# California Independent System Operator Corporation

## Financial Statements

## December 31, 2011 and 2010

# California Independent System Operator Corporation
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## December 31, 2011 and 2010

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## Report of Independent Auditors

To the Members of the Board of Governors
California Independent System Operator Corporation

In our opinion, the accompanying balance sheets and the related statements of revenues, expenses and changes in net assets and of cash flows present fairly, in all material respects, the financial position of the California Independent System Operator Corporation (the “Company”) at December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The Management’s Discussion and Analysis on pages 2 through 10 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

PricewaterhouseCoopers LLP

Sacramento, California
April 4, 2012

The following discussion and analysis of the California Independent System Operator Corporation (the Company) provides an overview of the Company's financial activities for the years ended December 31, 2011 and 2010. This discussion and analysis should be read in conjunction with the Company's financial statements and accompanying notes, which follow this section.

## BACKGROUND

The Company is a nonprofit public benefit corporation incorporated in May 1997, and is responsible for the operation of the long-distance, high-voltage power lines that deliver electricity throughout most of California (the California grid) and to neighboring control areas and states, along with Canada and Mexico.

The Company's principal objective is to ensure the reliability of the California grid, while fostering a competitive wholesale marketplace for electrical generation and related services in California. The Company operates pursuant to tariffs filed with the Federal Energy Regulatory Commission.

The Company operates a day-ahead market for all twenty four hours of the next operating day, and a real-time market for each operating hour. This market structure is the vehicle for providing open-access transmission service to users of the transmission grid, clearing energy bids and offers for short-term energy purchases and sales, performing economic dispatch to maintain continuous supply-demand balance and manage grid congestion, and procuring reserve capacity or ancillary services to maintain reliable operation under unexpected changes in grid conditions. The Company also performs a settlement and clearing function by collecting payments from users of these services and making pass-through payments to providers of such services.

The Board of Governors (the Board) of the Company is appointed by the California Governor and subject to confirmation by the California State Senate. A full Board is comprised of five members.

### Financial Reporting

The Company's accounting records are maintained in accordance with generally accepted accounting principles for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB) and, where not in conflict with GASB pronouncements, accounting principles prescribed by the Financial Accounting Standards Board (FASB).

Cash held by the Company on behalf of market participants is recorded in a restricted asset account with a corresponding liability due to market participants on the balance sheet. Except for the settlement and clearing function noted above, market transactions are maintained in financial records separate from the Company and accordingly the financial results of these market transactions are not included in the financial statements of the Company.

### Revenue and Rates

The Company charges a Grid Management Charge (GMC) to market participants to recover the Company's operating costs, capital expenditures and debt service costs, and to provide for an operating reserve.

The 2011 and 2010 unbundled GMC rates were comprised of the following six service categories: core reliability services; energy transmission services; forward scheduling; congestion management; market usage; and settlements, metering and client relations.

The following table summarizes the pro forma bundled GMC rate based on the budgeted revenue requirement divided by the estimated control area transmission volume. As reflected in the table, the pro forma GMC rate has remained under $.80 per MWh despite declining transmission volume during the past three years.

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Revenue requirement in millions | $ 189.8 | $ 195.1 | $ 193.0 |
| Estimated transmission volume in millions of MWh | 240.0 | 246.0 | 248.6 |
| Pro forma GMC rate per MWh | 0.791 | 0.793 | 0.776 |

**Liquidity**

The Company sets its annual revenue requirement at a level to cover three major expense groups: operations and maintenance budget, debt service, and capital projects budget. Those costs are offset by the miscellaneous revenue budget, which is primarily interest income and fees collected outside of the GMC.

Per the tariff, the operations and maintenance budget contains an operating reserve, which is based on 15% of the current year's operating and maintenance costs. Furthermore, the tariff requires the collection of a 25% debt service reserve based on the debt service to be paid during the year. The Company's operating and debt service reserves were fully funded in 2011 and 2010.

In July 2009, the Company issued $200.0 million of fixed rate bonds primarily for the construction of the Company's new facility in Folsom, California. The construction of the new facility was completed near the end of 2010. The new facility was occupied in January 2011. The remaining proceeds of the 2009 bonds are being used to fund computer hardware and software systems, equipment, and other planned capital projects. As of December 31, 2011, $31.3 million of these proceeds remain unspent for capital projects.

**The Market**

The Company continues to develop market enhancements to increase reliability, efficiency and provide accuracy of market results in the future. These enhancements increase the functionality and flexibility of the market system to meet the on-going needs of market participants.

**New Headquarters Facility**

In 2009, the Company began construction of its new headquarters facility on land the Company owns in Folsom, California. The facility is comprised of three interconnected buildings, namely the mission critical, office, and public wings. In October 2010, the mission critical wing was completed and subsequently occupied. The remaining wings were completed at the end of 2010 and occupied in January 2011. The new facility was completed three months earlier than originally scheduled, at a cost of $130.4 million and approximately $10.5 million under budget.

## FINANCIAL HIGHLIGHTS

**Balance Sheets, Statements of Revenues, Expenses and Changes in Net Assets**

The financial statements provide both short-term and long-term information about the Company's financial status. The balance sheets include all of the Company's assets and liabilities, using the accrual method of accounting, and identify any assets which are restricted as a result of bond covenants or external commitments. The balance sheets provide information about the nature and amount of resources and obligations at specific points in time.

The statements of revenues, expenses and changes in net assets report all of the Company's revenues and expenses during the year. The statements of cash flows report the cash provided and used during the year by operating activities, as well as other cash sources such as investment income and debt financing, and other cash uses such as payments for bond principal and capital additions.

**Condensed Balance Sheets (in millions):**

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Assets | | | |
| Current assets | $ 491.8 | $ 479.0 | $ 553.7 |
| Fixed assets, net | 303.9 | 351.3 | 289.8 |
| Other noncurrent assets | 94.9 | 101.4 | 152.5 |
| Total | $ 890.6 | $ 931.7 | $ 996.0 |
| Liabilities and Net Assets | | | |
| Current liabilities | $ 420.9 | $ 385.9 | $ 401.6 |
| Long-term debt, net of current portion | 259.2 | 289.3 | 333.6 |
| Other noncurrent liabilities | 19.4 | 17.5 | 14.2 |
| Net assets | 191.1 | 239.0 | 246.6 |
| Total | $ 890.6 | $ 931.7 | $ 996.0 |

## Assets

**Current Assets (in millions):**

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Cash and cash equivalents | $ 450.2 | $ 382.5 | $ 443.0 |
| Short-term investments | 22.8 | 61.8 | 62.4 |
| Accounts receivable and other assets | 18.8 | 34.7 | 48.3 |
| Total | $ 491.8 | $ 479.0 | $ 553.7 |

2011 Compared to 2010 - As of December 31, 2011, current assets amounted to $491.8 million reflecting an increase of $12.8 million during the year. This increase is largely due to increased cash and cash equivalents caused by increased collateral and market deposits. Accounts receivable and other assets decreased by $15.9 million largely due to a continued shorter GMC collection period resulting from the implementation of weekly settlements, and lower generation interconnection project receivables.

2010 Compared to 2009 - As of December 31, 2010, current assets amounted to $479.0 million reflecting a decrease of $74.7 million during the year. This decrease is largely due to reduced cash and cash equivalents caused by payment of a significant portion of the Company's refund liability for generator noncompliance fines, a year of scheduled debt payments, and disbursements for capital expenditures related to the new building. These decreases in cash balances were partially offset by increased cash balances from sales and maturities of investments and an increase in funds restricted for market participants. Accounts receivable and other assets decreased by $13.6 million due to a continued shorter GMC collection period resulting from the implementation of payment acceleration.

**Fixed Assets, net (in millions):**

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Net assets in service | $ 297.6 | $ 232.7 | $ 205.7 |
| Work-in-progress | 6.3 | 118.6 | 84.1 |
| Total | $ 303.9 | $ 351.3 | $ 289.8 |

2011 Compared to 2010 - Total fixed assets, net of accumulated depreciation, decreased in 2011 by $47.4 million compared to 2010. Net assets in service increased in 2011 compared to 2010 by $64.9 million due to the placement in service of completed assets and the remaining two wings of the new headquarters of $94.5 million, partially offset by higher depreciation expense. Work in-progress decreased by $112.3 million compared to 2010 due to the placement in service of the remaining two wings of the new headquarters and other projects of $126.8 million, partially offset by $22.1 million in new projects.

