

Memorandum

To: California ISO Board of Governors
From: Yakout Mansour, President and Chief Executive Officer
CC: California ISO Officers
Date: April 12, 2007
Re: ***CEO Report***

This item does not require Board action.

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

Market Redesign & Technology Upgrade (MRTU) Program

- Market Simulation Phase 2 was successfully completed on March 23rd allowing for enhanced rules/connectivity for market participants to submit bids and download reports and introducing Inter-Scheduling Coordinator ("Inter-SC") Trade functionality. The environment will remain open for unstructured testing for an additional month, until April 20th to facilitate market participant testing. Additionally, we have revamped the market simulations going forward based on feedback from stakeholders.
- The new Integrated Market Simulation (IMS) will commence on April 30th with the new Scheduling Infrastructure and Business Rules (SIBR) functionality. Release 2 will commence on May 29th with Day-Ahead Market testing. Subsequent releases will incrementally add functionality.
- The Congestion Revenue Right (CRR) Dry Run Report was filed with FERC on the scheduled due date – March 30th. We continue discussions with market participants based on the results of the Report to determine changes needed for MRTU.
- The California ISO continues to make progress on software development and certain program-wide activities. Last week, we reached an important milestone on integration testing – using real Master File and State Estimator data - between the Scheduling Infrastructure and SIBR system and the IFM system where results were produced for each of the 24 hours.

- We continue to face vendor delivery challenges, requiring us to continually reassess and make appropriate modifications to our development and testing schedules. So far, the February 1, 2008, new market Go-Live date is intact.

Operational Issues

- The California ISO has finalized the Summer 2007 Supply and Demand Operational Outlook. On March 29th, we provided an update on our 2007 summer preparedness plan to the California State Assembly, Committee on Utilities and Commerce. Our analyses are consistent with the generation and load forecasts, 2007 forecasted reserve margin, and probabilities of Stages 1, 2, and 3 occurrences provided by the California Energy Commission (CEC). We continue to coordinate with all entities to prepare for the summer.

In fact, the entire industry pulls together in the spring to get ready for summer peak demand. The California ISO-hosted summer preparedness workshops for grid operators will begin April 23rd and run for the next five weeks. During these workshops, specific operating scenarios are thoroughly tested using drills designed to enhance communications and operator techniques. Additionally, on April 24th, we will begin briefings with various market participants on expected summer operating conditions. Briefings are planned with SCE, PG&E, SDG&E, LADWP, SMUD, other MUNIs, (including their procurement representatives), as well as, generator owners and regional operations chiefs on 2007 summer preparedness.

- The California ISO and PG&E launched investigations with preliminary results indicating that the Midway North Operating Transfer Capability (OTC) was exceeded for 252 minutes on March 20th due to improper settings of the PG&E Internal Remedial Action Scheme (IRAS) at PG&E. The California ISO and PG&E are working collaboratively to standardize displays and communication regarding the IRAS and other complex operating systems.
- During the month of March, there was a small but statistically significant up-tick in price spikes relative to previous years. Price spikes are normal phenomena during the shoulder months but issues with the recent implementation of a new Intertie scheduling system appear to have contributed a nominal amount to the price spikes. The market impact was determined to be small and the system issues have been corrected. More details are provided in the Market Monitoring Report.

Planning Project Updates (Sunrise, Tehachapi, Trans Bay Cable)

- Sunrise Transmission Project

We attended a workshop on March 27 to present our testimony filed with the CPUC on March 1, regarding our evaluation of Sunrise and certain alternative analyses to Sunrise that the CPUC asked us to study. We have analyzed over 36 intervener identified alternatives/scenarios to Sunrise. There are several additional/new intervener scenario study requests that have been presented to the California ISO for evaluation and completion by May 1st. The schedule calls for filing testimony with the CPUC on April 20th; filing rebuttal testimony on June 15th; and hearings beginning on July 9th.

- Tehachapi Transmission Project

On March 14, SCE Chairman & CEO Al Fohrer and CPUC Commissioner Dian Grueneich, and I provided a briefing to State Senators George Runner, Jr. and Roy Ashburn, and Assembly Members Sharon Runner, Jean Fuller, and Bill Maze on the status of the Tehachapi transmission project. Our plan is to meet with federal officials

and members of the California Congressional Delegation on April 16th and 17th in Washington, D.C. to provide a similar briefing.

