

Memorandum

To: ISO Board of Governors
From: Yakout Mansour, President and Chief Executive Officer
Date: October 21, 2009
Re: **CEO Report**

This memorandum does not require Board action.

Since the last meeting I can now safely say summer 2009 has come to an end from the perspective of ISO grid and market operations, while at the same time there have been a number of events and changes here at the ISO I would like to bring to your attention.

1. GRID AND MARKET OPERATIONS

I am extremely pleased to report that the ISO successfully made it through its first summer of grid operations with the new market implemented last April. The grid not only remained reliable through a number of heat waves, fire storms and various outages, but all of this was accomplished while being supported by market operations in a way not previously experienced by the ISO. Understandably there were several issues that demanded our attention, including items previously reported to you such as price differences between day ahead and real time and exceptional dispatch. However, we view these challenges as opportunities to demonstrate the ISO's responsiveness to the interdependence between market and grid operations, having for example deployed a strike team to reduce exceptional dispatches and conducted a stakeholder workshop to understand market participants' perspective on this subject. While we are proud of the actions taken and recognize the advancements in several areas, we also understand the need to respond by taking further steps to address the known and unknown challenges ahead as we continue to support environmental policy objectives and strive to reliably and cost effectively solve for the complexities of the California grid.

2. INFRASTRUCTURE DEVELOPMENT

Renewable and Non-Generation Resource Integration. The ISO continues to make progress on several fronts to reliably integrate renewable and non-generation resources, including solar participation in the Participating Intermittent Resource Program (PIRP), studies necessary to support the 33% Renewable Portfolio Standard (RPS), and preliminary ancillary services market modifications. On October 5, 2009, the ISO completed system modifications and successfully tested

the ability of scheduling coordinators to submit and receive data necessary for solar resources to schedule in accordance with the PIRP protocols. Similar to wind resources, this system upgrade allows solar resources to mitigate the impact of deviations in expected energy output due to the resources' inherent variability. Also, in recognition of the potentially significant impacts to system operation from the addition of substantial quantities of photovoltaic and thermal solar resources, the ISO updated its tool and methodology to account for variable characteristics of solar resources when added to wind and load variability. This will allow the ISO to quantify the operational impact of varying penetration levels of wind and solar resources. The ISO continues to collect and develop the solar data to perform the evaluation, which form inputs into ongoing ISO studies to test the adequacy of the existing fleet to manage 20% RPS and to identify resources needed to integrate 33% RPS.

At the same time the ISO, in coordination with the California Public Utilities Commission (CPUC), California Energy Commission (CEC) and other stakeholders, is conducting a study to evaluate the operational impacts of a 33% RPS goal. This study utilizes four distinct 33% RPS scenarios developed by the CPUC, i.e., balanced wind and solar, high distributed generation, high wind, and high imports. The results will be provided to the CPUC to inform its 2010 long-term procurement proceeding. The study will be conducted in two phases. The first phase will assess each resource scenario in terms of need for new conventional capacity to address variability, potential for overgeneration, and overall portfolio costs and emission levels. The second phase will evaluate the potential for innovative technologies, such as storage, demand resource, and other operational procedures, including increasing the controllability of renewable resources, to provide for more efficient system operation at 33% RPS. In addition, consistent with directives from the Federal Energy Regulatory Commission (FERC), the ISO is engaged in a stakeholder process to ensure that non-generating resources, such as limited energy storage devices and demand response, can participate in the ISO's ancillary services markets on a basis comparable with traditional resources. The ISO published an issues paper addressing the ability of the ISO to modify the characteristics of its ancillary services products so as to encourage greater participation from non-generating resources, while maintaining compliance with reliability requirements. These activities in combination with many others at the ISO are coordinated and collectively managed to assure identified barriers to renewable and non-generation resources are resolved in a timely, efficient and effective manner.

Reliability Must Run Released Capacity. In this meeting we report the final results of the reliability must run process. Noteworthy released capacity includes certain generating units located at the South Bay facility in San Diego. The release of certain capacity and the extension of other units at this facility has been the focus of much discussion and debate, similar to what transpired within San Francisco with respect to the Potrero facilities, and I do not mention this here to raise any of those issues. Rather, I would like to take this opportunity to point out that while these units are no longer needed to meet the local reliability requirements used by the ISO in its planning processes, the loss of these units from the generation fleet will nevertheless have a negative impact on broader grid reliability. There is no question that in times of emergency beyond what the planning criteria require for reliability, such as the catastrophic fires experienced in San Diego just a few years ago, South Bay units 3 and 4 are called upon to help maintain system reliability. Without them as part of the existing fleet the potential for reliability

challenges under severe conditions will be exacerbated, even while continuing to meet the planning criteria.