2010 Compared to 2009 - Total fixed assets, net of accumulated depreciation, increased in 2010 by $61.5 million compared to 2009. Net assets in service increased in 2010 compared to 2009 by $27.0 million due to the placement in service of the mission critical wing of the new headquarters facility of $45.6 million and other completed assets. This was partially offset by depreciation expense. Work in-progress increased by $34.5 million compared to 2009 due to the costs of the new facility and other projects of $122.4 million, partially offset by $87.9 million in completed project assets, including the occupied wing of the new facility, that were transferred from work-in-progress to net assets in service during the year.

**Other Noncurrent Assets (in millions):**

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Long-term investments | $ 90.1 | $ 94.6 | $ 145.2 |
| Other assets | 4.9 | 6.9 | 7.3 |
| Total | $ 95.0 | $ 101.5 | $ 152.5 |

2011 Compared to 2010 **-** Other noncurrent assets decreased by $6.5 million in 2011. This change is largely attributable to decreased investments amounting to $4.5 million during the year due to the use of bond funds used for construction of the new building and to lower prepayment amounts at the end of 2011.

2010 Compared to 2009 - Other noncurrent assets decreased by $51.0 million in 2010. This change is largely attributable to decreased investments amounting to $50.6 million during the year due to the use of bond funds used for construction of the new building and an $11.6 million payment for bond interest from the capitalized interest account.

### Liabilities

**Current Liabilities (in millions):**

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Accounts payable and accrued expenses | $ 18.6 | $ 24.5 | $ 28.8 |
| Accrued salaries and compensated absences | 25.9 | 26.2 | 25.7 |
| Current portion of long-term debt | 28.6 | 42.2 | 39.1 |
| Due to market participants | 347.2 | 292.2 | 262.1 |
| Generator non-compliance fines refund obligation | 0.6 | 0.8 | 45.9 |
| Total | $ 420.9 | $ 385.9 | $ 401.6 |

2011 Compared to 2010 - Current liabilities at December 31, 2011, amounted to $420.9 million, an increase of $35.0 million during the year. This increase is primarily due to increased amounts held as collateral for market participants, as a result of increased market activity, and forfeited study deposits held pending Federal Energy Regulatory Commission approval. This was offset by a lower liability amount for the current portion of long-term debt of $13.6 million, and a reduction of $5.9 million in accounts payable and accrued expenses because of reduced expenditures.

2010 Compared to 2009 - Current liabilities at December 31, 2010, amounted to $385.9 million, a decrease of $15.7 million during the year. This decrease is primarily due to $43.8 million of the generator noncompliance fines refund obligation being paid in 2010, and accounts payable and accrued expenses decreasing by $4.3 million because of reduced expenditures. The decreases were partially offset by increased amounts held as collateral for market participants, as a result of increased market activity, and forfeited study deposits held pending Federal Energy Regulatory Commission approval.

**Long-Term Debt (in millions):**

Summarized activity of long-term debt for the year ended December 31, 2011, is as follows:

| | Beginning of Year | Issuance/ (Payments) | End of Year |
|---|---|---|---|
| CIEDB Revenue Bonds, Series 2008 | $ 126.9 | $ (42.3) | $ 84.6 |
| CIEDB Revenue Bonds, Series 2009 | 200.0 | - | 200.0 |
| Total long-term debt | $ 326.9 | $ (42.3) | $ 284.6 |

Summarized activity of long-term debt for the year ended December 31, 2010, is as follows:

| | Beginning of Year | Issuance/ (Payments) | End of Year |
|---|---|---|---|
| CIEDB Revenue Bonds, Series 2008 | $ 166.0 | $ (39.1) | $ 126.9 |
| CIEDB Revenue Bonds, Series 2009 | 200.0 | - | 200.0 |
| Total long-term debt | $ 366.0 | $ (39.1) | $ 326.9 |

Debt service requirements below reflect scheduled maturities of long-term debt at December 31, 2011. Interest is calculated using the stated fixed rate of the bonds. As of December 31, 2011, the Company had an underlying rating of A from S&P, A1 by Moody's and A+ by Fitch. Fitch rates the Company's outstanding 2009 Series A bonds at AA- due to the additional support of the pledged deed of trust on the Company's primary building.

| | Principal | Interest | Total |
|---|---|---|---|
| Debt Service Requirements (in millions): | | | |
| 2012 | $ 28.6 | $ 14.9 | $ 43.5 |
| 2013 | 39.6 | 13.2 | 52.8 |
| 2014 | 27.1 | 11.6 | 38.7 |
| 2015 | 3.8 | 10.9 | 14.7 |
| 2016 | 4.0 | 10.7 | 14.7 |
| 2017-2039 | 181.5 | 153.0 | 334.5 |
| Total | $ 284.6 | $ 214.3 | $ 498.9 |

2011 Compared to 2010 - At December 31, 2011 the Company had $284.6 million of outstanding bonds issued through the California Infrastructure and Economic Development Bank (CIEDB). The decrease in long-term debt is attributable to scheduled debt payments on the 2008 series bonds in the amount of $42.3 million in 2011.

2010 Compared to 2009 - At December 31, 2010 the Company had $326.9 million of outstanding bonds issued through the California Infrastructure and Economic Development Bank (CIEDB). The decrease in long-term debt is attributable to scheduled debt payments on the 2008 series bonds in the amount of $39.1 million in 2010.

**Other Noncurrent Liabilities (in millions):**

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Employee retirement plan obligations | $ 19.4 | $ 17.5 | $ 14.2 |
| Total | $ 19.4 | $ 17.5 | $ 14.2 |

2011 Compared to 2010 - Other noncurrent liabilities amounted to $19.4 million at December 31, 2011, an increase of $1.9 million during the year as a result of increases in employee retirement plan obligations attributable to the excess of plan costs over current year funding.

2010 Compared to 2009 - Other noncurrent liabilities amounted to $17.5 million at December 31, 2010, an increase of $3.3 million during the year mostly as a result of increases in employee retirement plan obligations attributable to the excess of plan costs over current year funding.

**Net Assets (in millions):**

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Invested in capital assets, net of related debt | $ 72.9 | $ 95.9 | $ 115.5 |
| Unrestricted | 118.2 | 143.1 | 131.1 |
| Total | $ 191.1 | $ 239.0 | $ 246.6 |

2011 Compared to 2010 - Net assets invested in capital assets net of related debt at December 31, 2011, totaled $72.9 million, a decrease of $23.0 million during the year. This change is attributable to the decrease in unspent debt proceeds. Unrestricted net assets amounted to $118.2 million at December 31, 2011, a decrease of $24.9 million during the year. The decrease is primarily due to the change in net assets partially offset by the changes in net assets invested in capital assets.

2010 Compared to 2009 - Net assets invested in capital assets net of related debt at December 31, 2010, totaled $95.9 million, a decrease of $19.6 million during the year. This change is attributable to the decrease in the capitalized interest fund as a result of debt service on the 2009 Bonds. Unrestricted net assets amounted to $143.1 million at December 31, 2010, an increase of $12.0 million during the year. The increase is primarily due to the payment of interest related to the 2009 bonds of $11.6 million from a restricted capitalized interest fund.

**Changes in Net Assets**

**Condensed Statement of Revenues, Expenses and Changes in Net Assets (in millions):**

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Operating revenues | $ 194.6 | $ 211.9 | $ 208.3 |
| Operating expenses | 231.2 | 215.6 | 213.1 |
| Operating (loss) income | (36.6) | (3.7) | (4.8) |
| Other income (expenses) | (11.3) | (3.8) | 10.5 |
| Total | $ (47.9) | $ (7.5) | $ 5.7 |

**Operating Revenues**

2011 Compared to 2010 - Total operating revenues decreased during the year by $17.3 million. This is primarily due to a $15.7 million decrease in the GMC, the Company's primary operating revenue. The decrease is the result of an overall lower revenue requirement in 2011 compared to 2010, and collections of GMC revenues in 2010 being higher than the revenue requirement for that year, which did not recur in 2011.

2010 Compared to 2009 - Total operating revenues increased during the year by $3.6 million due to $1.4 million in revenue recognized related to generator noncompliance fines, and a $2.0 million increase in generator interconnection studies revenue resulting from increased activity of renewable energy projects. The GMC, the Company's primary operating revenue, decreased slightly by $0.3 million in 2010 compared to 2009.

