

Memorandum

To: ISO Board of Governors
From: Yakout Mansour, President and Chief Executive Officer
Date: February 3, 2010
Re: **CEO Report**

This memorandum does not require Board action.

Since my last report, we welcomed in a new year and with that our annual assessment of corporate performance. In addition to reporting our performance for 2009 there are a few other items I would like to bring to your attention.

1. 2009 CORPORATE PERFORMANCE

I am proud of the ISO team for the results delivered across the board in 2009. Successful start up of the new market was perhaps the most visible and significant event, but by no means was it the only accomplishment worthy of recognition.

Excellence in Grid and Market Operations

Continuing the pursuit of excellence in grid and market operations remained the ISO's top objective for 2009. The operators adjusted to the new market and engaged the new functionality to optimize market systems in 2009. At the same time, they maintained the level of reliability and efficiency the ISO has delivered over the years.

Part of our measure of success in grid and market operations is our level of compliance with mandatory reliability standards. The ISO successfully completed self-certification of compliance with critical infrastructure protection standards. The organization also prepared for and successfully completed a comprehensive reliability standards audit by the Western Electricity Coordinating Council in the fall. Overall, this corporate metric served the organization by continuing to focus efforts on a robust compliance program and emphasize the importance of a culture of compliance.

The ISO also established goals to promote efficient market operation and respond to customer needs for quick resolution of issues as we went live with the new market. We focused on four key areas: accuracy of settlements, quality of solution, timeliness of day-ahead and real-time market processes, and identification and resolution of significant market issues. Our results for the year showed significant reductions in differences between initial and final settlement statements and significant

improvement in the number of prices requiring correction as the year progressed. We also achieved a very high percentage of on time day-ahead and real-time market results. Finally, we identified and resolved two-thirds of the significant market issues within 10 days and the remaining issues within 20 days.

As we initiated our new market, we also kept pace with designing additional market functionality, including payment acceleration, multi-stage generator modeling, scarcity pricing, and proxy demand resource. Overall, as the ISO initiated its new market, worked out issues and developed new functionality throughout 2009, we were very pleased with the results and with the high level of coordination and cooperation we received from market participants. We appreciate all who helped with the successful market launch in 2009.

Effective and Timely Infrastructure Development

Another major focus for the ISO is planning for the infrastructure required to meet demand in a reliable and cost-effective manner, while advancing state and federal priorities, including California's renewable portfolio standards. In 2009, the ISO delivered the first long term transmission plan that fulfills the requirements established by NERC, FERC's Order 890 and the ISO's own transmission planning processes described in our business practice manual. In addition, the ISO continued its efforts towards the reliable integration of renewable resources and the planning for a 33% renewable portfolio standard. In September, the ISO completed the preliminary Renewable Transmission Conceptual Plan based on Renewable Energy Transmission Planning Group (RETI) process study results and inputs. Continuing efforts are currently being integrated in a state wide policy process.

Organizational Effectiveness

Foundational to the ISO's ability to achieve its strategic commitments is the quality of its customer services and the effectiveness and best utilization of its people, processes and systems, i.e., organizational effectiveness. To support this objective the ISO focused on providing excellent customer service, developing the skills of its workforce, and financial management.

The ISO developed a strong process and team for identifying and addressing customer issues, resolving issues on average in fewer than four business days. We continued to cultivate the skills and talents of our employees, with courses from our in-house academy focusing on process and quality and requiring demonstrated improvement with on-the-job results. Finally, despite the budget pressures associated with the cutover to the new market, the ISO found ways to mitigate those costs through savings and general tight fiscal management throughout the year, resulting in actual expenses less than budget.

2. SYSTEM OPERATIONS

In December 2009, the ISO system operators steered us through unusually challenging seasonal system conditions. On December 7 and 8, a cold weather snap stressed the system with higher loads and multiple transmission and generation outages. At the same time, the Pacific Northwest was experiencing severe cold temperatures with higher loads, limiting our imports from that region. Supply was further limited when a transmission facility in the Southwest tripped offline, reducing

imports into Southern California. The ISO called on generation to resolve limited supply and requested intertie emergency energy and capacity assistance. The system operators' response demonstrates once again the quality of the team performing these critical reliability functions, and their skills in operating the system under the new market.

3. POTRERO

New data provided by Pacific Gas and Electric Company (PG&E) and its cable manufacturer allowed the ISO to update its analysis showing Potrero units 4, 5 and 6 can be removed from reliability must run status at the end of 2010, provided that PG&E's re-cabling project is reliably integrated.

The ISO already agreed to remove the largest and most polluting of the Potrero units once the TransBay Cable was operational. This new line running under the bay from the City of Pittsburgh into San Francisco is scheduled for commercial operation in March—but it has been in testing now for several weeks, and could be certified for commercial operation as early as this month. I delivered the good news to San Francisco Mayor Gavin Newsom in a letter, and the mayor responded with a news release heralding the closure of the plant.

4. WIND FORECASTING

The ISO reports a 20 percent improvement in forecasting wind generation based on the results of a year-long forecasting competition. The improvement represents a significant advancement in the ability of the power grid to integrate fluctuating wind power. The ISO is making its findings public in a study recently posted to its website. It should be noted that the residual inaccuracy is skill significant and will continue to receive our attention for improvements.

More than 3,000 megawatts of wind generation are connected to the transmission system right now, and monitoring intermittent wind production closely helps keeps the grid in balance. With wind resources expected to double over the next five years or so, accurate forecasting is imperative to maximize the usage of these renewable resources.