

Memorandum

To: ISO Board of Governors
From: Yakout Mansour, President and Chief Executive Officer
Date: March 18, 2009
Re: CEO Report

This memorandum does not require Board action.

1. MRTU READINESS

Program Update. On March 13, 2009, the Federal Energy Regulatory Commission (FERC) issued an order on the ISO's January 16, 2009 informational filing certifying readiness of the market redesign and technology upgrade to go live on March 31, 2009. This order accepts the filing based on the ISO's commitments to achieve the milestones and satisfactorily resolve the issues identified in the certification. With this acknowledgement from FERC, and given the ISO's continued commitment to address market participant concerns while using the tools we have to manage the migration to MRTU, our confidence in MRTU go-live on March 31, 2009 is high.

As of March 1, 2009, the ISO completed transition of all program-related activities to the responsible business units, marking the formal end of the MRTU capital program and the beginning of what will simply be maintenance of the new market design. Clearly, everyone involved deserves the recognition that this accomplishment warrants and I can't say enough to express my personal appreciation. Without the extraordinary dedication of the ISO team, the market participants, our respective vendors, and stakeholders, this time may not have come for us. As I said before, start-up challenges with complex systems like this are usually unavoidable, but I remain confident that we will overcome by building on the extraordinary collaborative momentum among all parties we have seen so far. We look forward to the opportunity to check in with you and to hear from the public at the meeting.

2. 2008 CORPORATE PERFORMANCE

The ISO's five year strategic plan establishes high level objectives and the annual corporate goals help drive the organization towards them. In 2008 the ISO achieved significant progress with respect to each of its three primary objectives as measured by the annual corporate goals and corporate initiatives. I am extremely proud of the organization's performance under incredibly challenging

circumstances, and will take this opportunity to briefly highlight accomplishments in the areas of excellence in grid and market operations, grid resource development and organizational effectiveness.

Grid and Market Operations. The operating environment has become increasingly complex at the same time new federal reliability standards and mandatory reporting requirements demand better processes to achieve detailed documentation of grid and market operations. Applicable to the ISO for 2008 were a total of 52 actively monitored standards with 257 specific requirements established by the North American Electric Reliability Corporation (NERC) and the Western Electric Coordinating Council (WECC), all of which were regularly monitored, tracked and reported. In the past the ISO measured operational performance based on reliability criteria that are now subsumed by the mandatory standards, making compliance with them an excellent measure of operational performance.

In 2008 substantial resources were devoted to develop a compliance program necessary to meet this goal, supporting grid and market operations and grid resource development in the process. Several divisions, including human resources, information technology and transmission planning, as well as grid and market operations, were tasked with meeting the challenge of building and supporting a formal compliance program for the ISO and meeting deadlines for self-certification of compliance to the WECC. Over the course of the year, the compliance team engaged with the business units responsible for the day-to-day compliance in a tremendous collaborative effort to ensure that the evidence was collected, organized and properly developed to support this goal, make three self-certifications and ultimately allow the ISO to successfully navigate the upcoming audit.

To meet the stringent new mandatory standards the ISO also engaged in extensive operator training exercises covering all actively monitored standards, as well as compliance related training in the areas of critical infrastructure protection and the compliance program more generally. The ISO maintained a very high level of compliance in 2008 while successfully maintaining reliability despite challenges posed by extreme operating conditions during a second season of devastating fires in Southern California.

The ISO also contributed to a number of forward looking operational enhancements, including a prototype visualization screen that will assist grid operations personnel in their ability to anticipate changes in renewable generation output and forecasting equipment and methodologies needed to enhance the accuracy of solar power forecasts. Along these same lines the ISO and the industry face an important transformation regarding electricity production and delivery with the onset of new and diverse environmental goals to increase the grid's renewable power mix and lower greenhouse gases.

These environmental mandates have triggered a proliferation of proposed wind, solar and geothermal generation projects as well as increased interest in other innovative technologies, such as storage and advanced metering. The ISO continues to take the lead on efforts to define system operation and infrastructure changes needed to reliably integrate this large base of renewable resources into the grid. Such efforts necessarily involve the participation of a broad array of entities, including the California Public Utilities Commission (CPUC), California Energy Commission (CEC), and regional entities such as the Bonneville Power Administration. It is with this collaborative spirit that we celebrate these additional 2008 accomplishments.

Robust and Transparent Electricity Markets. Progress towards the second strategic objective, grid resource development, was measured by the progress towards MRTU implementation. Go-live now lies directly in front of us and the internal achievements to prepare for this ultimate milestone were substantially completed in 2008, which led to our readiness and paved the way for extensive market simulation related activities. We reached this point internally primarily because of the extraordinary effort of the ISO staff working around the clock, through weekends and holidays. You have heard regularly from stakeholders with respect to these efforts and everyone should be proud of their accomplishments. Nonetheless, the challenges were bigger than any of us imagined and in the end we were not able to go live with MRTU in 2008. As a result, while not in any way a reflection of the effort or dedication of the organization or the individuals devoted to this goal, corporate performance was negatively impacted as a result, and rightly so.

Organizational Effectiveness. Despite the priority focus on compliance and MRTU, the ISO did not ignore its organizational effectiveness objective. The past year marked a transition in focus from operational excellence to organizational effectiveness, and significant progress was made on all three sub-objectives critical to making this happen. While stretched and often stressed, we were resourceful and diligent in maintaining our commitment to the development of critical knowledge and skills, customer service and financial management.

