>(126,804)</u>	<u>15,377</u>
Depreciable fixed assets				
Regional transmission operator software	336,834	19,519	(376)	355,977
Regional transmission operator hardware	34,081	1,677	(3,047)	32,711
Communication equipment	8,935	1,234	(2,338)	7,831
ISO Facilities (HQ and Alhambra)	63,306	94,589	(1,482)	156,413
Furniture, fixtures and other	14,338	8,122	(7,821)	14,639
	<u>457,494</u>	<u>125,141</u>	<u>(15,064)</u>	<u>567,571</u>
Less: Accumulated depreciation	<u>(224,784)</u>	<u>(69,360)</u>	<u>15,064</u>	<u>(279,080)</u>
	<u>232,710</u>	<u>55,781</u>	<u>-</u>	<u>288,491</u>
Total fixed assets, net	<u>\$ 351,273</u>	<u>\$ 79,399</u>	<u>\$ (126,804)</u>	<u>\$ 303,868</u>

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The Company capitalized interest related to the development of fixed assets of \$0.3 million and \$0.2 million for the years ending December 31, 2012 and 2011, respectively.

In January 2011, the remaining two wings of the new headquarters facility were fully occupied and as a result, \$84.8 million of assets were transferred from work-in-progress to fixed assets as they were placed in service.

5. Generator Noncompliance Fines

In 2000 and 2001, the Company billed generator noncompliance fines to market participants totaling \$122.1 million of which the Company collected \$60.7 million. Generally, these fines were assessed at a rate corresponding to twice the highest price paid in the Company's markets for energy. Because the prices for this period are being adjusted as a result of the Federal Energy Regulatory Commission Refund Case, as described in Note 12, the amount of the fines to be retained by the Company is being reduced, with any surplus collections being refunded with interest to market participants. The Company accrues interest in accordance with Federal Energy Regulatory Commission rulings on the portion of fines collected in excess of the estimated realizable amount, which is to be refunded to market participants when the amounts are settled. The ultimate settlement of fines is expected after the conclusion of the proceedings in the Federal Energy Regulatory Commission Refund Case and the financial settlement of the California Power Exchange (Cal PX).

Based on estimates of the mitigated energy prices the Company recorded fine revenues between the years 2000 to 2004 totaling \$29.5 million, resulting in a refund liability of \$31.2 million. On December 31, 2010, in connection with a settlement agreement that was approved by FERC the Company distributed \$43.9 million to the settling parties thereby reducing its refund liability.

In 2012, the Company increased its estimated generator noncompliance liability based on updated information it obtained related to interest and other factors that will serve to reduce the estimated amount of generator fine proceeds the Company will ultimately retain, which consequently increases the generator fine collections that will be returned to market participants. The final settlement of generator noncompliance fines will occur after the conclusion of the FERC Refund Case proceedings described in Note 12, which is expected to involve shortfalls in interest and principal in connection with prior settlements between the California Parties and suppliers. Based on current estimates obtained in 2012 from parties involved in these proceedings, the Company updated its estimate of the proportionate allocation of these shortfalls to the Company which resulted in an overall increase in the estimated liability of \$2.2 million and recognition of interest expense in the same amount in 2012.

The Company estimates the remaining liability (including interest) related to generator noncompliance fines to be \$2.8 million as of December 31, 2012.

There are significant uncertainties associated with the final settlement of generator noncompliance fines. While management's estimated liability at December 31, 2012 is based on the best information available, adjustments are likely to occur in the future to the estimated liability associated with interest and other shortfalls that will be incurred by the Cal PX, and allocated to the Company in connection with final disposition of the funds and obligations arising from the events of 2000 and 2001.

