PRICEWATERHOUSECOOPERS

California Independent System Operator Corporation

Financial Statements

December 31, 2008 and 2007

California Independent System Operator Corporation
Table of Contents
December 31, 2008 and 2007

PRICEWATERHOUSECOOPERS

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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, 2008 and 2007, 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 11 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 3, 2009

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, 2008 and 2007. 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, as well as with Canada and Mexico.

The Company operates day-ahead and hour-ahead markets for transmission congestion and ancillary services, operates a real-time market for balancing energy, and administers reliability-must-run (RMR) contracts. RMR contracts allow the Company access to power at contractually agreed-upon prices from generation units which, due to their location and other factors, must be operated at certain times to ensure the local transmission reliability. 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. Any market defaults are proportionately allocated to market participants based on net amounts due them for the month of default.

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 (FERC).

The Board of Governors (Board) of the Company is composed of five members appointed by the California Governor and confirmed by the California State Senate.

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). The Company's accounting records generally conform to the Uniform System of Accounts prescribed by the FERC.

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. 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.

Setting of 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. GMC revenues are recognized when the related energy transactions take place. All of the Company's receivables are due from entities in the energy industry, including utilities, generation owners, financial institutions and other electricity market participants. For the years ended December 31, 2008 and 2007, approximately 54 percent and 53 percent, respectively, of GMC revenues were from two market participants. In the event of a payment default by a market participant, GMC revenues have a priority claim against any market-related receipts, which means that even if an entity defaults on a GMC invoice, the Company receives the full GMC so long as sufficient funds were received on market invoices.

The 2008 and 2007 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 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). In accordance with the tariff, any surplus operating reserve balance is applied as a reduction in the revenue requirement for the following year. These operating reserve amounts are included in the net assets of the Company. The tariff requires GMC rates to be adjusted not more than once per quarter in the event that projected annual billing determinant volumes differ by more than five percent from those projections used to set rates. During 2008 and 2007, adjustments were made to certain GMC rates pursuant to these provisions. The Company believes these provisions provide it sufficient access to resources to meet its financial obligations to debt holders and other creditors.

The following table summarizes the pro forma bundled GMC rate based on the budgeted revenue requirement divided by the estimated control area transmission volume.

	2008	2007	2006
Pro forma GMC rate per MWh	$ 0.755	$ 0.760	$ 0.724
Estimated volume in millions of MWh	253.70	250.00	249.20

2008 Compared to 2007 **–** The pro forma bundled GMC rate per MWh was $0.005 lower in 2008 due to the budgeted revenue requirement being spread over a larger transmission volume. The budgeted revenue requirement increased in 2008 as compared to 2007 primarily due to an $8.9 million increase in budgeted costs for increased overtime and consulting costs, a $1.0 million increase in project funding and a $4.0 million increase in the revenue requirement due to a lower amount transferred from the operating reserve in 2008 as compared to 2007, partially offset by a $12.0 million reduction in debt service requirements.

2007 Compared to 2006 **–** The pro forma bundled GMC rate per MWh was $0.036 higher in 2007 due to an increase in the budgeted revenue requirement which was partially mitigated by an increase in transmission volume. The budgeted revenue requirement increased in 2007 as compared to 2006 primarily due to a $9.9 million increase in budgeted operating costs for increases in overtime and staffing, a $1.0 million increase in project funding and a $5.0 million increase in the revenue requirement due to a lower amount transferred from the operating reserve in 2007 as compared to 2006, partially offset by a $3.0 million reduction in debt service requirements and a $2.5 million increase in other revenues.

Liquidity

The Company's rate structure provides for operating reserves which for 2008 and 2007 were fully funded for each service category. The Company issued $197.0 million of fixed rate revenue bonds (the 2008 Series Bonds) in June 2008. The proceeds of the issuance were used to refund all variable rate demand bonds outstanding at the time of issuance, fund debt service reserves related to the issued debt, and pay certain debt issuance costs. The remaining proceeds will be used to fund computer hardware and software systems, other facilities and equipment, and other planned capital projects. In connection with the issuance of the 2008 Series Bonds, the Company retired the related interest rate swaps and associated bond insurance. There is sufficient unrestricted and restricted cash to conduct the Company's operations and fund the Company's current estimated capital and debt service requirements.

To mitigate the risk that an issuer of an investment will not fulfill its repayment obligation, the Company limits investments to those rated by a nationally recognized rating agency of A-1 (or equivalent) or better for commercial paper and A- (or equivalent) or better for medium-term notes. The Company typically holds investments to maturity. New funds available for investment were placed in money market accounts during 2008, thereby reducing investments to $87.2 million at December 31, 2008, compared to $128.9 million at December 31, 2007. The Company recorded a mark-to-market loss of $4.1 million on the Company's investment portfolio for the year ended December 31, 2008, as a result of declines in value of corporate bonds.