Employee skill development has been a top priority of the ISO and is the reason we established the ISO Academy, which has proven to be an excellent vehicle for providing critical training for entry and journey level engineers and economists as well as other targeted populations. For 2008 about ten percent of the employee population received cutting edge instruction in one or more areas of focus, including advanced analytics and complex methodologies, principles diagnosing pricing anomalies under the new market design, and business process and quality analysis. These courses were all taught by credible and distinguished instructors and concluded with a requirement that employees demonstrate their ability to directly apply learned knowledge and skill to real time work scenarios. In addition, the ISO continued its corporate internship program and welcomed a class of 24 interns – an increase of 9 interns over the previous year’s program. The majority of the interns are pursuing majors in either electrical engineering or economics, with many pursuing advanced degrees in these fields. This program is expected to provide a meaningful pipeline of new talent in these important areas.

Superior customer service generally presents one of the greatest opportunities for improvement in most organizations, and the ISO is no exception. Accordingly, the ISO targeted several areas to improve timeliness of issue resolution and other customer service related enhancements that would establish a foundation for enhancing the organizational commitment to customers at all levels as we move forward the new market design. With respect to customer service, the ISO met all established metrics for logging, tracking and resolving 4820 customer issues that measured responsiveness to customer inquiries, recording and analysis of the issues that arise, and identification and addressing the root causes. Specifically, of the 4820 issues logged, 88.9% or 4284 were closed or referred to other divisions within five days. Of the 536 issues referred to other divisions, 503 issues or 93.7% were resolved or closed, and of the same 536 issues, 292 issues had an expected resolution date

established and communicated to the customer, and of those 292 issues, 265 or 90.87% were resolved within the expected resolution timeframe.

Finally, the ISO excelled in the area of financial management, meeting its operating and maintenance budget objectives while absorbing about \$8.8 million in unbudgeted but necessary expenses. This accomplishment is even more significant in light of the challenges faced in 2008, particularly including the demands necessary to support the compliance program and, above all, MRTU. These activities presented numerous unexpected challenges throughout the year yet the organization was able to nonetheless deliver results without additional costs. We have been able to accomplish this with a number of initiatives, including increased efficiencies through resource management strategies, working closely with our vendors to manage their costs, and remaining nimble so that we can allocate our internal resources to the areas most in need. At the same time, the ISO continued to focus on improving its overall capabilities essential to the organization's ability to deliver exceptional results across the business.

Grid Resource Development. Meanwhile, the ISO made significant gains on a number of other initiatives in support of grid resource development. In particular, reform of the large generator interconnection process (the "GIPR") represented one of the cornerstones of our efforts to support the renewable portfolio standards and will in all likelihood be watched closely by others who are considering reforms of their own to address similar issues. Also worth noting in the area of infrastructure development was the long-awaited approval of the Sunrise project by the CPUC late in 2008. Measured progress on our demand response initiative was also achieved in demonstrating to numerous groups the value of various technologies and solutions represented within the demand response lab, supporting a myriad of proceedings at the CPUC focused on demand response issues, and collaborating with stakeholders to develop some initial products designed to increase demand participation in the ISO markets. These and other ISO efforts to improve the wholesale electricity markets will certainly benefit from the continued successful advancement of state and federal priorities. The dedication of resources and ongoing support to engage on issues such as once-through cooling and greenhouse gas regulation in 2008 were significant. In addition, the ISO continues to demonstrate leadership in the renewable power arena and ongoing national media attention recognizes our ground-breaking efforts to "green the grid".

3. INFRASTRUCTURE DEVELOPMENT

Transmission Plan. The transmission planning group has been working steadily on the 2009 ISO Transmission Plan. The plan marks a major milestone in the transition to a new study process that fulfills the requirements established by the North American Electric Reliability Corporation's (NERC) planning standards, FERC's Order No. 890 and the ISO's own transmission planning process described in its business practice manuals. At the same time, the plan and the underlying process represents the final step in the transition to a truly centralized transmission planning process. This accomplishment is possible only through adherence to the ISO's transmission planning principles and, perhaps more importantly, a process representative of a collaborative effort among the ISO, participating transmission owners and other stakeholders. The plan itself provides a summary of the results of various technical studies conducted by the ISO during the planning cycle, a detailed discussion of mitigation plans

proposed by the ISO, and new projects proposed through the request window. In the end, this transmission plan formulates the backdrop for a system expansion plan that benefits all Californians within the ISO footprint. Future iterations of the transmission plan will go further to reflect market drivers such as nodal prices, long-term transmission rights and environmental objectives as a consideration for grid enhancement.

4. PEOPLE

Tim Gage. It is with the fondest of memories that we mark the departure of Tim Gage from the ISO Board of Governors. Appointed in 2003, Tim's term wrapped up the end of February. Known for his ability to solve complex problems and provide wise fiscal counsel, Tim's presence on the Board will definitely be missed. He dealt with controversial issues with rare tact and judgment and earned the respect of every employee at the ISO as well as the industry at large. Please join the Board and Management in expressing our sincere appreciation and gratitude to Tim as he steps down. A reception will follow the meeting on March 26, 2009 in recognition of Tim's many years of dedicated service, where the public are invited to stay afterward to wish Tim well in his future endeavors and offer their remembrances along with his fellow Governors and the ISO team.