**Operating Expenses and Percentages (dollars in millions):**

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Salaries and related benefits | $ 105.1 | $ 102.9 | $ 107.4 |
| Communication and technology costs | 20.3 | 18.8 | 20.9 |
| Legal and consulting costs | 15.9 | 16.2 | 18.3 |
| Other: leases, facilities and administrative | 13.9 | 16.8 | 17.3 |
| Lease termination and loss on retirement of assets | 6.6 | - | 6.4 |
| Depreciation and amortization | 69.4 | 60.9 | 42.8 |
| Total | $ 231.2 | $ 215.6 | $ 213.1 |
| | | | |
| Salaries and related benefits | 45 % | 48 % | 50 % |
| Communication and technology costs | 9 | 9 | 10 |
| Legal and consulting costs | 7 | 7 | 9 |
| Other: leases, facilities and administrative | 6 | 8 | 8 |
| Lease termination and loss on retirement of assets | 3 | 0 | 3 |
| Depreciation and amortization | 30 | 28 | 20 |
| Total | 100 % | 100 % | 100 % |

2011 Compared to 2010 - Operating expenses were $15.6 million higher for the year ended December 31, 2011, as compared to the year ended December 31, 2010. This increase is comprised of $8.5 million of increased depreciation related to hardware and software placed in service and a full year of depreciation of the new facility. Other increases were $6.6 million of lease termination and loss on retirement of assets primarily related to the unrecoverable lease and termination costs of the abandoned facilities.

Total labor costs increased in 2011 by $2.2 million due mostly to annual performance-based merit increases. Communications and technology costs increased by $1.5 million due to required additional software maintenance contracts. These increases were offset by decreases in all other operating expenditures in the amount of $3.2 million in 2011.

2010 Compared to 2009 - Operating expenses were $2.5 million higher for the year ended December 31, 2010, as compared to the year ended December 31, 2009. This increase is comprised of $18.1 million of increased depreciation and amortization related to hardware and software placed in service for use in the control room of the new facility and a full year of amortization of the new market software, offset by decreases in all other operating expenditures in the amount of $15.6 million in 2010.

Total labor costs decreased in 2010 by $4.5 million and there were no abandonment and retirement of asset costs in 2010, compared to $6.4 million in 2009. The decreases in labor costs are due to less overtime in 2010 than required for the implementation of the new market in 2009. Additionally, communications and technology and legal and consulting costs decreased by a total of $4.2 million also due to lower expenditure requirements since the implementation of the new market in 2009.

**Other Income (Expense) (in millions):**

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Interest income | $ 2.9 | $ 5.9 | $ 7.3 |
| Interest expense | (14.5) | (10.6) | (9.6) |
| Interest expense recovery | 0.3 | 1.0 | 12.8 |
| Total | $ (11.3) | $ (3.7) | $ 10.5 |

2011 Compared to 2010 - Interest income decreased by $3.0 million at December 31, 2011, compared to December 31, 2010, due to lower fund balances available for investments and lower interest rates. Interest expense increased by $3.9 million primarily due to lower capitalized interest as a result of the completion of the new facility in late 2010.

2010 Compared to 2009 - Interest income decreased by $1.4 million at December 31, 2010, compared to December 31, 2009, due to lower fund balances available for investments and lower interest rates. Interest expense increased by $1.0 million, due to a full year of interest on the 2009 Bond series, partially offset by higher capitalized interest. Interest expense recovery was lower by $11.8 million in 2010 due to less interest expense recovery being recognized related to the generator noncompliance fines.

## California Independent System Operator Corporation
### Balance Sheets
### December 31, 2011 and 2010 ($ in thousands)

| | 2011 | 2010 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents, including restricted amounts | $ 450,166 | $ 382,548 |
| Accounts receivable | 11,965 | 25,445 |
| Short-term investments, including restricted amounts | 22,790 | 61,789 |
| Other current assets | 6,835 | 9,219 |
| Total current assets | 491,756 | 479,001 |
| Noncurrent assets: | | |
| Long-term investments, including restricted amounts | 90,074 | 94,552 |
| Fixed assets, net | 303,868 | 351,273 |
| Other assets | 4,856 | 6,883 |
| Total noncurrent assets | 398,798 | 452,708 |
| Total assets | $ 890,554 | $ 931,709 |
| **Liabilities and Net Assets** | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | $ 18,541 | $ 24,568 |
| Accrued salaries and compensated absences | 25,919 | 26,185 |
| Current portion of long-term debt | 28,585 | 42,250 |
| Due to market participants | 347,208 | 292,168 |
| Generator noncompliance fines refund obligation | 638 | 772 |
| Total current liabilities | 420,891 | 385,943 |
| Noncurrent liabilities: | | |
| Long-term debt, net of current portion | 259,201 | 289,277 |
| Employee retirement plan obligations | 19,343 | 17,460 |
| Total noncurrent liabilities | 278,544 | 306,737 |
| Total liabilities | 699,435 | 692,680 |
| Commitments and contingencies | | |
| Net assets | | |
| Invested in capital assets, net of related debt | 72,887 | 95,910 |
| Unrestricted | 118,232 | 143,119 |
| Total net assets | 191,119 | 239,029 |
| Total liabilities and net assets | $ 890,554 | $ 931,709 |

The accompanying notes are an integral part of these financial statements.

## California Independent System Operator Corporation
### Statements of Revenues, Expenses and Changes in Net Assets
### Years Ended December 31, 2011 and 2010 ($ in thousands)

| | 2011 | 2010 |
|---|---|---|
| Operating revenues: | | |
| GMC revenue | $ 186,390 | $ 202,108 |
| Other revenues | 8,189 | 9,742 |
| Total operating revenues | 194,579 | 211,850 |
| Operating expenses: | | |
| Salaries and related benefits | 105,126 | 102,944 |
| Equipment leases and facility costs | 7,270 | 8,700 |
| Communications, technology and temporary staffing contracts | 20,292 | 18,787 |
| Legal and consulting services | 15,854 | 16,216 |
| Training, travel and professional dues | 2,631 | 2,860 |
| Insurance, administrative and other expenses | 4,005 | 5,207 |
| Lease termination and loss on retirement of assets | 6,632 | - |
| Depreciation and amortization | 69,360 | 60,910 |
| Total operating expenses | 231,170 | 215,624 |
| Loss from operations | (36,591) | (3,774) |
| Other income (expense): | | |
| Interest income | 2,940 | 5,898 |
| Interest expense | (14,513) | (10,649) |
| Interest expense recovery | 254 | 998 |
| Total other (expense) income | (11,319) | (3,753) |
| Change in net assets | (47,910) | (7,527) |
| Net assets, beginning of year | 239,029 | 246,556 |
| Net assets, end of year | $ 191,119 | $ 239,029 |

The accompanying notes are an integral part of these financial statements.

## California Independent System Operator Corporation
### Statements of Cash Flows
### Years Ended December 31, 2011 and 2010 ($ in thousands)

| | 2011 | 2010 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Receipts from scheduling coordinators for GMC | $ 196,187 | $ 215,818 |
| Other receipts | 11,872 | 9,742 |
| Payments to employees and to others for related benefits | (103,430) | (99,408) |
| Payment of generator noncompliance fines refund obligation | - | (43,859) |
| Payments to vendors/others | (49,524) | (55,824) |
| Receipts from market participants | 371,655 | 409,388 |
| Payments to market participants | (316,615) | (379,319) |
| Net cash provided by operating activities | 110,145 | 56,538 |
| **Cash flows from capital and related financing activities:** | | |
| Purchases and development of fixed assets | (30,411) | (125,234) |
| Repayment of bonds | (42,250) | (39,100) |
| Interest on debt | (16,608) | (10,147) |
| Net cash used in capital financing activities | (89,269) | (174,481) |
| **Cash flows from investing activities:** | | |
| Purchases of investments | (44,047) | (42,807) |
| Sales and maturities of investments | 87,525 | 94,107 |
| Interest received | 3,264 | 6,195 |
| Net cash provided by investing activities | 46,742 | 57,495 |
| Net increase (decrease) in cash and cash equivalents, restricted and unrestricted | 67,618 | (60,448) |
| Cash and cash equivalents, restricted and unrestricted, beginning of year | 382,548 | 442,996 |
| Cash and cash equivalents, restricted and unrestricted, end of year | $ 450,166 | $ 382,548 |

The accompanying notes are an integral part of these financial statements.