Market Redesign and Technology Upgrade (MRTU) Project

The MRTU Project is a significant effort to improve the reliability and market operations of the California grid and the information systems that support it. It is a multi-year project that became operational March 31, 2009. It includes major system components including:

- Day-Ahead Market - A series of integrated pricing runs to account for hourly self-schedules and bids, reliability needs and market power mitigation in the 24-hour period before electricity flows in real time.
- Congestion Revenue Rights - Financial instruments that allow market participants to obtain risk protection from congestion charges in the day-ahead market.
- Scheduling Infrastructure Business Rules - A system that validates and publishes bids for information and use in other applications.
- Real-Time Market - A system that simultaneously optimizes energy and ancillary services based on locational marginal pricing (LMP), so that congestion is managed efficiently and reliably.
- Settlements and Market Clearing - An integrated set of systems that process settlement statements, billing, invoicing, cash clearing and credit business functions for the markets.
- State Estimator with a Full Network Model - A computer software program that provides a near real-time assessment of system conditions within the California grid.

The main benefits associated with the MRTU Project are:

- Enhanced Reliability - MRTU provides transparent rules for buyers and sellers in California's wholesale electricity markets where prices will reflect actual costs based on the physical flow of electricity on transmission lines. By creating a day-ahead market and scheduling process, the power flows over the next 24 hours can be modeled according to the actual physical constraints so that risks of shortages and congestion on transmission lines can be assessed and minimized.
- Improved Information - By providing transparent nodal marginal prices that reflect the true cost of energy and transmission, MRTU reveals areas with congested transmission lines so that qualified entities can build new lines or generation resources, with the Company's coordination, to improve efficiency and reliability.
- Improved Cost Management - The alignment of costs with market participant behavior is expected to lead to increased confidence in the Company-managed markets. The operating signals from LMP and the anticipated more efficient mix of resources identified by the day-ahead market will be important cost management improvements.
- New Robust Technology - Replacing the dated computer infrastructure with new hardware, architecture and systems will provide the Company with greater functionality and flexibility. A new suite of systems provides more effective and reliable support for grid and market operations.

New Headquarters Facility
The Company intends to construct and occupy, with a targeted completion date of 2011, a new headquarters and operations facility on land the Company owns in Folsom, California. The Company is currently planning a bond issuance in Summer 2009 to fund the facility costs. Expenditures on the facility prior to the availability of such bond proceeds are being funded from general Company funds and funds from the 2008 bond offering.

Commitments and Contingencies
As part of the tariffs and applicable contracts, the Company has a dispute resolution process for market participants, RMR owners and transmission owners to register disagreements about information in the settlement statements or billing amounts for market and RMR activity. Once good faith efforts, known as good faith negotiations (GFN), have been made to negotiate and resolve disputes, written claims may be submitted either to mediation or arbitration. Several disputes and other claims, some of which are material in amount, have been filed with the Company and are in the process of being resolved. To date, all prior settlements, market adjustments and matters in GFN have been resettled against the market and the Company believes that any settlements or market adjustments relating to current disputes and the matters in GFN would be resettled against the market as permitted by the tariff.

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):

	2008	2007	2006
Assets			
Current assets	$ 378.5	$ 331.7	$ 288.7
Fixed assets, net	257.3	212.9	165.9
Other noncurrent assets	70.7	77.3	34.9
Total	$ 706.5	$ 621.9	$ 489.5
Liabilities and Net Assets			
Current liabilities	$ 279.8	$ 276.2	$ 202.1
Long-term debt	173.4	125.1	116.7
Other Noncurrent liabilities	12.5	13.1	9.3
Net assets	240.8	207.5	161.4
Total	$ 706.5	$ 621.9	$ 489.5

Assets

Current Assets (in millions):

	2008	2007	2006
Cash and cash equivalents	$ 298.3	$ 220.8	$ 153.8
Investments	21.5	58.5	90.5
Accounts receivable and other assets	58.7	52.4	44.4
Total	$ 378.5	$ 331.7	$ 288.7

2008 Compared to 2007 - Current assets amounted to $378.5 million at December 31, 2008, an increase of $48.8 million during the year, which make up about 53 percent of the Company's assets. The increase in cash, cash equivalents, and investments of $40.5 primarily related to an increase of $24.0 million of bond proceeds restricted for capital expenditures, an increase of $32.9 million in amounts restricted for market participants and cash provided by operations of $81.1 million. The increases were partially offset by decreases in cash, cash equivalents and investments primarily related to decrease in debt service funds of $45.9 million arising from the refinancing of the bonds and $52.8 million used for fixed assets. Accounts receivable and other assets increased by $7.3 million due primarily to higher GMC receivables at the end of 2008 as compared to 2007 and increases in other current assets from prepaid amounts.

2007 Compared to 2006 - Current assets amounted to $331.7 million at December 31, 2007, an increase of $43.0 million during the year, which make up about 53 percent of the Company's assets. Cash and cash equivalents increased by $67.0 million in 2007 while short term investments decreased by $32.0 million. Increases in cash, cash equivalents and investments primarily related to proceeds from the issuance of bonds of $59.2 million and increases in pass-through fees due to others and market funds pending settlement of $17.9 million, market participant security deposits of $44.6 million and generator interconnection study deposits of $8.6 million. Decreases in cash, cash equivalents and investments primarily related to draws from the bond construction fund for capital expenditures of $58.0 million and a transfer to long term investments of $39.9 million. Accounts receivable and other assets increased by $8.0 million due primarily to a supplemental increase in certain GMC rates for the fourth quarter of 2007 to offset lower volumes during the year.