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6. Long-term Debt and Related Agreements

Long-term debt consists of the following at December 31 (in thousands):

	2012	2011
CIEDB Revenue Bonds, Series 2009 Fixed interest rates of 3.00% - 6.25% with maturities through 2039	\$ 196,545	\$ 200,000
CIEDB Revenue Bonds, Series 2008 Fixed interest rates of 4.00% - 5.00% with maturities through 2014	59,490	84,620
Unamortized net premium		
Series 2009 bonds	447	1,749
Series 2008 bonds	1,648	1,417
Total long-term debt	<u>258,130</u>	<u>287,786</u>
Less: Current portion	(39,580)	(28,585)
Total long-term debt, less current portion	<u>\$ 218,550</u>	<u>\$ 259,201</u>

Summarized activity of long-term debt for the year ended December 31, 2012, is as follows
(in thousands):

	Beginning of Year	Payments	End of Year
CIEDB Revenue Bonds, Series 2009	\$ 200,000	\$ (3,455)	\$ 196,545
CIEDB Revenue Bonds, Series 2008	84,620	(25,130)	59,490
Total long-term debt	<u>\$ 284,620</u>	<u>\$ (28,585)</u>	<u>\$ 256,035</u>

Summarized activity of long-term debt for the year ended December 31, 2011, is as follows
(in thousands):

	Beginning of Year	Payments	End of Year
CIEDB Revenue Bonds, Series 2009	\$ 200,000	\$ -	\$ 200,000
CIEDB Revenue Bonds, Series 2008	126,870	(42,250)	84,620
Total long-term debt	<u>\$ 326,870</u>	<u>\$ (42,250)</u>	<u>\$ 284,620</u>

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Scheduled future debt service payments for these bonds as of December 31, 2012, are as follows (in thousands):

	Principal	Interest	Total
2013	\$ 39,580	\$ 13,228	\$ 52,808
2014	27,145	11,605	38,750
2015	3,830	10,868	14,698
2016	3,980	10,711	14,691
2017	4,140	10,544	14,684
2018 - 2039	177,360	142,408	319,768
	<u>\$ 256,035</u>	<u>\$ 199,364</u>	<u>\$ 455,399</u>

Both the 2008 and 2009 Bonds are supported by a pledge of the Company's revenues and operating reserves. In addition, the 2009 Bonds are supported by a deed of trust on the Company's headquarters building and land. The premiums on the bonds are being amortized over the life of the bonds.

Interest expense recorded by the Company related to long-term debt includes interest paid on the bonds (net of interest capitalized to fixed assets), and amortization of the bond issuance costs and the bond premiums.

7. Derivative Financial Instrument – CRRs

As described in Note 2, beginning September 1, 2012, the Company is the central counterparty to market participant transactions which includes Congestion Revenue Rights (CRRs). CRRs are financial instruments that enable market participants to reduce their congestion-related price risk when delivering or selling energy on the grid. A CRR provides an economic hedging mechanism against congestion charges that can be transacted by market participants separately from transmission service. These instruments are considered derivative financial instruments for accounting purposes, which would require presentation at fair value if they were recognized as assets and liabilities of the Company.

Consistent with its role in facilitating other market transactions, the Company facilitates the allocation, auctioning and ultimate settlement of CRRs in its market, but does not have economic risks and rewards associated with these financial instruments. Any market defaults are allocated to market participants. As such they are not recognized as assets and liabilities in the Company's statements of net position. However, unlike other market transactions administered by the Company, CRRs can be outstanding for extended periods of time. At December 31, 2012, the average life of the Company's CRRs was 3.2 years and there are a total of 62 CRR holders. The estimated net fair value of both the CRR assets and liabilities as of December 31, 2012 was \$789.4 million related to a total of 834,012 megawatts, which vary in length from one month to several years. The value of each megawatt of CRR is a function of numerous factors including the length of period the CRR covers.