## California Independent System Operator Corporation
### Statements of Cash Flows
### Years Ended December 31, 2011 and 2010 ($ in thousands)

| (continued) | 2011 | 2010 |
|---|---|---|
| **Supplemental information:** | | |
| Cash paid for interest for bonds | $ 16,608 | $ 18,972 |
| Cash paid for interest for generator noncompliance fines | $ - | $ 14,112 |
| **Reconciliation of loss from operations to net cash provided by operating activities** | | |
| Loss from operations | $ (36,591) | $ (3,774) |
| Adjustments to reconcile loss from operations to net cash provided by operating activities: | | |
| Depreciation and amortization | 69,360 | 60,910 |
| Lease termination and loss on retirement of assets | 6,632 | - |
| Changes in operating assets and liabilities: | | |
| Accounts receivable and other assets | 16,959 | 13,174 |
| Accounts payable and other accrued expenses | (1,255) | 18 |
| Generator noncompliance fines refund obligation | - | (43,859) |
| Due from market participants | 55,040 | 30,069 |
| Net cash provided by operating activities | $ 110,145 | $ 56,538 |
| **Supplemental disclosure of noncash financing and investing activities** | | |
| Amortization of bond premium | $ 1,491 | $ 2,152 |
| Amortization of bond issuance costs and loss of refunding | (479) | (614) |
| Generator fines interest included in interest expense | - | (1,925) |
| Generator fines interest expense recovery | 254 | 998 |
| Change in purchases and development of fixed assets included in accounts payable and accrued expenses | (8,667) | (1,581) |

The accompanying notes are an integral part of these financial statements.

## 1. Organization and Operations

The Company, a nonprofit public benefit corporation incorporated in May 1997, is responsible for the operation of the long-distance, high-voltage power lines that deliver electricity throughout most of California (the California grid) and to neighboring control areas and states, along with Canada and Mexico. The Company charges a GMC to market participants to recover the Company's costs and to provide an operating reserve. The Company's principal objective is to ensure the reliability of the California grid, while fostering a competitive wholesale marketplace for electrical generation and related services in California. The Company operates pursuant to tariffs filed with the Federal Energy Regulatory Commission.

The Company operates a day-ahead market for all twenty four hours of the next operating day, and a real-time market for each operating hour. The Company also performs a settlement and clearing function by collecting payments from users of these services and making pass-through payments to providers of such services. Cash held by the Company on behalf of market participants is recorded in a restricted asset account with a corresponding liability due market participants on the balance sheet. Except for the settlement and clearing function noted above, market transactions are maintained in financial records separate from the Company, and accordingly, the financial results of these market transactions are not included in the financial statements of the Company. GMC revenues have a priority claim against any market-related receipts. Any market defaults are allocated to market participants.

The Board of the Company is appointed by the California Governor and is subject to confirmation by the California State Senate. A full Board is comprised of five members.

## 2. Summary of Significant Accounting Policies

### Method of Accounting

The accompanying financial statements have been prepared on an accrual basis of accounting in accordance with accounting principles for proprietary funds as prescribed by the GASB, and where not in conflict with GASB pronouncements, accounting principles prescribed by the FASB. The Company uses the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

### Use of Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could materially differ from those estimates.

### Cash and Cash Equivalents

Cash and cash equivalents, restricted and unrestricted, include cash in bank accounts, money market funds, and other highly liquid investments with original maturities of three months or less. Cash and cash equivalents are unrestricted unless specifically restricted by bond indentures or the tariff.

**Accounts Receivable and Revenue Recognition**
The GMC is based on rates filed with Federal Energy Regulatory Commission and is designed to recover the Company's operating costs, capital expenditures, debt service costs, and to provide for an operating reserve. The GMC and other market service billings are recognized as revenue, based on estimated meter data submitted by market participants and therefore may be subject to adjustment after final invoices have been issued.

The 2011 and 2010 GMC rates were comprised of the following service categories: core reliability services; energy transmission services; forward scheduling; congestion management; market usage; and settlements, metering and client relations.

The operating reserve is calculated separately for each GMC service category and accumulates until the reserve becomes fully funded (at 15 percent of budgeted annual operating costs for each rate service category). At December 31, 2011, the operating reserve for each service category was fully funded. In accordance with the tariff, any surplus operating reserve balance is applied as a reduction in revenue requirements in the following year. The tariff requires GMC rates to be adjusted not more than once per quarter. Rate adjustments are based on the greater of a 5% difference in projected volumes used to set rates or $1.0 million in estimated annual GMC revenues. During 2011 and 2010, adjustments were made to certain GMC rates pursuant to these provisions.

**Generator Interconnection Studies**
The Company is responsible for conducting generator interconnection studies. The project sponsors are the owners of generating plants planning to become connected to the California grid which is controlled by the Company. The project sponsors request that the Company conduct these studies and they are required to make a deposit before any studies are performed. At any time, the project sponsors may withdraw from the studies.

In accordance with the tariff, the Company charges the project sponsors the actual costs of the studies. Related study costs include both internal costs and external costs and are recorded, when incurred, as operating expenses. As costs are incurred, the Company recognizes revenue for the same amount, which is recorded as a component of other revenues. The Company applies the deposits against the related receivable as costs are incurred. Beginning in 2010, the tariff rules regarding deposits changed to require that certain deposits related to projects abandoned by the project sponsor be retained by the Company and distributed to market participants following Federal Energy Regulatory Commission approval.

**Generator Noncompliance Fines**
From December 8, 2000 through June 30, 2001, the Company assessed noncompliance fines on participating generators that failed to fully comply with dispatch instructions when the Company was seeking to prevent an imminent or threatened system emergency. In accordance with the tariff, these fines are retained by the Company. The Company recorded the net realizable amount of such fines as revenue when the underlying noncompliance event occurred, and adjusts such amounts in recognition of evolving factors affecting the ultimate recognition of the fines charged and to reflect payments of the liability.

**Investments**
Investments include government and federal agency securities, corporate bonds, a guaranteed investment contract, and a forward delivery agreement with maturities of more than three months. Investments are carried at fair value except for the guaranteed investment contract and the forward delivery agreement. The guaranteed investment contract and the forward delivery agreement are nonparticipating investment contracts that cannot be negotiated or transferred and their redemption terms do not consider market rates. As a result, these investments are carried at cost. Income on

investments and the gain or loss on the fair value of investments is recorded as a component of interest income.

**Fixed Assets**

Fixed assets are recorded at cost. Depreciation is computed using the straight-line method over the assets' estimated useful lives. Most of the Company's investment in fixed assets consists of the newly-constructed building and related assets which are being depreciated over twenty to thirty years and information systems, which are being depreciated over three to five years. The cost of improvements to or replacement of fixed assets is capitalized. Interest incurred during development is capitalized. When assets are retired or otherwise disposed of, the cost and related depreciation are removed from the accounts and any resulting gain or loss is reflected in the Company's statement of changes in revenues, expenses and changes in net assets for the period. Repairs and maintenance costs are expensed when incurred. The Company capitalizes direct costs of salaries and certain indirect costs incurred to develop or obtain software for internal use. Costs incurred related to software development during the preliminary stage of a project and training and maintenance costs are expensed as incurred. Costs related to abandoned projects are expensed when the decision to abandon is made.

**Other Assets**

Other assets consist primarily of debt issuance costs that are amortized over the life of the bonds using the bonds outstanding method (which approximates the effective interest method). Other assets also include an employee note receivable (see Note 5) and certain employee retirement plan trust accounts.

**Compensated Absences**

The Company accrues vacation leave when the employee becomes eligible for the benefit. The Company does not record sick leave or other leave as a liability since there are no cash payments for sick leave or other leave made when employees terminate or retire. At December 31, 2011 and 2010, the total accrued liability for vacation was $7.0 million and $6.7 million, respectively.

**Income Taxes**

The Company is exempt from federal income tax under Section 501(c) (3) of the U.S. Internal Revenue Service (IRS) Code and is exempt from California State franchise income taxes.

**Net Assets**

The Company classifies its net assets into three components:

- **Invested in capital assets, net of related debt** - This component of net assets consists of capital assets, net of accumulated depreciation reduced by the outstanding debt balances, net of unamortized debt expenses.
- **Restricted** - This component consists of net assets with constraints placed on their use. Constraints include those imposed by debt covenants (excluding amounts considered in net capital, above) and by the Company's tariff and agreements with external parties.
- **Unrestricted** - This component of net assets consists of net assets that do not meet the definition of "invested in capital, net of related debt" or "restricted".

The Company had no restricted net assets at December 31, 2011 or 2010.

**Concentration of Credit Risk**

Financial instruments that subject the Company to credit risk consist primarily of accounts receivable relating to GMC billings due from market participants and cash and cash equivalents and investments.

All of the Company's receivables are due from entities in the energy industry, including utilities, generation owners and other electricity market participants. For the years ended December 31, 2011 and 2010, approximately 58 percent of GMC revenues were from two market participants.

GMC revenues have a priority claim against any market-related receipts, which means that even if an entity defaults on an invoice containing a GMC charge, the Company receives the full GMC so long as sufficient funds were received on other market invoices.