- **Trans Bay Cable Project**

The Trans Bay Cable Project is a 400 MW HVDC project that will be routed underwater from Pittsburg Substation in the Sacramento/San Joaquin Delta Area to Potrero Substation in SF (about 50 miles). This project was needed for reliability in 2011, but was advanced to 2009 based on its operational and economic benefits. The project was approved in Sept. 2005 for an estimated cost of \$300 million. The project is now needed for reliability and scheduled for operation in early 2010. The project slipped a year from 2009 to 2010 due primarily to the time required for permitting, but the reliability need for the project advanced a year from 2011 to 2010 based on meeting Locational Capacity Requirements which has, for the most part in 2007, replaced Reliability Must-Run. The projects cost is now estimated to be approximately \$400 million. The cost increase is primarily due to increased cost of materials and construction. Originally, the project was going to utilize Conventional DC Conversion technology, but now will use Voltage Source Conversion technology. Management is assessing the impact of these changes and will advise the Board accordingly.

2006 Annual Report on Market Performance

- Each year, the Department of the Market Monitoring publishes an annual report on the performance of the markets administered by the California ISO which is ultimately submitted to FERC. The initial draft was shared at the FERC technical conference on April 5. The report covers calendar year 2006 and incorporates historical performance results. Key highlights of the Report include:
 - In 2006, the California ISO and short-term bilateral energy markets were stable, competitive, and performed remarkably well under extreme summer heat wave conditions.
 - Average estimated cost of wholesale energy in 2006 dropped considerably from \$57.83 per MWh of load to \$47.55 per MWh due to lower gas prices and abundance of hydroelectric generation.
 - Total estimated wholesale energy and ancillary services costs declined by 16 percent in 2006, from \$13.6 billion in 2005 to \$11.4 billion in 2006.
 - Total intra-zonal congestion costs declined from \$222 million in 2005 to \$207 million in 2006.
 - Overall, there was a gain of approximately 15,800 MW of new generation capacity in 2006 compared to 2001. Approximately 5,500 MW of generation retirements including Mojave's retirement of coal-fired generating units. The Report indicates imports continue to play a key role in meeting demand. Resource Adequacy (RA) forward procurement continues to be key element in meeting local and system-wide needs. Additionally, Conservation, Demand Response and Interruptible Programs will continue to be essential in providing load-relief during critical times of need.

Regulatory/Government Highlights

- March 20th FERC Order approved the California ISO waiver request to allow for 180-day "Queue Cluster Window" to study the Tehachapi Transmission Project.

Financial Highlights

- March 2007 estimated revenues are \$22.6M or \$7.2M higher than budget. The higher revenues are primarily due to the \$6.6M refund of GMC from SDG&E. March 2007 estimated operating expenses are \$12.2M or \$1.6M lower than budget. The variance is primarily attributable to lower third-party contract costs in March.
- On April 5, the California ISO successfully completed a \$60 Million Bond offering that will fund the completion of MRTU program and provide \$3 million for additional 2007/2008 capital expenditures. The funding was completed at an attractive rate (approximately 4.1 per cent including amortization of all issuance costs). We obtained an interest rate swap to cover the full amount of the bonds resulting in a fixed rate over the six-year life of the bonds.

People

- The California ISO now stands at 514 full-time employees, including five new hires that joined us in the month of March 2007. We have 26 vacancies. Included in the vacancies and headcount are the 9 MRTU positions, 8 positions paid for by the Western Electricity Coordinating Council (WECC) and 5 positions to be reimbursed through the new Generator Interconnections study process (LGIP).

The new hires are: Jason Sherman, Operator in Training, Operations; Ken Evans, Operations Training Development Analyst, Operations; Steve Anners, Transmission Dispatcher – Alhambra, Operations; Peter Klauer, Senior Business Systems Analyst, Information Technology; and Kamal Abouelijoud, Software Quality Assurance Analyst, Information Technology.

Five-Year Business Plan (2007 – 2011)

- The California ISO completed its five-year business planning process defining the corporate strategic objectives and initiatives for the period covering 2007 to 2011. The process consisted of extensive external consultation with industry leaders and internal deliberations and analysis of key assumptions, uncertainties, strategies, and needs. Our employees have actively engaged in efforts to address the identified needs and the fulfillment of the corporate strategic objectives and initiatives through the alignment of specific division initiatives and the establishment of individual performance goals.