Fixed Assets, net (in millions):

	2008	2007	2006
Net assets in service	$ 34.1	$ 33.1	$ 28.5
MRTU work-in-progress	192.9	155.9	123.1
Land and other work-in-progress	30.3	23.9	14.3
Total	$ 257.3	$ 212.9	$ 165.9

2008 Compared to 2007 - The Company has invested approximately $257.3 million in fixed assets and work-in-progress, net of accumulated depreciation, at December 31, 2008. Net fixed assets were about 36 percent of the Company's assets, approximately two percent more than the previous year. During 2008, the Company capitalized approximately $56.7 million of additions to fixed assets, including additions to work-in–progress. The largest component of the additions were related to the 2008 costs of approximately $37.0 million for the MRTU Project described above. The internally developed software related to MRTU was substantially complete and capitalization ceased on December 1, 2008. The MRTU assets were placed in service on March 31, 2009.

2007 Compared to 2006 - The Company has invested approximately $212.9 million in fixed assets and work-in-progress, net of accumulated depreciation, at December 31, 2007. Net fixed assets were about 34 percent of the Company's assets, the same percentage as the previous year. During 2007, the Company capitalized approximately $62.1 million of additions to fixed assets, including additions to work-in–progress. The largest component of the additions were related to the 2007 costs of approximately $54.2 million for the MRTU Project described above.

Other Noncurrent Assets (in millions):

	2008	2007	2006
Investments	$ 65.7	$ 70.4	$ 30.5
Other assets	5.0	6.9	4.4
Total	$ 70.7	$ 77.3	$ 34.9

2008 Compared to 2007 - Other noncurrent assets amounted to $70.7 million at December 31, 2008, a decrease of $6.6 million during the year, principally related to a decrease in the value of corporate notes.

2007 Compared to 2006 - Other noncurrent assets amounted to $77.3 million at December 31, 2007, an increase of $42.4 million during the year. The largest component is long-term investments which increased by $39.9 million primarily due to increased investment in U.S. governmental agency securities, which were funded by the liquidation of investments in corporate bonds that were carried in current assets.

Liabilities

Current Liabilities (in millions):

	2008	2007	2006
Accounts payable and accrued expenses	$ 12.2	$ 15.0	$ 13.1
Accrued salaries and compensated absences	22.3	19.9	17.8
Current portion of long-term debt	31.0	64.6	71.7
Due to market participants	155.8	122.9	51.9
Generator non-compliance fines refund obligation	56.7	52.0	45.8
GMC refund obligation	1.8	1.8	1.8
Total	$ 279.8	$ 276.2	$ 202.1

2008 Compared to 2007 - Current liabilities amounted to $279.8 million at December 31, 2008, an increase of $3.6 million during the year. Amounts due to market participants increased by $32.9 million primarily related to increases in generator interconnection study deposits of $45.0 million offset by decreases in other restricted market participant funds of $12.1 million. Generator noncompliance fines refund obligation increased $4.7 million due to additional accrued interest on the related refund.

2007 Compared to 2006 - Current liabilities amounted to $276.2 million at December 31, 2007, an increase of $74.1 million during the year. Amounts due to market participants increased by $71.0 million primarily related to increases in market participant security deposits of $44.5 million, other restricted market participant funds of $17.9 million and generator interconnection study deposits of $8.6 million. Generator noncompliance fines refund obligation increased $6.2 million due to additional accrued interest on the related refund.

Long-Term Debt (in millions):

	Principal	Interest	Total
Debt Service Requirements			
2009	$ 31.0	$ 8.4	$ 39.4
2010	39.1	6.4	45.5
2011	42.3	4.3	46.6
2012	25.1	3.1	28.2
2013	36.0	1.3	37.3
2014	23.5	0.1	23.6
Total	$ 197.0	$ 23.6	$ 220.6

Debt service requirements above reflect scheduled maturities of long-term debt at December 31, 2008. Interest is calculated using the stated fixed rate of the bonds.

As of December 31, 2008, the Company had an underlying rating of A- (with stable outlook) from S&P and A2 (with stable outlook) by Moody's.

2008 Compared to 2007 - At December 31, 2008, the Company had $197.0 million of outstanding bonds issued through the California Infrastructure and Economic Development Bank (CIEDB). Proceeds of the bonds were used to refund all variable rate demand bonds outstanding at the time of issuance, fund debt service reserves related to the issued debt, and pay certain debt issuance costs. The remaining proceeds will be used to fund computer hardware and software systems, other facilities and equipment, and other planned capital projects. Included in the balance is an unamortized premium on the 2008 bonds of $7.4 million. Long-term debt (net of current portion) makes up about 24 percent of the Company's liabilities and net assets, approximately 4 percent more than the previous year. The increase in long-term debt was primarily attributable to the issuance of new bonds which included additional debt to finance capital projects.

