

## Memorandum

To: ISO Board of Governors  
From: Yakout Mansour, President and Chief Executive Officer  
CC: ISO Officers  
Date: January 18, 2007  
Re: *CEO Report*

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### ***This item does not require Board action***

The following highlights some of the events affecting the ISO and/or the electricity industry since the date of the last meeting of the Board of Governors.

### **Market Redesign Technology Upgrade (MRTU) Program**

- Regarding the specifics of the program, we continue to make progress on each specific phase and certain program-wide activities. The majority of System Development activities are now complete with the exception of the FERC-ordered changes and certain components of the Integrated Forward Market and Scheduling Infrastructure and Business Rules systems. Market Simulation Phase 1 is now complete and Phase 2 is on schedule to begin January 22<sup>nd</sup>. In addition, the SaMC project has delivered its first set of charge codes for testing. Regarding program-wide activities, the first phase of Training is completed, as is the Participant Assessment Planning component of the External Readiness effort. In addition, Phase 1 Execution Start of Market Simulation is now complete. Finally, Phase 2 of Training, Internal and External Readiness, Market Simulation and CRR Allocation/Auction activities are all on schedule. The ISO and its vendors are aggressively and cooperatively working to mitigate the delays on these projects.

### **Operational Issues**

- The recent cold spell made all operators across the region snap to attention. In anticipation of the cold spell, we coordinated with the Bonneville Power Administration, Salt River Project ("SRP") and others throughout the region to ensure that we could provide assistance to one another if needed. While we were able to weather the spell, we did stand ready and provided emergency assistance power to SRP for a short duration on Monday, January 15th.

## Planning & Infrastructure Development

- As further detailed in the appropriate materials, Management is seeking Board approval of the proposed Tehachapi transmission project. While the project itself is necessary as a result of the requirements of the established CAISO Tariff Large Generator Interconnection Process ("LGIP") and thus does not require specific Board approval, we nonetheless believe the Board should approve the project. First and foremost, the Tehachapi project directly supports the reliable and least-cost interconnection of new planned renewable resources to the ISO grid. The Tehachapi Project also meets one of our primary corporate objectives to support key state public policy initiatives. Second, the Tehachapi project is unique in both its size and scope, with a projected cost of close to \$1.8 Billion and a staged implementation of over five years. I believe that a project of such size, scope and importance necessitates strong support from the Board.
- You have today before you the ISO's 2006 Transmission Plan. The proposed plan represents the "end of the beginning" of reforming the ISO's transmission planning process. The new plan, and planning process, is important because for the first time it reflects a more proactive ISO approach to identifying needed projects. The plan has a short-term (seasonal/yearly), mid-term (1-5 years) and long-term (10 year) focus and includes not only the projects proposed by our Participating Transmission Owners but projects the ISO has specifically identified to address reliability and economic needs. The short-term sections include the seasonal operating guides intended to facilitate reliable operations. The mid-term items are primarily focused on the transmission projects needed for economic and reliability over the next few years. The longer-term items are typically those initially identified to address perceived needs including access to needed new resources. By its nature, the plan is something that will evolve over time and become more refined the closer we get to the operating year in question. I would like to thank all of our Participating Transmission Owners and other market participants who participated in the development of the plan, as well as the leadership exhibited by the Planning and Infrastructure Development division.

## Regulatory/Government Highlights

- On December 14-15th, FERC held a technical conference on "seams" issues in Phoenix, Arizona. As you may recall, FERC staff was directed to hold the conference as a result of the September 21, 2006, FERC order on the ISO's MRTU proposal. FERC Commissioners were in attendance and the conference was otherwise well attended by industry participants from across the region. Chuck King, Mark Rothleder and myself were invited speakers from the ISO at the conference. The conference resulted in a healthy dialogue on the need for a going-forward collaboration to address seams issues in general. While no party identified an MRTU-related seams issue that will necessitate any major change to MRTU and its implementation date, I believe parties did identify potential opportunities to improve regional market coordination. The ISO is committed to further exploring those opportunities with other transmission providers and control area operators in the West.
- As further detailed in the Regulatory Update, on December 22, 2006, President Peevey of the California Public Utilities Commission ("CPUC") issued an Assigned Commissioner's Ruling ("ACR") and scoping memo regarding the CPUC's Resource Adequacy Phase 2 proceeding. The ACR sets forth a proposed scope and schedule for addressing the thirty or so issues that need to be addressed in the proceeding. The CPUC proposes to address the issues in phases over the 2007 and 2008 timeframe. One issue of particular importance is the issue of whether to and how to establish a centralized capacity market. The CPUC proposes to issue a decision on that and other issues by early 2008. That issue alone, let alone the many other issues identified by the CPUC, will require the dedication of a number of ISO

staff and resources. We are committed to support the CPUC's efforts and otherwise help establish the market and regulatory mechanisms necessary to attract the needed investment in the state's energy infrastructure.