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While these amounts are not presented in the statements of net position, their estimated net fair value is disclosed for informational purposes given their longer term nature. Their fair value was determined based on several factors including actual auction prices transacted in the most recent annual and monthly auction processes, the Company's models which calculate the estimated value of all transmission constraints, net present value discounting and other factors. In addition to the high level of uncertainty associated with these inputs to the valuation calculation model, changes to actual or anticipated flows and constraints on the transmission system managed by the Company or in the value of electricity flowing on the transmission system create volatility that can significantly affect CRR values. Changes in generation, load, weather, and transmission outages are other factors that can have immediate and significant impact on CRR values.

The following is a summary of CRR megawatts, by type, outstanding at December 31, 2012.

Type	Megawatts
Monthly (January 2013)	40,166
Annual (February - December 2013)	447,208
Long Term (January 2014 - December 2022)	346,638
	<u>834,012</u>

8. Fair Value of Financial Instruments

The following valuation methods and assumptions were used as a basis for the fair value of each class of financial instrument:

Investments

The fair values of investments, including cash equivalents, except as noted below, are based upon quoted market prices. Fair values for the guaranteed investment contract and forward delivery agreement are based on counterparty quotes.

Long-Term Debt

The fair value of fixed rate long-term debt, which includes the short-term portion, is based on current market quotes.

The fair values of the Company's financial instruments as of December 31, 2012, are presented below (in thousands):

	Recorded Value	Fair Value
Investments, including cash and cash equivalents	\$ 511,637	\$ 513,886
Long-term debt, including current portion	(258,130)	(271,461)

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The fair values of the Company's financial instruments as of December 31, 2011, are presented below (in thousands):

	Recorded Value	Fair Value
Investments, including cash and cash equivalents	\$ 563,030	\$ 565,825
Long-term debt, including current portion	(287,786)	(301,035)

The carrying values reported in the statements of net position for current assets and liabilities approximate fair value.

9. Employee Benefit Plans

The Company maintains a number of employee benefit plans. A description of the plans and key provisions is included below. Obligations included in the Company's statements of net position related to these plans consist of the following at December 31 (in thousands):

	2012	2011
Post-employment medical benefit plan	\$ 20,046	\$ 17,966
Executive pension restoration plan	1,156	883
Executive savings plan	556	494
Total employee retirement plan obligations	\$ 21,758	\$ 19,343

Post-Employment Medical Benefit Plan

Plan Description

The Company sponsors the California ISO Retirees Medical Plan, a defined benefit plan, to provide post-employment health care benefits to all eligible employees who retire from the Company on or after attaining age 60. The required years of service to qualify for plan benefits is five years for employees currently employed and ten years for employees hired after 2012. Depending on years of service, the Company pays between 60% and 70% of the premiums on the coverage elections made by the beneficiaries not to exceed \$8,000 for individual retiree coverage and \$16,000 for retiree plus spouse and/or dependent. Plan benefits are available to eligible retirees and to their spouses, domestic partners and eligible dependents, as provided for under the terms of the plan. Current plan coverage extends for the lifetime of the participants and their beneficiaries, except for dependents, which generally terminates at age 25. There are 38 active employees and 29 retirees eligible to receive benefits pursuant to the plan as of December 31, 2012.

Funding and Investment Policy

The Company has established a trust for the purposes of funding the plan. The trust was established as a tax-exempt voluntary employees' beneficiary association. All assets of the trust are to be used for the exclusive benefit of the participants and beneficiaries of the plan. Although the Company has fiscal accountability for these assets and holds them in a fiduciary capacity, the assets are not considered assets of the Company and are therefore not included in the statements of net position of the Company. As of December 31, 2012 and 2011, the trust assets were \$6.6 million and \$5.3 million, respectively. Trust assets are primarily invested in US Treasury, government sponsored enterprises, and corporate obligations.

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The Company's current funding policy is to annually contribute an amount such that the total amount in the trust approximates the actuarially determined liability attributable to retirees and their spouses and to active participants who are fully eligible to retire. The Company does not provide funding into the plan related to future obligations associated with employees who have not become eligible to retire.