2007 Compared to 2006 - At December 31, 2007, the Company had $189.7 million of outstanding variable rate demand revenue bonds issued through the CIEDB. Proceeds of the bonds were utilized to finance a portion of the costs of the Company's MRTU Project, other capital projects and operating systems, a portion of the Company's start-up costs, working capital needs and facility expansion. Long-term debt (net of current portion) makes up about 20 percent of the Company's liabilities and net assets, approximately 4 percent less than the previous year. The increase in long-term debt was primarily attributable to the issuance of new bonds less scheduled payments and less the portion of the principal amount becoming a current liability.

Other Noncurrent Liabilities (in millions):

	2008	2007	2006
Derivative liability	$ -	$ 1.4	$ -
Employee retirement plan obligations	12.5	11.7	9.3
Total	$ 12.5	$ 13.1	$ 9.3

2008 Compared to 2007 - Other noncurrent liabilities amounted to $12.5 million at December 31, 2008, a decrease of $0.6 million during the year. The overall decrease was the result of the termination of the interest rate swap (the derivative liability) of $1.4 million during 2008 in connection with the bond refunding, partially offset by an increase in employee retirement plan obligations of $0.8 million which was attributable to the excess of plan costs over current year funding.

2007 Compared to 2006 - Other noncurrent liabilities amounted to $13.1 million at December 31, 2007, an increase of $3.8 million during the year. The increase in employee retirement plan obligations of $2.4 million was primarily attributable to an increase in the post-employment medical benefit plan obligation, caused by higher annual cost of the plan, offset by a $0.9 million increase in the 2006 liability due to a retroactive change in accounting principle. The increase in the derivative liability of $1.4 million reflected the decrease in value of the interest rate swap (which was terminated in 2008, as discussed above) from increasing interest rates.

Net Assets (in millions):

	2008	2007	2006
Invested in capital assets, net of related debt	$ 136.2	$ 81.5	$ 32.4
Restricted	1.6	43.5	51.1
Unrestricted	103.0	82.5	77.8
Total	$ 240.8	$ 207.5	$ 161.3

2008 Compared to 2007 – Net assets invested in capital assets, net of related debt, amounted to $136.2 million at December 31, 2008, an increase of $54.7 million during the year. The increase was attributable primarily to the capitalized costs funded from unrestricted funds. Restricted net assets amounted to $1.6 million at December 31, 2008, a decrease of $41.9 million from the year prior, which was primarily attributable to lower bond sinking requirements of the 2008 revenue bonds as compared to the requirements for the bonds that were refunded. Unrestricted net assets amounted to $103.0 million at December 31, 2008, an increase of $20.5 million during the year, due primarily to a surplus of revenues over expenses in 2008, partially offset by the net changes reflected in the other two categories.

2007 Compared to 2006 – Net assets invested in capital assets, net of related debt, amounted to $81.5 million at December 31, 2007, an increase of $49.1 million during the year. The increase was attributable primarily to the capitalized costs funded from unrestricted funds. Restricted net assets amounted to $43.5 million at December 31, 2007, a decrease of $7.6 million from the year prior, which was primarily attributable to lower bond sinking requirements. Unrestricted net assets amounted to $82.5 million at December 31, 2007, an increase of $4.7 million during the year, due primarily to a surplus of revenues over expenses in 2007, partially offset by the net changes reflected in the other two categories.

Changes in Net Assets

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

	2008	2007	2006
Operating revenues	$ 200.7	$ 200.6	$ 189.9
Operating expenses	161.8	153.8	148.4
Operating income	38.9	46.8	41.5
Other income (expenses)	(5.6)	(0.6)	(0.2)
Total	$ 33.3	$ 46.2	$ 41.3

Operating Revenues

2008 Compared to 2007 - Total operating revenues in 2008 were substantially the same as in 2007. In 2008, GMC from regular operations for the year was $194.8 million. GMC from regular operations in 2008 was higher than in 2007 due primarily to higher volumes of activity related to certain billing determinants. In 2007, GMC from regular operations was $187.7 million. The 2007 GMC revenue also included $7.1 million of GMC amounts from San Diego Gas and Electric Company (SDG&E), as described below, and which did not recur in 2008.

2007 Compared to 2006 - Operating revenues were $200.6 million in 2007, an increase from 2006 of $10.7 million which was primarily attributable to certain GMC rate categories being higher in 2007 and collection of $7.1 million of GMC amounts from SDG&E in prior years. In 2007, a settlement was reached with SDG&E relating to GMC charges associated with transactions on certain shared ownership facilities which SDG&E previously disputed as a result of a FERC order, which limited their ability to pass the charges through to certain parties.

Operating Expenses and Percentages (dollars in millions):

	2008	2007	2006
Salaries and related benefits	$ 91.6	$ 83.5	$ 73.4
Communication and technology costs	23.9	21.5	23.7
Legal and consulting costs	15.7	16.6	17.0
Other: leases, facilities and administrative	17.8	17.2	17.6
Depreciation and amortization	12.8	15.0	16.7
Total	$ 161.8	$ 153.8	$ 148.4
Salaries and related benefits	56.6 %	54.3 %	49.4 %
Communication and technology costs	14.8	14.0	16.0
Legal and consulting costs	9.7	10.7	11.5
Other: leases, facilities and administrative	11.0	11.2	11.9
Depreciation and amortization	7.9	9.8	11.2
Total	100.0 %	100.0 %	100.0 %

2008 Compared to 2007 - Operating expenses were $161.8 million in 2008, $8.0 million higher than in 2007. The increase in 2008 as compared to 2007 is primarily attributable to higher total salaries and related benefits resulting from an increase in the number of employees.