The Company's concentration of credit risk related to cash and cash equivalents, and investments is described in Note 3.

**Subsequent Events**

The Company evaluates events or transactions that occur after the balance sheet date but before financial statements are issued for potential recognition or disclosure in the financial statements. The Company has evaluated all subsequent events through April 4, 2012, the date the financial statements were issued, and no items were noted that need to be disclosed.

## 3. Cash and Cash Equivalents and Investments

**Investment Policy and Credit Risk**

The Company's investment policy restricts investments to securities issued by, or explicitly guaranteed by, the United States Government, debt obligations issued by government sponsored enterprises and supranational agencies, municipal and state obligations, corporate debt obligations, bank obligations, repurchase and other types of investment agreements, fixed income mutual funds, and money market funds. The Company's investment policy includes restrictions for investments relating to maximum amounts invested as a percentage of the total portfolio, maximum maturities, and minimum credit ratings.

To mitigate the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment, the Company limits purchases of investments to those rated at the time of purchase by at least two of the following nationally recognized statistical rating organizations: Standard & Poor's, Moody's, and Fitch. The investment must have a minimum rating of at least A-1 (or equivalent) for short-term obligations such as commercial paper and at least A- (or equivalent) for longer term obligations like corporate medium-term notes. In the event of split ratings, the lowest rating is considered the overall credit rating.

**Concentration of Credit Risk**

This is the risk of loss associated with the percentage of an entity's investment in a single issuer. The Company's investment policy limits investments in any single issuer to no more than 5% of the portfolio, with exceptions relating to US government obligations, pooled investments such as money market funds, and investments procured in connection with Company bond offerings. As of December 31, 2011, other than investments in US government obligations and money market funds, the Company had no investments in any one issuer representing more than 5% of total cash and cash equivalents and investments.

**Custodial Credit Risk**

Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Company will not be able to recover the value of its deposits, investments or collateral securities that are in the possession of an outside party.

The Company may maintain balances in bank accounts exceeding the FDIC insured level of $250,000. In the event of a bank default, the Company's deposits may not be returned. The Company had noninterest-bearing bank deposits in amounts of $34.5 million and $10.8 million at

December 31, 2011 and 2010, respectively. These deposits qualify for FDIC insurance coverage under Section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“DFA”) until December 31, 2012.

All other investments purchased by the Company, by policy, are held in custodial accounts by third-party custodians and are registered in the Company’s name, thereby minimizing any custodial credit risk.

**Interest Rate Risk**

Changes in interest rates may adversely affect the fair value of the Company’s investments and its cash flows. The nature of the Company’s investment needs and cash flows requires the majority of the investments to be held with maturities of one year or less. The investment policy further limits the maximum maturity of any investment to 5 years with the exception of bond reserve funds which are invested in accordance with the terms of the related bond indenture. The fair value of the resulting short-term investment portfolio is therefore, less affected by rising interest rates. The cash flows from short-term portfolios can be more affected by declining interest rates as maturing investments are reinvested at lower interest rates.

**Summary of Balances**

At December 31, 2011, the Company's cash, cash equivalents and investments consist of the following (in thousands):

| Description | Credit Rating* | Remaining Maturities (in Years) Less than 1 | 1 - 5 | More than 5 | Total |
|---|---|---|---|---|---|
| Cash and cash equivalents - unrestricted | | | | | |
| Deposits | | $ 31,132 | $ - | $ - | $ 31,132 |
| Money Market Funds | *AAAm* | 55,839 | - | - | 55,839 |
| Money Market Funds | *AAA* | 103 | - | - | 103 |
| | | 87,074 | - | - | 87,074 |
| Cash and cash equivalents - restricted | | | | | |
| Deposit | | 108 | - | - | 108 |
| Money Market Funds | *AAAm* | 290,510 | - | - | 290,510 |
| Money Market Funds | *AAA* | 72,474 | - | - | 72,474 |
| | | 363,092 | - | - | 363,092 |
| Total cash and cash equivalents | | 450,166 | - | - | 450,166 |
| Short term investments - unrestricted | | | | | |
| U.S Treasury | *AA+* | 2,018 | - | - | 2,018 |
| Corporate Notes | *AA* | 1,003 | - | - | 1,003 |
| Corporate Notes | *A+* | 3,623 | - | - | 3,623 |
| Corporate Notes | *A* | 520 | - | - | 520 |
| Corporate Notes | *AA-* | 3,002 | - | - | 3,002 |
| | | 10,166 | - | - | 10,166 |
| Short term investments - restricted | | | | | |
| U.S. Treasury | *AA+* | 5,241 | - | - | 5,241 |
| Government-sponsored Enterprises | *AA+* | 7,383 | - | - | 7,383 |
| | | 12,624 | - | - | 12,624 |
| Total short-term Investments | | 22,790 | - | - | 22,790 |
| Long-term investments - unrestricted | | | | | |
| Affinity Insurance Ltd. | *N/A* | - | - | 37 | 37 |
| U.S. Treasury | *AA+* | - | 6,588 | - | 6,588 |
| Government-sponsored Enterprises | *AA+* | - | 8,072 | - | 8,072 |
| Municipal Bonds | *AA+* | - | 2,332 | - | 2,332 |
| Corporate Notes | *AAA* | - | 2,690 | - | 2,690 |
| | *AA+* | - | 2,621 | - | 2,621 |
| | *AA* | - | 2,633 | - | 2,633 |
| | *AA-* | - | 3,237 | - | 3,237 |
| | *A+* | - | 2,215 | - | 2,215 |
| | *A* | - | 10,965 | - | 10,965 |
| | *A-* | - | 5,927 | - | 5,927 |
| | *BBB+* | - | 3,235 | - | 3,235 |
| Long-term investments - restricted | | | | | |
| U.S. Treasury | *AA+* | - | 5,067 | - | 5,067 |
| Guaranteed Investment Contract | *Unrated* | - | 19,697 | - | 19,697 |
| Forward Delivery Agreement | *Unrated* | - | - | 14,758 | 14,758 |
| Total long-term Investments | | - | 75,279 | 14,795 | 90,074 |
| Total cash, cash equivalents and investments | | $ 472,956 | $ 75,279 | $ 14,795 | $ 563,030 |

** Represents lowest rating (Fitch, Moody's or S&P), presented on the S&P scale.*

At December 31, 2010, the Company's cash, cash equivalents and investments consist of the following (in thousands):

| Description | Credit Rating* | Remaining Maturities (in Years) Less than 1 | 1 - 5 | More than 5 | Total |
|---|---|---|---|---|---|
| Cash and cash equivalents | | | | | |
| Unrestricted | | | | | |
| Deposits | | $ 9,409 | $ - | $ - | $ 9,409 |
| Money market funds | *Unrated* | 55 | - | - | 55 |
| Money market funds | *AAAm* | 66,388 | - | - | 66,388 |
| | | 75,852 | - | - | 75,852 |
| Restricted | | | | | |
| Deposits | | 7,137 | - | - | 7,137 |
| Money market funds | *AAAm* | 299,559 | - | - | 299,559 |
| | | 306,696 | - | - | 306,696 |
| Total cash and cash equivalents | | 382,548 | - | - | 382,548 |
| Investments | | | | | |
| Short-term investments - unrestricted | | | | | |
| Negotiable CD | *Unrated* | 5,002 | - | - | 5,002 |
| Government-sponsored Enterprises | *AAA* | 5,001 | - | - | 5,001 |
| | | 10,003 | - | - | 10,003 |
| Short-term investments - restricted | | | | | |
| Government-sponsored Enterprises | *AAA* | 24,744 | - | - | 24,744 |
| US Treasury | *AAA* | 27,042 | - | - | 27,042 |
| Total short-term investments | | 51,786 | - | - | 51,786 |
| Total short-term investments | | 61,789 | - | - | 61,789 |
| Long-term investments | | | | | |
| Unrestricted | | | | | |
| Preferred and common stock | *N/A* | - | - | 37 | 37 |
| Government-sponsored Enterprises | *AAA* | - | 5,065 | - | 5,065 |
| Municipal Bonds | *AAA* | - | 2,279 | - | 2,279 |
| US Treasury | *AAA* | - | 6,084 | - | 6,084 |
| Corporate Notes | *A* | - | 10,415 | - | 10,415 |
| | *A-* | - | 9,526 | - | 9,526 |
| | *AA-* | - | 7,147 | - | 7,147 |
| | *AA* | - | 5,717 | - | 5,717 |
| | *AAA* | - | 5,357 | - | 5,357 |
| | *A+* | - | 2,273 | - | 2,273 |
| | *AA+* | - | 1,028 | - | 1,028 |
| | *Unrated* | - | 2,654 | - | 2,654 |
| | | - | 57,545 | 37 | 57,582 |
| Restricted | | | | | |
| Guaranteed Investment Contract | *Unrated* | - | 19,697 | - | 19,697 |
| Forward delivery agreement | *Unrated* | - | | 14,964 | 14,964 |
| US Treasury | *AAA* | - | 2,309 | - | 2,309 |
| | | - | 22,006 | 14,964 | 36,970 |
| Total long-term investments | | - | 79,551 | 15,001 | 94,552 |
| Total investments | | 61,789 | 79,551 | 15,001 | 156,341 |
| Total cash, cash equivalents and investments | | $ 444,337 | $ 79,551 | $ 15,001 | $ 538,889 |