Annual Other Post-Employment Benefits (OPEB) Cost and Net OPEB Obligation

The Company's annual OPEB cost for the California ISO Retirees Medical Plan is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with GASB Statement No. 45 "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions". The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 15 years (using the level dollar open method). The ARC is adjusted for the amortized amount of the discounted present value (ordinary annuity) of the balance of the net OPEB obligation at the beginning of the year.

The Company's annual OPEB cost at December 31, 2012 and 2011, and for the years then ended, is as follows (in thousands):

	2012	2011
Annual required contribution	\$ 4,310	\$ 3,720
Interest on net OPEB obligation	719	797
Adjustment to annual required contribution	<u>(1,616)</u>	<u>(1,516)</u>
Annual OPEB cost	3,413	3,001
Contributions made	<u>(1,333)</u>	<u>(670)</u>
Increase in net OPEB obligation	2,080	2,331
Net OPEB obligation		
Beginning of year	<u>17,966</u>	<u>15,635</u>
End of year	<u>\$ 20,046</u>	<u>\$ 17,966</u>

The Company's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and net OPEB obligation for the years ended December 31, 2012, 2011 and 2010 were as follows (in thousands):

Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
2010	3,401	12 %	15,635
2011	3,001	22 %	17,966
2012	3,413	39 %	20,046

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Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan and include types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The following significant actuarial methods and assumptions were used in the calculation of annual OPEB cost for the year ending December 31, 2012.

Valuation date	January 1, 2012
Actuarial cost method	Projected unit credit
Amortization method	Level dollar, open
Remaining amortization period	15 years
Asset valuation method	Market
Investment rate of return	4.00%
Healthcare cost trend rate	8.0% initial, 5.0% ultimate

The projection of future benefit payments for an ongoing plan involves estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

The schedule below reflects multiyear trend information to show the status of funding based on the actuarial value of plan assets relative to the actuarial accrued liabilities. This information is required supplementary information (dollars in thousands):

Actuarial Valuation Date	Actuarial Value of Assets (a)	APBO (b)	Unfunded APBO (b - a)	Funded Ratio (a/b)
January 1, 2011	4,608	18,022	13,414	26%
January 1, 2012	5,343	22,727	17,384	24%
January 1, 2013	6,564	20,046	13,482	33%

The actuarial valuation as of January 1, 2013, incorporated changes to actuarial assumptions which are different from the assumptions used in the calculation of the annual pension costs for the year ending December 31, 2012. Such changes included a decrease in the investment rate of return from 4.0% to 3.5%, plan eligibility changes and the change in the cost-sharing of the plan coverage costs, including the employer cost cap. The APBO decreased by \$2.7 million between 2012 and 2013. This change is primarily to due plan changes, which reduced the obligation by \$9.5 million partially offset by increases in the obligation resulting from assumption changes of \$3.7 million and to the increases associated with the normal cost of the plan of \$3.1 million.

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The actuarial valuation as of January 1, 2012, incorporated changes to actuarial assumptions which are different from the assumptions used in the calculation of the annual pension costs for the year ending December 31, 2011. Such changes included a decrease in the investment rate of return from 5.1% to 4.0%, a decrease in the health care cost trend rate from 8.5% to 8.0% and changes to the retirement age rates. The increase in the APBO between 2011 and 2012 associated with changes in assumptions is \$1.8 million.

Executive Pension Restoration Plan

The Company sponsors the Executive Pension Restoration Plan, a nonqualified defined contribution plan, which allows certain officers of the Company to make contributions and receive Company contributions in excess of the 401(k) contribution limits set forth by IRS regulations as described in the retirement savings benefits plan below.

The contributions and earnings thereon are held in a trust and the balances as of December 31, 2012 and 2011, were \$1.2 million and \$0.9 million, respectively, and are included in Other Assets with a corresponding liability in Employee Retirement Plan Obligations. In connection with this plan, the Company recognized expenses for contributions of \$117,000 and \$67,000 in 2012 and 2011, respectively.