- On or about January 22, 2007, the ISO will file a petition for declaratory order seeking guidance from FERC that would enable the ISO to implement a new mechanism to facilitate the financing and development of transmission facilities designed to connect renewable resources to the grid. The filing was deferred until now to accommodate discussions with the public power sector and to reflect their concerns in the filing.
- On January 10, 2007, the ISO filed comments at FERC regarding the Western Electricity Coordinating Council's (WECC's) proposed Regional Delegation Agreement. As you know, WECC has proposed to become a "Regional Reliability Organization" or "RRO" under the National Electric Reliability Corporation ("NERC"). FERC earlier approved NERC as the "Electric Reliability Organization" that was to be established under the Energy Policy Act of 2005. The ISO's comments stated that it supports a strong WECC as the RRO but also recommended certain changes to the WECC governance structure. Specifically, the ISO recommended that WECC establish a separate class for ISOs/RTOs, separate and distinct from the existing Transmission Owners class. The ISO stated that such a recommendation is consistent with the governance structure of NERC and other RROs and recognizes the unique role of ISOs/RTOs in integrating reliability requirements with organized electricity markets. We look forward to working with WECC, its members, and others in the region in establishing a strong RRO and in further supporting the implementation of the Energy Policy Act of 2005.

### **Financial Highlights (estimated)**

- Year-to-date estimated revenues through December are \$199.4M, \$13.7M higher than budget. The variance is due to higher GMC revenues and to higher interest income (which are applied against bond and other interest expenses of \$12.1M). Year-to-date estimated operating expenses through December are \$132.8M, \$1.1M lower than budget, primarily due to lower third-party vendor contract expenses.
- At this Board meeting, we will be advising the Board of plans to issue additional debt to finance the unfunded portion of the approved MRTU budget, and to seek approval of a "Reimbursement Agreement", which will enable us to apply bond proceeds to "reimburse" the GMC operating reserve for any MRTU expenditures so funded prior to the bond issuance date. Our current plans are to file with the FERC for authorization to issue the bonds in early February, seek Board approval at the March meeting, and, following both Board and FERC approval, issue the bonds in April, 2007.

### **People**

- The ISO now stands at 505 full-time employees, including three new hires that joined us in the month of December. We have 35 vacancies. Included in the vacancies and headcount are the 8 MRTU positions, 9 positions paid for by the Western Electricity Coordinating Council and 2 positions to be reimbursed through the new Generator Interconnection study process. The new hires are: Jeanette Aranas, Receptionist, Corporate Services; Zhivago Gonzalez, Manager Software Quality Assurance, Information Technology; and Bill DiCapo, Counsel, Legal & Regulatory.
- I would like to acknowledge the efforts of the Long-Term Congestion Revenue Rights ("LT CRR") team. You have today before you a LT CRR proposal that is the product of much hard work and collaboration with stakeholders – much of that over the holiday season. The LT CRR proposal represents a critical piece of market functionality strongly desired by many sectors of the market. While parties may not support all aspects of the proposal, I believe the proposal appropriate balances competing interests and needs and will lead the industry. I would like to thank the entire

LT CRR team, including Anjali Sheffrin, Lorenzo Kristov, David Withrow, Anna McKenna, Cindy Hinman, Jacquie De Rosa, Roger Treinen, as well as the Market Surveillance Committee, for their efforts. Please stand and be recognized as true ISO Ambassadors!

- Finally, it is with both great pride and sorrow that I acknowledge that Tom French and Dariush Shirmohammadi have left the ISO. Tom was offered an opportunity at his previous employer, Pacific Gas & Electric Company. Dariush decided to leave to be closer to his family and pursue other professional opportunities.

Tom's long tenure at the ISO was marked by both his excellent leadership of the Grid Assets department, his long history in guiding the ISO's Transmission Maintenance Coordination Committee, and his outstanding collaborative work with the California Energy Commission and other external parties in developing a common perspective on our loads and resources forecasts. I wish Tom the best in his new endeavors and his departure is yet another indication of the "market" value of our people!