

Memorandum

To: ISO Board of Governors
From: Yakout Mansour, President and Chief Executive Officer
Date: July 10, 2009
Re: CEO Report

This memorandum does not require Board action.

1. ISO MARKETS

Near Term Update. The beginning of July marked three months of successful operations under the new market design. At this point the systems continue to perform in a stable and consistent manner with only a few minor issues occasionally having a manageable impact on either day-ahead or real-time market operations. This level of system performance has made it possible to focus on improving market performance, which is precisely where we had hoped to be at this time. As expected there are a number of issues and activities underway to address the issues identified so far and a more complete overview will be provided during the Board meeting.

Price volatility in the real-time market represents a significant area of concern and the ISO has taken a number of immediate steps that appear to have mitigated the problem to some degree. The efforts have focused on improving load forecasting and reducing sources of actual and model flow differences on the transmission system. It is critical for the forecast and network model to mimic what happens in real time to the greatest extent possible. Other areas of focus have largely centered on improvements in the price correction and exceptional dispatch processes. Finally, a number of policy clarifications are being proposed and future improvements are being considered.

One critical measure of the quality of solution recently came into view when the initial invoices for the month of April were first published on June 24. Again this was a time where we prepared for the worst and hoped for the best. Based on the volume and type of disputes received to date it appears the quality of solution as measured by the initial response to the first monthly invoices is positive. Again it is very early and we will continue to closely monitor the settlement process, but we are cautiously optimistic with respect to this quality of solution measure.

Long Term Update. Planned and longer term market and performance improvements continue forward. Recently we deployed a suite of critical variance fixes and enhancements as a pre-summer release and are planning for a similar post-summer release in September. Payment acceleration completed its development and testing phase and began its dry run period on July 1. Other planned improvements such as multi-stage generator modeling are continuing. FERC mandated enhancements continue on track with the exception of convergence bidding, which is still in the planning and design stages and out beyond the established deadline. Market participants and the Board can be assured we are taking prompt and careful steps in advising the market, mindful of the lessons learned from the market redesign program itself.

The ISO recently filed three agreements with FERC, one each with Southern California Edison, San Diego Gas and Electric and Pacific Gas and Electric, to kick off the participating load pilot project and allow each to bid three and five megawatts of load into the ancillary services market as non-spinning reserves. The pilot projects are aimed at small aggregated demand response resources from residential, commercial and industrial end use customers. These pilot projects are important in that they will help inform the way demand response is measured, tracked, and implemented to ensure that these resources can perform consistently and reliably.

Looking forward even further, the market initiatives roadmap process is underway and is similar to the past four years, although the rankings alone will not dictate the order in which the ISO tackles enhancements. The catalogue itself will contain a listing of enhancements that staff and stakeholders consider potentially important. The ranking of these enhancements will be an input into the strategic planning process that may then qualify their addition to a future implementation plan. A revised 2009 catalogue and the release paper containing the high level ranking will publish on July 13, followed by the detailed ranking process leading to publication of the high priority enhancements straw proposal in August.

2. OPERATIONS

Early Summer Outlook. So far this summer grid operations has managed through one heat wave without incident, which produced the peak load thus far for 2009 of 39,456 megawatts on June 29. A cooler than normal June seems to have improved fire conditions and extended hydro resources, at least temporarily. However, it is still early in the summer season and it now appears we may have an El Nino type weather pattern continuing to develop which has given us late August and early September peak loads in the recent past.

3. COMPLIANCE

Critical Infrastructure Protection Standards. The ISO continues to spend considerable resources to assure timely compliance with the mandatory reliability standards, including most recently the critical infrastructure protection (CIP) standards. As of June 30 the ISO compiled all of the evidence necessary to support a self-certification of compliance with the CIP standards and will file the certification in a timely manner. This has been another monumental effort by the compliance team and business units from across the organization, demonstrating the progress we have made towards establishing a culture of compliance. While work to prepare the materials

for the self-certification is in the final stages, the ISO at the same time has transitioned its focus to preparing for the full audit planned this fall. This again will represent another significant compliance milestone and we remain committed and focused to meeting the expectations established for the organization. Going forward from there, we will continue to expand the compliance program to better assure compliance in all areas of the business.

3. FINANCE

Ratings and Bond Issuance. In anticipation of issuing the bonds recently authorized by the Board, the ISO engaged in the process necessary to obtain a rating from three major firms. A strong bond rating means it will cost less for the ISO to borrow money, and it is also seen as a sign of the improving financial health of the organization. I am pleased to report good news with Standard and Poor's (S&P) upgrading the ISO rating from an "A-minus" to an "A," putting the organization in the upper-medium investment grade. Fitch, rating the ISO for the first time, gave the organization an AA-minus, a high grade/ high quality investment grade two notches above the S&P rating. The third firm, Moody's, is keeping the ISO rating at "A2," roughly equal to the S&P rating, but improved the future outlook from "stable" to "positive." While the different firms gave different reasons for strengthening the ISO's ratings, one standout achievement was the successful launch of the new market design, particularly as noted by S&P in its press release.

4. EXTERNAL ACTIVITIES

Renewable Energy Issues Forum. Working in collaboration with stakeholders, the ISO is undertaking a major endeavor to integrate renewable resources into the ISO grid and markets. Significant progress is being made and more remains to be accomplished to achieve the state's goals for renewable energy. To that end, the ISO is hosting a Renewable Energy Issues Forum on July 21 to discuss the challenges associated with reliably integrating green power. The forum is an opportunity to identify transmission and technology solutions for addressing the problems associated with intermittency of renewable resources. The Renewable Energy Issues Forum will consist of three panel discussions, each comprising a unique set of industry experts. A full agenda and other details will be available soon.