2007 Compared to 2006 - Operating expenses were $153.8 million in 2007, $5.5 million higher than 2006. The increase in 2007 as compared to 2006 is primarily attributable to higher total salaries and related benefits resulting from an increase in the number of employees.

Other Income (Expense) (in millions):

	2008	2007	2006
Interest income	$ 3.7	$ 13.1	$ 10.1
Interest expense	(8.9)	(11.9)	(11.1)
Change in derivative valuation	(0.4)	(1.8)	0.8
Total	$ (5.6)	$ (0.6)	$ (0.2)

2008 Compared to 2007 - Interest income was $9.4 million lower in 2008 compared to 2007 due primarily to lower interest earnings caused by lower interest rates of $3.4 million, a loss of $4.1 million from the mark-to-market of investments and $1.9 million of interest income recorded in 2007 related to the SDG&E settlement that did not recur in 2008. Interest expense was $3.0 million lower in 2008 versus 2007. The decreased expense was primarily due to 2008 bond premium amortization of $2.4 million which did not exist in 2007, $1.8 million decrease in interest on generator fines driven primarily from lower FERC interest rates and $1.2 million increase in capitalized interest on work in progress. The change in derivative valuation in 2008 is due to the lower mark to market on the swaps during the period they were outstanding in 2008 as compared to 2007.

2007 Compared to 2006 - Interest income was $3.0 million higher in 2007 compared to 2006 due primarily to an increase in the investment portfolio, as cash, cash equivalents, and investments increased to $349.7 million as of December 31, 2007 from $274.8 million as of December 31, 2006. Interest expense was $0.8 million higher in 2007 versus 2006 due to higher debt balances. The change in the derivative liability in 2007 is due to higher interest rates at year end compared to 2006.

California Independent System Operator Corporation
Balance Sheets
December 31, 2008 and 2007

($ in thousands)

	2008	2007
Assets		
Current assets:		
Cash and cash equivalents, including restricted amounts	$ 298,312	$ 220,775
Accounts receivable	51,582	49,327
Short-term investments, including restricted amounts	21,496	58,516
Other current assets	7,117	3,067
Total current assets	378,507	331,685
Noncurrent assets:		
Long-term investments, unrestricted	65,715	70,396
Fixed assets, net	257,253	212,927
Other assets	5,023	6,898
Total noncurrent assets	327,991	290,221
Total assets	$ 706,498	$ 621,906
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued expenses	$ 12,190	$ 14,959
Accrued salaries and compensated absences	22,345	19,946
Current portion of long-term debt	31,000	64,600
Due to market participants	155,767	122,919
Generator noncompliance fines refund obligation	56,685	52,003
GMC refund obligation	1,800	1,800
Total current liabilities	279,787	276,227
Noncurrent liabilities:		
Long-term debt, net of current portion	173,372	125,100
Derivative liability	-	1,378
Employee retirement plan obligations	12,495	11,718
Total noncurrent liabilities	185,867	138,196
Total liabilities	465,654	414,423
Commitments and contingencies		
Net assets		
Invested in capital assets, net of related debt	136,189	81,429
Restricted	1,616	43,545
Unrestricted	103,039	82,509
Total net assets	240,844	207,483
Total liabilities and net assets	$ 706,498	$ 621,906

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, 2008 and 2007

($ in thousands)

	2008	2007
Operating revenues:		
GMC revenue	$ 194,841	$ 194,831
Other revenues	5,903	5,795
Total operating revenues	200,744	200,626
Operating expenses:		
Salaries and related benefits	91,638	83,508
Equipment leases and facility costs	9,615	9,433
Communications, technology and temporary staffing contracts	23,912	21,475
Legal and consulting services	15,678	16,573
Training, travel and professional dues	3,585	3,752
Insurance, administrative and other expenses	4,503	4,143
Depreciation and amortization	12,822	14,978
Total operating expenses	161,753	153,862
Income from operations	38,991	46,764
Other income (expense):		
Interest income	3,729	13,144
Interest expense	(9,359)	(13,733)
Total other income (expense)	(5,630)	(589)
Change in net assets	33,361	46,175
Net assets, beginning of year	207,483	161,308
Net assets, end of year	$ 240,844	$ 207,483

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

California Independent System Operator Corporation
Statements of Cash Flows
Years Ended December 31, 2008 and 2007

($ in thousands)

