

Memorandum

To: California ISO Board of Governors
From: Yakout Mansour, President and Chief Executive Officer
Date: May 21, 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.

General

As reported at the Board's April meeting, on April 15 and 16, 2007, the CAISO experienced two events that tested several systems and procedures where a contract employee activated an emergency power-off switch, and several hours later sent a threatening e-mail that led to the evacuation of the Folsom campus. Our team responded very well to this event. When the emergency power-off switch was activated, our Energy Management System remained available, helping assure the continued reliable operation of the CAISO Control Area. Although we lost our market systems, they were restored within a few hours. The evacuation was handled very well by our staff, and key functions were performed without a hitch (e.g., publishing settlement statements, processing payroll, and paying Reliability Must Run invoices).

Management has already taken several actions in response to these events. We have implemented increased restrictions on access to the computer room and the control room and will also require that access to both information systems and physical facilities is immediately suspended when access to either information systems or facility access is removed. Management has also engaged a contractor to provide an independent review of the events and our procedures. The Chairman of the ADR/Audit Committee (Tim Gage) and I will oversee this investigation.

Market Redesign & Technology Upgrade (MRTU) Program

- The new Integrated Market Simulation (IMS) consists of five releases over the next six months. Release 1 began on April 30th with the new Scheduling Infrastructure and Business Rules (SIBR) functionality and will conclude on May 18th. Through week 2, we had 94 Scheduling Coordinator IDs participating and the target level of percentage of bid submission for Day-Ahead and Real-Time bids and trades was exceeded.

- IMS Release 2 is scheduled to begin on May 29th with Day-Ahead functionality from “Bid-to-Bill”. The Day-Ahead market will be run daily, market results will be published, settlements will be run for Day-Ahead charge types, and settlements statements will be produced. During this release, we will be providing individual workshops to go over each Scheduling Coordinator’s bids, trades, and results.
- We continue to face vendor delivery challenges and integration issues that result in delaying the start of End-to-End testing, requiring us to continually re-assess and make appropriate modifications to our development and testing priorities and schedules. We have restructured the internal program team to better respond to the delays and effectiveness of testing variances and required fixes. We’ve taken these steps because the next three months are critical to ensure we are ready for the last IMS release in September. These interim milestone challenges do not impact the February 1, 2008, new market Go-Live date.
- The Congestion Revenue Rights (CRR) component of the new MRTU markets must actually start production this summer, ahead of the February 2008 MRTU Go-Live. The results of the first year CRR allocations and auctions must be in the hands of the market participants before the rest of the new markets start up. Since February 2007, we have engaged stakeholders to work with us to finalize and file at FERC certain details and open issues that are needed for the CRR production process, which will begin in July and run through the end of the year. Some of these details and open issues were resolved in our May 7th filing to FERC, which the Board approved last month. Our next filing to FERC in early June, pending Board approval this month, addresses the credit requirements associated with participating in the CRR allocations and auctions and with holding CRRs. A third and final filing planned for the remaining open issues will be brought to the Board in the July meeting for filing at FERC shortly thereafter. Concurrently with the resolution of these open CRR issues, our staff is now collecting data from participants in preparation for the summer CRR production runs, and continues to be available to discuss with market participants the results of the CRR Dry Run Report that was filed with FERC on March 30th.
- The Market Surveillance Committee has been involved in a number of activities in past month related to the implementation of MRTU. Opinions will be submitted to the Board at this month’s meeting on two of three areas including: 1) Convergence Bidding; and 2) Day ahead and hour ahead scheduling requirements under MRTU. Analysis is proceeding in two other areas related to the 1) California’s Greenhouse Gas emissions control policies on the California electricity market; and 2) Backstop capacity product to replace the Reliability Capacity Service Tariff (RCST) under MRTU.

Operational Update

- On May 8, 2007, the California ISO declared statewide generation restricted maintenance operations due to higher than forecasted temperatures. This is a normal precautionary measure to avoid actions which would unnecessarily jeopardize generator availability.
- The California ISO-hosted summer preparedness workshops for grid operators began on April 23rd and will run for the next five weeks. During these workshops, specific operating scenarios are thoroughly tested using drills designed to enhance communications and operator techniques. Over 400 attendees this year received 32 hours of Emergency Operations Training, which includes eight hours of simulation training as mandated by NERC.

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

- Sunrise Transmission Project

On April 20th, we submitted the third part of our initial testimony, containing a summary of the Sunrise alternative scenarios that the California ISO had been asked to evaluate by various interveners. Following the April 20th

submission, the CAISO studied several other alternative scenarios for two specific interveners-UCAN and Ranchos Penasquitos Concerned Citizens (RPCC) and submitted these results on May 14th. Another testimony workshop was held on May 15th at which the CAISO presented an overview of the April 20th and May 14th alternative scenario results and answered questions. Additional model runs are now being performed at the request of the CPUC Energy Division and the CPUC's environmental consultants, and these results will be provided on or about June 8th.

- Trans Bay Cable Project

I would like to clarify our position on the project following the discussion we had at the last meeting. The ISO assessment of the project need has not changed, in fact, it is reinforced. The due diligence review assesses the changes in the project technology, cost, and timeline and the HVDC technology to be deployed, not whether the project goes ahead or not.

Financial Highlights

- Year-to-date revenues through April 2007 are \$67.9M or \$6.8M higher than budget. The variance is due to a one-time refund of the SDGE Grid Management Charge (GMC), higher interest income of \$4.0M (which is applied against bond and other interest expenses), and partially offset by lower GMC revenues of \$3.7M. The GMC revenue variance is primarily attributable to the generally mild January and February weather. Year-to-date operating expenses through April 2007 are \$51.0M, virtually on target.

People

The California ISO now stands at 517 full-time employees, including 10 new hires that joined us in the month of April. We have 23 vacancies, which include 6 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:

Kim Dang, Senior IT Budget Analyst, IT

Michael E. Jackson, Senior Applications Engineer, IT

Renelle Maier, Senior Systems Analyst, IT

Adam Rico, Associate Recruiting Specialist, Human Resources

Doug Seifter, Operations Trainee, Operations

Kevin Riedinger, Transmission Dispatcher, Operations

Susan Middleton, Operations Trainer, Operations

Joy Li, Senior Market Design Engineering Specialist, Operations

Robert Underwood, Senior Procurement Agent, Corporate Services

Carol Allotey, Executive Assistant, PID/External Affairs

I am very pleased to announce that the Board of Governors approved the appointment of Ms. Nancy Saracino as Vice President, General Counsel and Corporate Secretary effective May 29, 2007. She will be heading the California ISO's Legal and Regulatory Division. Prior to joining us, Ms. Saracino served as Chief Deputy Director of the California Department of Water Resources, assisting in the supervision of the Department and its 2,700 employees as well as

implementing policy for the protection, conservation, and management of the state's water supply. She has extensive experience in the area of energy law having served as Chief Counsel to the Department of Water Resources, representing the state of California during renegotiation of power contracts relating to the energy crisis. As lead negotiator, she worked to optimize and protect ratepayer value in the Department of Water Resources' \$22 billion energy contract portfolio. Ms. Saracino also currently serves as Steering Committee Member for the California Sustainability Alliance.