Executive Savings Plan

The Company sponsors the Executive Savings Plan, a nonqualified defined contribution plan under section 457(b) of the IRS Code. The Company contributes a percentage of each officer's annual base compensation to the plan. Officers may elect to make voluntary contributions, subject to statutory limitations. The contributions and earnings thereon are held in a trust and the balance as of December 31, 2012 and 2011 was \$556,000 and \$494,000, respectively and is included in Other Assets, with a corresponding liability in Employee Retirement Plan Obligations. In connection with this plan, the Company recognized expenses of \$110,000 and \$106,000 in 2012 and 2011, respectively.

Retirement Savings Benefits Plan

The Company sponsors a defined contribution retirement plan, the California ISO Retirement Savings Benefits Plan (the Retirement Plan) that is subject to the provisions of the Employee Retirement Income Security Act of 1974 and covers substantially all employees. The Retirement Plan is administered by the Company with the assistance of a third party. The assets of the plan are held separately from Company assets and are not combined with the assets in the statements of net position.

Employees may elect to contribute up to fifty percent of their eligible compensation to the Retirement Plan, subject to statutory limitations. The Company matches contributions up to six percent of an employees' eligible compensation and an additional contribution equal to five percent of eligible compensation for employees with less than five years of service, or seven percent for employees who have at least five years but not more than ten years of service. An additional contribution of one percent of eligible compensation is also made by the Company for each five year increment of service after an employees' ten year anniversary.

Employees' contributions to the Retirement Plan for 2012 and 2011 were \$7.5 million and \$6.7 million, respectively. In connection with this plan, the Company's contributions to the Retirement Plan for 2012 and 2011 were \$8.1 million and \$7.6 million, respectively.

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Supplemental Executive Retirement Plan

In 2011, the Company discontinued the Company sponsored California ISO Supplemental Executive Retirement Plan, a nonqualified defined benefit plan intended to provide selected executives of the Company with target retirement benefits based upon an executive's average earnings and total number of years of service with the Company, as defined in the plan. The plan was fully funded and distributed as of December 31, 2011. In connection with this plan, the Company recognized expenses of \$514,000 in 2011.

10. Insurance Programs and Claims

The Company is exposed to various risks of loss related to torts; theft, damage to, and destruction of assets; errors and omissions; nonperformance of duty; injuries to employees; and natural disasters. The Company maintains various commercial and mutual insurance plans that provide coverage for most claims in excess of specific dollar thresholds, which range from \$500 to \$1.0 million per claim. Primary insurance policies have coverage limits set based on the Company's assessment of reasonable exposure within that risk category, with consideration of insurance types and coverage limits for comparable entities. Additionally, the Company maintains excess liability coverage that provides umbrella coverage for certain exposures to a limit of \$135.0 million. Losses incurred below insurance deductibles are expensed as incurred. In the last three years, the Company did not incur any claims in excess of the coverage described above.

The Company is a participant in a group captive insurance company for workers compensation insurance coverage. The Company's annual net insurance costs for such coverage vary based on claims incurred at the Company, and to a lesser extent, claims activity of other members of the captive insurance company. The Company's annual insurance expense is limited through reinsurance and risk sharing arrangements of the captive to an additional percentage of the initial base premium paid.

11. Lease and Contract Commitments

The Company has long-term operating leases and service contracts that expire at various times through 2030 including telecommunication equipment and services, information system equipment and services and systems infrastructure.

The following are the future minimum payments under these agreements as of December 31, 2012 (in thousands):

2013	\$	4,097
2014		1,515
2015		1,509
2016		810
2017		603
2018 - 2030		<u>2,769</u>
	\$	<u>11,303</u>

Lease and service contract costs of approximately \$12.5 million were charged to operating expense in both 2012 and 2011.