	2008	2007
Cash flows from operating activities:		
Receipts from scheduling coordinators	$ 192,586	$ 186,867
Other receipts	5,903	5,795
Payments to employees	(88,589)	(79,099)
Payments to vendors/others	(63,576)	(56,487)
Receipts from market participants	168,496	163,222
Payments to market participants	(135,648)	(92,163)
Net cash provided by operating activities	79,172	128,135
Cash flows from noncapital financing activities:		
Repayment of bonds	(16,352)	(14,000)
Interest on debt	(142)	(1,328)
Net cash used in noncapital financing activities	(16,494)	(15,328)
Cash flows from capital and related financing activities:		
Purchases and development of fixed assets	(57,750)	(59,747)
Proceeds from issuance of bonds	202,722	59,168
Repayment of bonds	(173,348)	(44,700)
Interest on debt	(2,614)	(6,117)
Net cash used in capital financing activities	(30,990)	(51,396)
Cash flows from investing activities:		
Purchases of investments	(209,648)	(161,021)
Sales and maturities of investments	251,349	153,154
Interest received	4,148	13,428
Net cash provided by investing activities	45,849	5,561
Net increase in cash and cash equivalents, restricted and unrestricted	77,537	66,972
Cash and cash equivalents, restricted and unrestricted, beginning of year	220,775	153,803
Cash and cash equivalents, restricted and unrestricted, end of year	$ 298,312	$ 220,775

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

California Independent System Operator Corporation
Statements of Cash Flows
Years Ended December 31, 2008 and 2007

($ in thousands)

(continued)	2008	2007
Supplemental information:		
Cash paid for interest	$ 5,502	$ 7,057
Reconciliation of income from operations to net cash provided by operating activities		
Income from operations	$ 38,991	$ 46,764
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization	12,822	14,978
Changes in operating assets and liabilities:		
Accounts receivable and other assets	(3,934)	(10,854)
Accounts payable and other accrued expenses	(1,555)	6,188
Due from/(to) market participants	32,848	71,059
Net cash provided by operating activities	$ 79,172	$ 128,135
Supplemental disclosure of noncash financing and investing activities		
Amortization of bond premium	$ 1,786	$ -
Amortization of bond issuance costs and loss of refunding	(844)	(505)
Change of valuation of derivative financial instruments	(400)	(1,750)
Generator fines interest included in interest expense	(4,682)	(6,155)
Purchases and development of fixed assets included in accounts payable and accrued expenses	2,249	4,420

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 the California grid and to neighboring control areas and states, as well as 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 low-cost wholesale marketplace for electrical generation and related services in California. The Company operates pursuant to tariffs filed with the FERC.

The Company operates day-ahead and hour-ahead markets for transmission congestion and ancillary services, operates a real-time market for balancing energy, and administers RMR contracts. RMR contracts allow the Company access to power at contractually agreed-upon prices from generation units which, due to their location and other factors, must be operated at certain times to ensure the reliability of local transmission. 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 as 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. Any market defaults are proportionately allocated to market participants based on net amounts due them for the month of default.

The Board of the Company is composed of five members appointed by the California Governor and confirmed by the California State Senate.

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. In particular, the Company's results of operations and financial position are materially affected by the management estimates associated with generator noncompliance fines, as discussed in Note 6. Actual results could materially differ from these, and other, estimates.

Cash and cash equivalents

Cash and cash equivalents, restricted and unrestricted, include cash on hand, governmental securities, commercial paper, money market investments, mutual funds and certificates of deposit and other highly liquid investments with original maturities of three months or less. Cash and cash equivalents are unrestricted unless specifically restricted as described below. Cash and cash equivalents restricted by bond indenture agreements for capital expenditures include amounts held for expenditures related to capital projects. Cash and cash equivalents restricted by the tariff for market participants include amounts held in escrow, funds pending settlement, amounts due to others, and deposits. Cash and cash equivalents restricted for debt service include amounts held by a bond trustee under an indenture agreement for scheduled repayments of bond principal and for a debt service reserve fund.

Accounts receivable and revenue recognition
The GMC, which is based on rates filed with FERC, is designed to recover the Company's operating costs, capital expenditures and debt service costs, and to provide for an operating reserve. GMC revenues are recognized when the related energy transactions take place. Since the GMC is billed and collected approximately 65 days after each month-end, GMC revenues are recognized based on estimates of the underlying volumes of energy transactions and are trued-up upon final billing. GMC and other market service billings are dependent upon accurate generation, load and other information, much of which is accumulated through meter data, and some of which are not available to the Company for up to 65 days. Meter data is subject to estimation by the Company when data is not submitted timely, and is subject to delayed adjustment when meter data previously submitted is subsequently adjusted under specific circumstances. On occasion, such adjustments may result in adjustments to true-up GMC billings after the final invoices have been issued.

The 2008 and 2007 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 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, 2008, 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. These operating reserve amounts are included in the net assets of the Company and are not included in the GMC refund obligations described below. The tariff requires GMC rates to be adjusted not more than once per quarter in the event that billing determinant volumes differ by more than five percent from those projections used to set rates. During 2008 and 2007, 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, which are the owners of the generating plants that are planned to be connected to the California grid, request the Company to conduct these studies and are required to make a deposit before any studies are performed. At any time, the project sponsors may withdraw from the studies and have the right to any remaining unapplied deposits.

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 once the studies are completed.

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. During 2008 and 2007, there were no adjustments to generator fine revenues.

Investments
Investments include government and federal agency securities, corporate bonds, guaranteed investment contracts and forward delivery agreements with maturities of more than three months. Investments are carried at fair value except for guaranteed investment contracts (GICs) and forward delivery agreements. The GICs and forward delivery agreements 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 from the mark-to-market on investments is recorded as a component of interest income.