3. STAKEHOLDER SYMPOSIUM

The ISO conducted a first-of-its-kind stakeholder symposium in early October to unite stakeholders, policymakers and the Board of Governors in discussions on the key issues facing the energy industry. Attended by over 200 key representatives from across the energy and environmental communities, the symposium enabled dialogue on four major topics, including environmental stewardship, markets and new technologies, operations and compliance, and infrastructure development. The symposium also included keynote presentations by FERC Chairman Jon Wellinghoff and CPUC President Michael Peevey. The ISO sincerely appreciates the views shared by the FERC Chairman and the CPUC President in their keynote addresses, which played a big role in shaping the collaborative nature of the breakout discussions. The information exchanged will help guide the ISO through our strategic planning process and we look forward to engaging the Board in discussions on major themes from the event.

Stakeholders have responded very favorably to the symposium. We have conducted a brief survey and found that nearly 100% of respondents suggested that we host another similar forum in the future. Many commented positively about the opportunity to interact with Board members in a relaxed setting, while others expressed appreciation for the business networking opportunity that the event provided. I would like to extend my personal thanks to the Board for their active role in planning and facilitating the symposium and stakeholders for participating in the event. I would also like to recognize the ISO staff who planned and managed the event. In particular, I would like to note the contributions of Lorie O'Donley, Mercy Parket-Helget, Rita Roberts, Julia Payton, Katie Pennel, Angela Glover and event manager, Tom Doughty.

4. PEOPLE

Appointment of New Board Member – Kristine Hafner. It is with great pleasure that I welcome Kristine Hafner, Ph.D to the ISO Board of Governors. We look forward to working with her during her term which has just begun and runs until December 31, 2011. No doubt her extensive background and experience will serve the organization well, and we appreciate the engagement of the stakeholders during the nomination process, which once again has proven effective.

Dr. Hafner retired in 2008 from the University of California Office of the President as Associate Vice President of Information Resources and Communications and Chief Information Officer. Prior to her retirement, she oversaw delivery of a broad range of information technology services for the university's ten campuses, five medical centers and the Lawrence Berkeley National Laboratory, which the university manages under a contract to the U.S. Department of Energy. Dr. Hafner's areas of responsibility included planning, design and delivery of UC-wide administrative, student services and research computing initiatives, IT policy development, data center and telecommunication services and system wide IT procurement. Other positions Ms. Hafner held upon joining the

university system in 1997 included Deputy to the Senior Vice President of Business and Finance and Director of Business Initiatives.

Previously, Dr. Hafner spent fifteen years at IBM, managing large systems marketing activities in the Midwest region and managing and performing strategic business consulting engagements with private and public sector clients in a variety of industries in the United States.

Dr. Hafner completed her Ph.D. at the University of Wisconsin, Madison, and then pursued MBA coursework at the University of Pennsylvania Wharton Graduate Business School.

Appointment of Vice-President Market & Infrastructure Development – Dr. Keith Casey. It is my pleasure to announce that Dr. Keith Casey is our new Vice President, Market and Infrastructure Development (MID), having been appointed by the Board at its last meeting. As Director of Market Monitoring, Keith demonstrated exceptional leadership skills and become renown in the industry for his expertise in gauging the health of competitive markets, benchmarking our market with other organized grids and providing keen insights on the impacts of market design on prices as well as the timely and transparent signals for key infrastructure investment. Keith was a part of the ISO start-up team and has grown with the organization, playing a key role in the design of our new market. He also served as an expert witness in various state and federal regulatory proceedings on market design and transmission improvement projects. Over the years, Keith has been a knowledgeable and trusted source of information for the Board, the CEO, and management on all market analysis matters. This combination of skills and expertise will serve the ISO very well as we integrate renewable resources and optimize the electricity infrastructure in California to facilitate the implementation of environmental policies.

New Title of Vice President, Policy and Client Services – Karen Edson. In recognition of the key role Karen Edson and her team have been performing over the years in shaping the policy of the organization, Karen's title evolves into Vice President, Policy and Client Services. She will continue to oversee Government Affairs and Communications & Public Relations while expanding her strategic development scope to include significant policy issues facing the organization. This function becomes even more critical as we address the tremendous changes in our industry and shape the role of the ISO to meet the challenges ahead.