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In January 2011, the Company relocated to a permanent headquarter building and vacated the leased headquarter buildings, which had three separate active leases at the time of the relocation. Although the Company was no longer occupying the leased space, in accordance with the lease agreements, the Company was required to pay for on-going costs associated with each of the leases, as well as monthly rent through November 2012 for one lease, and instead of making monthly lease payments for the other two lease agreements that had expiration dates through December 2016, the Company opted to pay the related early termination fees. As a result of these estimated unrecoverable lease and termination costs required, a liability and related expense in the amount of \$6.4 million was recorded in 2011. During 2012 and 2011, payments in the amount of \$3.9 million and \$2.3 million, respectively, were recorded against the liability. As of December 31, 2012, all settlement costs have been paid and the remaining liability balance of \$0.3 million was recognized as a gain in 2012.

12. Contingencies and Settlements

The Federal Energy Regulatory Commission Refund Case

In 2000 and 2001, the California energy markets, including those managed by the Company, experienced high prices, shortages of energy and reserves, rolling blackouts and liquidity problems for many market participants. Several of them, including the California Power Exchange (Cal PX), filed for bankruptcy.

Purchasers of energy during this period sought refunds at the Federal Energy Regulatory Commission. In a proceeding that is still ongoing, the Federal Energy Regulatory Commission has issued a series of orders related to mitigating the clearing prices in markets administered by the Company and the Cal PX for the period from October 2, 2000 through June 20, 2001 (the Federal Energy Regulatory Commission Refund Case). Several of the Company's market participants have settled their liability arising from the Federal Energy Regulatory Commission Refund Case and related proceedings. Management believes the ultimate outcome of the Federal Energy Regulatory Commission Refund Case will have no material financial impact on the Company as these refund amounts are funded and will ultimately be resettled among market participants, except for the Generator Noncompliance Fines, as described in Note 5.

Market Billing Disputes in Good Faith Negotiations

As part of the tariff and applicable contracts, the Company has dispute resolution processes for market participants, transmission owners and RMR owners to register disagreements regarding information reflected in the settlement statements or billing amounts for market and RMR activity.

Market disputes are addressed in the normal course of operations, some of which result in adjustments to previously issued settlement statements. When adjustments are made, the adjustment amounts are reallocated to market participants based on the allocation methodology related to the charge code being adjusted, with no net cost or credit being realized by the Company. With respect to pending market disputes at December 31, 2012, including those that have escalated to good faith negotiations, management believes that any settlements or market adjustments would be resettled against the market with no liability to the Company.

Indemnifications

The Company's bylaws require its annual financial statements to include disclosures about certain payments made by the Company related to indemnifications to or on behalf of officers and Board members. There were no such payments in 2012 or 2011.

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Other Matters

The Company, during the ordinary course of its operations, has been involved in various lawsuits and claims, some of which are still pending. In addition, the Company is subject to compliance requirements of mandatory reliability standards promulgated by Federal Energy Regulatory Commission-approved mandatory reliability standards (i.e. NERC Reliability Standards), which if violated could result in penalties assessed to the Company.

On September 8, 2011, an 11-minute system disturbance occurred in the Pacific Southwest, leading to cascading power outages and leaving approximately 2.7 million customers without power in Southern California, Arizona and northern Mexico. Service was restored in Southern California early the next morning.

The FERC and the North American Electric Reliability Corporation (“NERC”) conducted a joint inquiry into the outages and, on May 1, 2012, they issued a joint report with their analysis and conclusions as to the causes of the events. The report includes recommendations to help industry operators prevent similar outages in the future, but does not address potential reliability violations or an assessment of responsibility of the parties involved.

Management believes it is possible that penalties could be assessed against the entities involved in the events of September 8, which could include the Company. To the extent that any material penalties were assessed against the Company, Management believes that it is probable that it would be able to obtain authorization from FERC to recover those penalties from market participants through the penalty allocation request and approval process set forth in the Company’s Tariff.

There are several other matters currently pending related to alleged violations of these standards. Management is of the opinion that none of these matters will have a material adverse impact on the financial position or results of the operations of the Company.