** S&P Rating, if available, or Fitch*

The Company's cash, cash equivalents and investments at December 31 consist of unrestricted and restricted funds as follows (in thousands):

| | 2011 | 2010 |
|---|---|---|
| Unrestricted funds, operating account | $ 147,793 | $ 143,752 |
| Restricted funds: | | |
| Market participants | 347,208 | 292,168 |
| Capital expenditures | 31,267 | 55,336 |
| Debt service | 36,762 | 47,633 |
| Total | $ 563,030 | $ 538,889 |

Cash and cash equivalents restricted for market participants consist of the following at December 31 (in thousands):

| | 2011 | 2010 |
|---|---|---|
| Security deposits | $ 173,774 | $ 141,746 |
| Market funds pending settlement | 61,772 | 67,704 |
| Pass-through fees due to others | 10,810 | 10,341 |
| Generator interconnection study deposits | 81,166 | 59,830 |
| Forfeited deposits pending distribution | 19,686 | 12,547 |
| Total amounts restricted for market participants | $ 347,208 | $ 292,168 |

Cash, cash equivalents and investments restricted for market participants consist of amounts held by the Company to be remitted to market participants or others on their behalf. Security deposits are amounts received from market participants who are required to post collateral for their transactions in the Company's markets. Market funds pending settlement consist of amounts collected during the settlement and clearing function that will pass through to market participants in subsequent periods. Pass-through fees due to others consist of amounts collected from market participants that will be paid to market participants for summer reliability, startup costs and emission costs. Generator interconnection study deposits are amounts collected for future studies. Forfeited deposits consist of generator interconnection study amounts forfeited by project sponsors that are pending Federal Energy Regulatory Commission approval for distribution.

## 4. Fixed Assets

Changes in the Company's fixed assets for the year ended December 31, 2011, are as follows (in thousands):

| | 2010 | Additions and Transfers In | Deletions and Transfers Out | 2011 |
|---|---|---|---|---|
| Nondepreciable fixed assets: | | | | |
| Land | $ 7,617 | $ 1,481 | $ - | $ 9,098 |
| Work-in-progress | 110,946 | 22,137 | (126,804) | 6,279 |
| | 118,563 | 23,618 | (126,804) | 15,377 |
| Depreciable fixed assets: | | | | |
| Regional transmission operator software | 336,834 | 19,519 | (376) | 355,977 |
| Regional transmission operator hardware | 34,081 | 1,677 | (3,047) | 32,711 |
| Communication equipment | 8,935 | 1,234 | (2,338) | 7,831 |
| ISO Facilities (HQ and Alhambra) | 63,306 | 94,589 | (1,482) | 156,413 |
| Furniture, fixtures and other | 14,338 | 8,122 | (7,821) | 14,639 |
| | 457,494 | 125,141 | (15,064) | 567,571 |
| Less: accumulated depreciation | (224,784) | (69,360) | 15,064 | (279,080) |
| | 232,710 | 55,781 | - | 288,491 |
| Total fixed assets, net | $ 351,273 | $ 79,399 | $ (126,804) | $ 303,868 |

Changes in the Company's fixed assets for the year ended December 31, 2010, are as follows (in thousands):

| | 2009 | Additions and Transfers In | Deletions and Transfers Out | 2010 |
|---|---|---|---|---|
| Nondepreciable fixed assets: | | | | |
| Land | $ 7,617 | $ - | $ - | $ 7,617 |
| Work-in-progress | 76,438 | 122,411 | (87,903) | 110,946 |
| | 84,055 | 122,411 | (87,903) | 118,563 |
| Depreciable fixed assets: | | | | |
| Regional transmission operator software | 332,553 | 26,719 | (22,438) | 336,834 |
| Regional transmission operator hardware | 26,395 | 9,363 | (1,677) | 34,081 |
| Communication equipment | 5,170 | 3,168 | 597 | 8,935 |
| ISO Facilities (HQ and Alhambra) | 17,488 | 45,818 | - | 63,306 |
| Furniture, fixtures and other | 10,657 | 2,835 | 846 | 14,338 |
| | 392,263 | 87,903 | (22,672) | 457,494 |
| Less: accumulated depreciation | (186,546) | (60,910) | 22,672 | (224,784) |
| | 205,717 | 26,993 | - | 232,710 |
| Total fixed assets, net | $ 289,772 | $ 149,404 | $ (87,903) | $ 351,273 |

The Company capitalized interest related to the development of fixed assets of $0.2 million and $7.6 million for the years ending December 31, 2011 and 2010, respectively. The 2010 amount includes a reduction of $3.9 million for income earned on unspent debt proceeds. There were no such amounts in 2011.

On September 30, 2010, the mission critical wing of the new headquarters facility was completed and subsequently occupied. As a result, $45.6 million in assets were transferred from work-in-progress to fixed assets as they were placed in service. Included in work-in-progress at December 31, 2010, is the cost of the remaining two wings of the new headquarters facility in the amount of $84.8 million.

In January 2011, the remaining two wings of the new headquarters facility were fully occupied and as a result, $84.8 million of assets were transferred from work-in-progress to fixed assets as they were placed in service.

## 5. Employee Note Receivable

The Company provided $500,000 in financing to an officer of the Company in connection with the purchase of his primary residence. In 2011, the officer retired and the remaining balance on the note was repaid. The balance due at December 31, 2010 was $390,000, including accrued interest, which is included in other assets in the accompanying balance sheet.

The loan was collateralized by a subordinated deed of trust on the property, accrued interest at 6.5 percent per annum compounded annually, and required annual payments of $68,000. Portions of the note were forgiven by the Company based on the officer's continuing employment as set forth in the employment agreement.

## 6. Generator Noncompliance Fines

In 2000 and 2001, the Company billed generator noncompliance fines to market participants totaling $122.1 million of which the Company collected $60.7 million. Generally, these fines were assessed at a rate corresponding to twice the highest price paid in the Company's markets for energy. Because the prices for this period are being adjusted as a result of the Federal Energy Regulatory Commission Refund Case, as described in Note 12, the amount of the fines to be retained by the Company is being reduced, with any surplus collections being refunded with interest to market participants. The ultimate settlement of fines is expected after the conclusion of the proceedings in the Federal Energy Regulatory Commission Refund Case and the financial settlement of the California Power Exchange (Cal PX).

Based on estimates of the mitigated energy prices the Company recorded fine revenues between the years 2000 to 2004 totaling $29.5 million, resulting in a refund liability of $31.2 million.

In accordance with Federal Energy Regulatory Commission rulings, the Company accrues interest on the portion of fines collected in excess of the estimated realizable amount, which is to be refunded to market participants when the amounts are settled. Such interest expense amounted to $1.9 million in 2010. There was no such interest in 2011.

In 2010, the Company determined an additional adjustment was necessary to comply with the Federal Energy Regulatory Commission refund order and to reverse the mitigation of certain energy sales. The effect of this adjustment was an increase in generator noncompliance fine revenue of $1.4 million, which is recorded as a component of other income, and a reduction in interest previously accrued of $0.9 million, which is recorded as interest expense recovery.

Also in 2010, in connection with a settlement at Federal Energy Regulatory Commission involving Sempra Energy Trading, the Company made arrangements to distribute the generator noncompliance fines to be refunded to the market. The Settlement was approved by the Federal Energy Regulatory Commission on December 22, 2010, and on December 30, 2010, the Company distributed $43.9 million to the settling parties.

The Company estimates the remaining liability (including interest) related to generator noncompliance fines, after the payment described above and after other adjustments, to be $638,000 and $772,000 as of December 31, 2011 and 2010, respectively.

While there are significant uncertainties associated with this process, management believes it is unlikely that there will be any material future adjustment in generator fines to be recognized by the Company.