Fixed assets
Fixed assets are recorded at cost. Depreciation is computed on the straight-line method over the assets' estimated useful lives. Most of the Company's investment in fixed assets consists of information systems, which are being depreciated over useful lives of 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 charged to expense 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 project stage and training and maintenance costs are expensed as incurred. Costs of software development related to abandoned projects are expensed when the decision to abandon is made.

Other assets
Other assets consist primarily of debt issuance costs, which are amortized over the life of the bonds using the bonds outstanding method (which approximates the effective interest method), a loan to an officer (see Note 5) and certain employee retirement plan trust accounts.

Compensated absences
The Company accrues vacation leave when the employee earns the right to the benefit. The Company does not record sick leave or other leave as a liability until it is taken by the employee, since there are no cash payments for sick leave or other leave made when employees terminate or retire. At December 31, 2008 and 2007, the total accrued liability for vacation was $5.9 million and $5.5 million, respectively.

GMC refund obligation
GMC refund obligation consists of previously collected GMC revenue to be refunded to market participants, generally as a result of GMC settlement agreements as described in Note 12.

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.

Interest rate swap agreements
The Company enters into interest rate swap agreements to modify the effective rate of interest on outstanding variable-rate debt. Interest expense is reported net of the swap payments received or paid as a component of interest expense in the statements of revenues, expenses and changes in net assets. The Company's interest rate swaps are accounted for as derivative instruments and are recorded on the balance sheet at fair value at December 31, 2007. At December 31, 2008, the Company did not have any interest rate swap agreements.

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), by the Company's tariff and by 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".

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, 2008 and 2007, approximately 54 percent and 53 percent, respectively, of GMC revenues were from two market participants. GMC revenues have a priority claim against any market-related receipts.

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

Implementation of FASB Statement No. 157
In September 2006, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 157, *Fair Value Measurements* ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and expands disclosures about fair value measurements. SFAS 157 applies under other existing accounting pronouncements that require or permit fair value measurements, as the FASB previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS 157 does not require any new fair value measurements. For the year ending December 31, 2008, the Company adopted SFAS 157 as it relates to financial assets and liabilities, except where the new standard conflicts with GASB pronouncements. The adoption of SFAS 157 did not impact the Company's financial position or results of operations.

3. Cash and Cash Equivalents and Investments

Cash and cash equivalents and investments
The Company's investment policy, which has been approved by its Board, restricts investments to obligations that are unconditionally guaranteed by the United States (U.S.) government or its agencies or instrumentalities; municipal and state obligations or tax-exempt obligations; bankers' acceptances; certificates of deposit; repurchase agreements; general obligation bonds of corporations; commercial paper and GICs. Additionally, bond sinking and reserve fund portfolios are dictated by bond agreements as contained in the indenture of trust. The Company's investment policy includes restrictions for investments relating to maximum amounts invested as a percentage of the total portfolio and maximum maturities and minimum credit ratings.

Credit risk
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 by a nationally recognized rating agency of A-1 (or equivalent) or better for commercial paper and A1/A3 (or equivalent) or better for medium-term notes.

Interest rate risk
It is the policy of the Company to diversify its overall investment portfolio. Portfolio diversification is employed as a way to control interest rate risk, by limiting investment maturities as a means of managing exposure to fair value losses arising from increases in interest rates. Investments are diversified as to maturities and as to kind of investment to reduce the risk of loss, which might result from over concentration of assets in a specific maturity, in a specific kind of investment, or from a specific issuer. Of the Company's total portfolio at December 31, 2008 and 2007, all of the Company's cash and cash equivalents have maturities of 90 days or less. The investments have a maximum maturity of five years.

Concentration of credit risk
This is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. The Company's investment policy limits investments by asset class. In 2008 and 2007, investments with issuers comprising more than five percent of the Company's total investment portfolio are noted below:

	2008	**2007**
Morgan Stanley	23%	10%
Federal Home Loan Mortgage Corporation (FHLMC)	16%	8%
Federal National Mortgage Association (FNMA)	9%	12%
Wells Fargo	-	27%
JPMorgan	-	6%
Federal Farm Credit Bank (FFCB)	-	6%
Federal Home Loan Bank (FHLB)	-	6%

Custodial credit risk
For an investment, 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. As of December 31, 2008, the Company had adopted a formal policy for custodial credit risk, but it had not yet been implemented.

The Company has bank deposits in the amounts of $1.9 million and $2.5 million at December 31, 2008 and 2007, respectively, that are uninsured and uncollateralized. All of the Company's investments are uninsured and held by a custodian. None of the investments are registered in the Company's name, except for the GICs and forward delivery agreements.