## 7. Long-term Debt and Related Agreements

Long-term debt consists of the following at December 31 (in thousands):

| | 2011 | 2010 |
|---|---|---|
| CIEDB Revenue Bonds, Series 2009 | | |
| Fixed interest rates of 3.00% - 6.25% with maturities from 2012 through 2039 | $ 200,000 | $ 200,000 |
| CIEDB Revenue Bonds, Series 2008 | | |
| Fixed interest rates of 4.00% - 5.00% with maturities through 2014 | 84,620 | 126,870 |
| Unamortized net premium: | | |
| Series 2009 bonds | 1,749 | 1,852 |
| Series 2008 bonds | 1,417 | 2,805 |
| Total long-term debt | 287,786 | 331,527 |
| Less: current portion | (28,585) | (42,250) |
| Total long-term debt, less current portion | $ 259,201 | $ 289,277 |

Summarized activity of long-term debt for the year ended December 31, 2011, is as follows (in thousands):

| | Beginning of Year | Issuance/ (Payments) | End of Year |
|---|---|---|---|
| CIEDB Revenue Bonds, Series 2009 | $ 200,000 | $ - | $ 200,000 |
| CIEDB Revenue Bonds, Series 2008 | 126,870 | (42,250) | 84,620 |
| Total long-term debt | $ 326,870 | $ (42,250) | $ 284,620 |

Summarized activity of long-term debt for the year ended December 31, 2010, is as follows (in thousands):

| | Beginning of Year | Issuance/ (Payments) | End of Year |
|---|---|---|---|
| CIEDB Revenue Bonds, Series 2009 | $ 200,000 | $ - | $ 200,000 |
| CIEDB Revenue Bonds, Series 2008 | 165,970 | (39,100) | 126,870 |
| Total long-term debt | $ 365,970 | $ (39,100) | $ 326,870 |

Scheduled future debt service payments for the 2008 and 2009 Series A Bonds as of December 31, 2011, are as follows (in thousands):

| | Principal | Interest | Total |
|---|---|---|---|
| 2012 | $ 28,585 | $ 14,870 | $ 43,455 |
| 2013 | 39,580 | 13,228 | 52,808 |
| 2014 | 27,145 | 11,605 | 38,750 |
| 2015 | 3,830 | 10,868 | 14,698 |
| 2016 | 3,980 | 10,711 | 14,691 |
| 2017 - 2039 | 181,500 | 152,952 | 334,452 |
| | $ 284,620 | $ 214,234 | $ 498,854 |

Both the 2008 and 2009 Bonds are supported by a pledge of the Company's revenues and operating reserves. In addition, the 2009 Bonds are supported by a deed of trust on the new headquarters building and land. The premiums on the bonds are being amortized over the life of the bonds.

Interest expense recorded by the Company related to long-term debt includes interest paid on the bonds (net of interest capitalized to fixed assets), and amortization of the bond issuance costs and the bond premiums.

## 8. Fair Value of Financial Instruments

The following valuation methods and assumptions were used as a basis for the fair value of each class of financial instrument:

**Investments**
The fair values of investments, including cash equivalents, except as noted below, are based upon quoted market prices. Fair values for the guaranteed investment contract and forward delivery agreement are based on counterparty quotes.

**Long-term debt**
The fair value of fixed rate long-term debt, which includes the short-term portion, is based on current market quotes.

The fair values of the Company's financial instruments as of December 31, 2011, are presented below (in thousands):

| | Recorded Value | Fair Value |
|---|---|---|
| Investments, including cash and cash equivalents | $ 563,030 | $ 565,825 |
| Long-term debt, including current portion | (287,786) | (301,035) |

The fair values of the Company's financial instruments as of December 31, 2010, are presented below (in thousands):

| | Recorded Value | Fair Value |
|---|---|---|
| Investments, including cash and cash equivalents | $ 538,889 | $ 540,437 |
| Long-term debt, including current portion | (331,527) | (340,125) |

The carrying values reported on the balance sheet for current assets and liabilities approximate fair value.

## 9. Employee Benefit Plans

The Company maintains a number of employee benefit plans. The description of the plans and their key provisions is included below. Obligations included in the Company's balance sheets related to these plans consist of the following at December 31 (in thousands):

| | 2011 | 2010 |
|---|---|---|
| Executive pension restoration plan | $ 883 | $ 1,069 |
| Post-employment medical benefit plan | 17,966 | 15,635 |
| Supplemental executive retirement plan | - | 369 |
| Executive savings plan | 494 | 387 |
| Total employee retirement plan obligations | $ 19,343 | $ 17,460 |

**Retirement savings benefits plan**

The Company sponsors a defined contribution retirement plan, the California ISO Retirement Savings Benefits Plan (the Retirement Plan) that is subject to the provisions of the Employee Retirement Income Security Act of 1974 and covers substantially all employees. The Retirement Plan is administered by the Company with the assistance of a third party. The assets of the plan are held separately from Company assets and are not combined with the assets on the balance sheet.

Employees may elect to contribute up to fifty percent of their eligible compensation to the Retirement Plan, subject to statutory limitations. The Company matches contributions up to six percent of an employees' eligible compensation and an additional contribution equal to five percent of eligible compensation for employees with less than five years of service, or seven percent for employees who have at least five years but not more than ten years of service. An additional contribution of one percent of eligible compensation is also made by the Company for each five year increment of service after an employees' ten year anniversary.

Employees' contributions to the Retirement Plan for 2011 and 2010 were $6.7 million and $6.9 million, respectively. The Company's contributions to the Retirement Plan for 2011 and 2010 were $7.6 million and $7.7 million, respectively.

**Executive pension restoration plan**
The Company sponsors the Executive Pension Restoration Plan, a nonqualified defined contribution plan, which allows certain officers of the Company to make contributions and receive Company contributions in excess of the 401(k) contribution limits set forth by IRS regulations as described in the retirement savings benefits plan above.

The contributions and earnings thereon are held in a trust and the balances as of December 31, 2011 and 2010, were $883,000 and $1,069,000, respectively and are included in Other Assets with a corresponding liability in Employee Retirement Plan Obligations. The Company recognized expenses for contributions of $67,000 and $135,000 in 2011 and 2010, respectively.

**Supplemental executive retirement plan**
In 2011, the Company discontinued the Company sponsored California ISO Supplemental Executive Retirement Plan, a nonqualified defined benefit plan intended to provide selected executives of the Company with target retirement benefits based upon an executive's average earnings and total number of years of service with the Company, as defined in the plan. The plan was fully funded and distributed as of December 31, 2011. The Company recognized expenses of $514,000 and $130,000 in 2011 and 2010, respectively, in connection with this plan.

**Executive savings plan**
The Company sponsors the Executive Savings Plan, a nonqualified defined contribution plan under section 457(b) of the IRS Code. The Company contributes a percentage of each officer's annual base compensation to the plan. Officers may elect to make voluntary contributions, subject to statutory limitations. The contributions and earnings thereon are held in a trust and the balance as of December 31, 2011 and 2010 was $494,000 and $387,000, respectively and is included in Other Assets, with a corresponding liability in Employee Retirement Plan Obligations. The Company recognized expenses of $106,000 and $89,000 in 2011 and 2010, respectively, in connection with this plan.

**Post-employment medical benefit plan**

***Plan description***
The Company sponsors the California ISO Retirees Medical Plan, a defined benefit plan, to provide post-employment health care benefits to all employees who retire from the Company on or after attaining age 60 with at least five years of service and to their spouses, domestic partners and eligible dependents, as provided for under the terms of the plan. Current plan coverage extends for the lifetime of the participants and their beneficiaries, except for dependents, which generally terminates at age 26. The Company pays 60% of the premiums on the coverage elections made by the beneficiaries. There are 29 active employees and 23 retirees eligible to receive benefits pursuant to the plan as of December 31, 2011.

***Funding and investment policy***
The Company has established a trust for the purposes of funding the plan. The trust was established as a tax-exempt voluntary employees' beneficiary association. All assets of the trust are to be used for the exclusive benefit of the participants and beneficiaries of the plan. Although the Company has fiscal accountability for these assets and holds them in a fiduciary capacity, the assets are not considered assets of the Company and are therefore not included on the balance sheets of the Company. As of December 31, 2011 and 2010, the trust assets were $5.3 million and $4.6 million, respectively. Trust assets were primarily invested in US Treasury, government sponsored enterprises, and corporate obligations. The investment of the trust assets generally follows the Company's investment policy.

The Company's current funding policy is to annually contribute an amount such that the total amount in the trust approximates the actuarially determined liability attributable to retirees and their spouses and to active participants who are fully eligible to retire. The Company does not provide funding into the plan related to future obligations associated with employees who have not become eligible to retire.

***Annual Other Post-employment Benefits (OPEB) Cost and Net OPEB Obligation***

The Company's annual OPEB cost for the California ISO Retiree Medical Plan is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45 "*Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions".* The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 15 years (using the level dollar open method). The ARC is adjusted for the amortized amount of the discounted present value (ordinary annuity) of the balance of the net OPEB obligation at the beginning of the year.

The Company's annual OPEB cost at December 31, 2011 and 2010, and for the years then ended, is as follows (in thousands):

| | 2011 | 2010 |
|---|---|---|
| Annual required contribution | $ 3,720 | $ 3,987 |
| Interest on net OPEB obligation | 797 | 633 |
| Adjustment to annual required contribution | (1,516) | (1,219) |
| Annual OPEB cost | 3,001 | 3,401 |
| Contributions made | (670) | (416) |
| Increase in net OPEB obligation | 2,331 | 2,985 |
| Net OPEB obligation, beginning of year | 15,635 | 12,650 |
| Net OPEB obligation, end of year | $ 17,966 | $ 15,635 |

The Company's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and net OPEB obligation for the years ended December 31, 2011, 2010 and 2009 were as follows (in thousands):

| Year Ended | Annual OPEB Cost | Percentage of Annual OPEB Cost Contributed | Net OPEB Obligation |
|---|---|---|---|
| 2009 | $ 3,756 | 55% | $ 12,650 |
| 2010 | 3,401 | 12% | 15,635 |
| 2011 | 3,001 | 22% | 17,966 |

***Actuarial methods and assumptions***

Projections of benefits for financial reporting purposes are based on the substantive plan and include types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The following significant actuarial methods and assumptions were used in the calculation of annual OPEB cost for the year ending December 31, 2011.

| | |
|---|---|
| Valuation date | January 1, 2011 |
| Actuarial cost method | Projected unit credit |
| Amortization method | Level dollar, open |
| Remaining amortization period | 15 years |
| Asset valuation method | Market |
| Investment rate of return | 5.10% |
| Healthcare cost trend rate | 8.5% initial, 5% ultimate |

The projection of future benefit payments for an ongoing plan involves estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

The schedule below reflects multiyear trend information to show the status of funding based on the actuarial value of plan assets relative to the actuarial accrued liabilities. This information is required supplementary information (dollars in thousands):

| **Actuarial Valuation Date** | **Actuarial Value of Assets (a)** | **APBO (b)** | **Unfunded APBO (b - a)** | **Funded Ratio (a/b)** |
|---|---|---|---|---|
| January 1, 2010 | $ 4,137 | $ 18,009 | $ 13,872 | 23% |
| January 1, 2011 | 4,608 | 18,022 | 13,414 | 26% |
| January 1, 2012 | 5,343 | 22,727 | 17,384 | 24% |

The actuarial valuation as of January 1, 2012, incorporated changes to actuarial assumptions which are different from the assumptions used in the calculation of the annual pension costs for the year ending December 31, 2011. Such changes included a decrease in the investment rate of return from 5.1% to 4.0%, a decrease in the health care cost trend rate from 8.5% to 8.0% and changes to the retirement age rates. The increase in the APBO between 2011 and 2012 associated with changes in assumptions is $1.8 million.

The actuarial valuation as of January 1, 2011, was based on actuarial methods and assumptions that were generally consistent with those used in the calculation of the annual pension cost for the year ending December 31, 2010, except for the rate of return (which changed from 5.00 percent to 5.1 percent), health care cost trend rate (which changed from 8.43 percent to 8.5 percent) and HMO pre-65 morbidity adjustment (which changed from 52 percent to 45 percent, as a result of lower than expected number of retirees). Additionally, the valuation included the estimated impact of the provisions of the PPACA. The net effect of the all changes in these assumptions maintained the APBO on approximately the same level as the previous year.

## 10. Insurance Programs and Claims

The Company is exposed to various risks of loss related to torts; theft, damage to, and destruction of assets; errors and omissions; nonperformance of duty; injuries to employees; and natural disasters. The Company maintains various commercial and mutual insurance plans that provide coverage for most claims in excess of specific dollar thresholds, which range from $500 to $1.0 million per claim. Primary insurance policies have coverage limits set based on the Company's assessment of reasonable exposure within that risk category, with consideration of insurance types and coverage limits for comparable entities. Additionally, the Company maintains excess liability coverage that provides umbrella coverage for certain exposures to a limit of $135.0 million. Losses incurred below insurance deductibles are expensed as incurred. In the last three years, the Company did not incur any claims in excess of the coverage described above.

The Company is a participant in a group captive insurance company for workers compensation insurance coverage. The Company's annual net insurance costs for such coverage vary based on claims incurred at the Company, and to a lesser extent, claims activity of other members of the captive insurance company. The Company's annual insurance expense is limited through reinsurance and risk sharing arrangements of the captive to an additional percentage of the initial base premium paid.

## 11. Lease and Contract Commitments

The Company has long-term operating leases and service contracts that expire at various times through 2031 including telecommunication equipment and services, information system equipment and services and systems infrastructure.

The following are the future minimum payments under these agreements as of December 31, 2011 (in thousands):

| | |
|---|---|
| 2012 | $ 12,506 |
| 2013 | 3,318 |
| 2014 | 793 |
| 2015 | 809 |
| 2016 | 810 |
| 2017 - 2031 | 3,372 |
| | $ 21,608 |

Lease and service contract costs of approximately $12.5 million and $12.6 million were charged to operating expense in 2011 and 2010, respectively.

The Company has leased office space under three separate leases, which served as the location of the headquarters prior to the relocation, in January 2011, to the newly constructed headquarters.

One lease expires in November 2012, and the other two leases expire in December 2016, with early termination options available beginning in November 2012. Although the Company is no longer using the leased space, the Company is required to pay monthly rent through November 2012, early termination fees to terminate the leases early, and other on-going costs associated with each of the leases.

In 2011, the period in which the properties were vacated and were no longer being used in operations, the Company recorded an expense in the amount of $6.4 million for the net estimated unrecoverable lease and termination costs. During 2011, payments in the amount of $2.3 million were recorded against the liability. The balance of the lease termination liability as of December 31, 2011, is $4.1 million and is recorded as a component of accounts payable and accrued expenses on the balance sheet.

## 12. Contingencies and Settlements

**The Federal Energy Regulatory Commission Refund Case**
In 2000 and 2001, the California energy markets, including those managed by the Company, experienced high prices, shortages of energy and reserves, rolling blackouts and liquidity problems for many market participants. Several of them, including the California Power Exchange (Cal PX), filed for bankruptcy.

Purchasers of energy during this period sought refunds at the Federal Energy Regulatory Commission. The Federal Energy Regulatory Commission has issued a series of orders related to mitigating the clearing prices in markets administered by the Company and the Cal PX for the period from October 2, 2000 through June 20, 2001 (the Federal Energy Regulatory Commission Refund Case). Several of the Company's market participants have settled their liability arising from the Federal Energy Regulatory Commission Refund Case and related proceedings. Management believes the ultimate outcome of the Federal Energy Regulatory Commission Refund Case will have no material financial impact on the Company as these refund amounts are funded and will ultimately be resettled among market participants, except for the Generator Noncompliance Fines, as described in Note 6.

**Market billing disputes in good faith negotiations**
As part of the tariff and applicable contracts, the Company has dispute resolution processes for market participants, transmission owners and RMR owners to register disagreements regarding information reflected in the settlement statements or billing amounts for market and RMR activity.

Market disputes are addressed in the normal course of operations, some of which result in adjustments to previously issued settlement statements. When adjustments are made the adjustment amounts are reallocated to market participants based on the allocation methodology related to the charge code being adjusted, with no net cost or credit being realized by the Company. With respect to pending market disputes at December 31, 2011, including those that have escalated to good faith negotiations, management believes that any settlements or market adjustments would be resettled against the market with no liability to the Company.

**Indemnifications**
The Company's bylaws require its annual financial statements to include disclosures about certain payments made by the Company related to indemnifications to or on behalf of officers and Board members. There were no such payments in 2011 or 2010.

**Other matters**
The Company, during the ordinary course of its operations, has been involved in various lawsuits and claims, some of which are still pending. In addition, the Company is subject to compliance

requirements of mandatory reliability standards promulgated by Federal Energy Regulatory Commission-approved mandatory reliability standards (i.e. NERC Reliability Standards), which if violated could result in penalties assessed to the Company. There are several matters currently pending related to alleged violations of these standards. Management is of the opinion that none of these matters will have a material adverse impact on the financial position or results of the operations of the Company.