Summary of Balances

At December 31, 2008, the Company's cash, cash equivalents and investments consist of the following (in thousands):

Description	Credit Rating*	Remaining Maturies (in Years) Less than 1	1 - 5	More than 5	Total Fair Value
Cash and cash equivalents					
Unrestricted					
Deposit overdrafts		$ (1,162)	$ -	$ -	$ (1,162)
Money market funds					
	AAA	18,703	-	-	18,703
	AAAm	61,923	-	-	61,923
		79,464	-	-	79,464
Restricted					
Deposits		300	-	-	300
Money market funds	*AAAm*	218,548	-	-	218,548
		218,848	-	-	218,848
Total cash and cash equivalents		298,312	-	-	298,312
Investments					
Short-term investments					
Unrestricted					
FHLMC	*AAA*	14,042	-	-	14,042
Restricted					
FNMA	*AAA*	7,454	-	-	7,454
Total short-term investments		21,496	-	-	21,496
Long-term investments					
Unrestricted					
Preferred and common stock	*N/A*	-	-	37	37
FFCB	*AAA*	-	3,064	-	3,064
Corporate notes					
	AA	-	12,362	-	12,362
	A+	-	11,506	-	11,506
	AA-	-	7,662	-	7,662
	A	-	4,269	-	4,269
	AAA	-	3,372	-	3,372
	BBB+	-	2,529	-	2,529
	BBB	-	1,217	-	1,217
		-	45,981	37	46,018
Restricted					
GIC	*Not Rated*	-	19,697	-	19,697
Total long-term investments		-	65,678	37	65,715
Total investments		21,496	65,678	37	87,211
Total cash, cash equivalents and investments		$ 319,808	$ 65,678	$ 37	$ 385,523

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

At December 31, 2007, 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 Fair Value
Cash and cash equivalents					
Unrestricted					
Deposit overdrafts		$ (451)	$ -	$ -	$ (451)
Money market funds	*Unrated*	77	-	-	77
Money market funds	*AAAm*	60,342	-	-	60,342
		59,968	-	-	59,968
Restricted					
Deposits		220	-	-	220
Money market funds	*AAAm*	160,588	-	-	160,588
		160,808	-	-	160,808
Total cash and cash equivalents		220,776	-	-	220,776
Investments					
Short-term investments					
Unrestricted					
FNMA	*AAA*	3,502	-	-	3,502
GIC	*Not Rated*	418	-	-	418
		3,920	-	-	3,920
Restricted					
Forward delivery agreements	*AAA*	20,160	-	-	20,160
GIC	*Not Rated*	34,435	-	-	34,435
		54,595	-	-	54,595
Total short-term investments		58,515	-	-	58,515
Long-term investments					
Unrestricted					
Preferred and common stock	*N/A*	-		37	37
FFCB	*AAA*	-	8,029	-	8,029
FNMA	*AAA*	-	15,560	-	15,560
FHLMC	*AAA*	-	10,050	-	10,050
FHLB	*AAA*	-	9,554	-	9,554
Corporate notes	*A- or better*	-	21,165	-	21,165
		-	64,358	37	64,395
Restricted					
GIC	*Not Rated*	-	6,000	-	6,000
Total long-term investments		-	70,358	37	70,395
Total investments		58,515	70,358	37	128,910
Total cash, cash equivalents and investments		$ 279,291	$ 70,358	$ 37	$ 349,686

**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):

	2008	2007
Unrestricted funds, operating account	$ 139,525	$ 128,284
Restricted funds:		
Market participants	155,767	122,919
Debt service	29,778	61,954
Capital expenditures	60,454	36,530
Total	$ 385,524	$ 349,687

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

	2008	2007
Security deposits	$ 46,931	$ 52,939
Market funds pending settlement	27,239	36,428
Pass-through fees due to others	26,058	22,937
Generator interconnection study deposits	55,539	10,615
Total amounts restricted for market participants	$ 155,767	$ 122,919

Cash and cash equivalents 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 those market participants required to post security deposits 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. A portion of the market funds pending settlement ($18.2 million and $26.5 million at December 31, 2008 and 2007, respectively) are being held pending resolution of the FERC Refund Case (Note 12). 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 consist of amounts collected for future studies.

4. Fixed Assets

Changes in the Company's fixed assets for the year ended December 31, 2008, are as follows (in thousands):

	2007	Additions and Transfers In	Deletions and Transfers Out	2008
Nondepreciable fixed assets:				
Land	$ 9,380	$ -	$ -	$ 9,380
Work-in-progress, MRTU	155,924	36,980	-	192,904
Work-in-progress, other	14,563	20,316	(13,982)	20,897
	179,867	57,296	(13,982)	223,181
Depreciable fixed assets:				
Information systems:				
Scheduling infrastructure, scheduling applications, balance of business systems and other systems	143,603	3,468	(50)	147,021
Metering and data acquisition and			-	
other systems	75,361	6,447	(10,232)	71,576
Energy management system	16,680	1,995	(1,711)	16,964
Leasehold improvements	15,259	1,666	-	16,925
Furniture and fixtures	10,726	406	(700)	10,432
	261,629	13,982	(12,693)	262,918
Less: accumulated depreciation	(228,569)	(12,822)	12,545	(228,846)
	33,060	1,160	(148)	34,072
Total fixed assets, net	$ 212,927	$ 58,456	$ (14,130)	$ 257,253

Changes in the Company's fixed assets for the year ended December 31, 2007, are as follows (in thousands):

	2006	Additions and Transfers In	Deletions and Transfers Out	2007
Nondepreciable fixed assets:				
Land	$ 9,380	$ -	$ -	$ 9,380
Work-in-progress, MRTU	107,283	54,165	(5,524)	155,924
Work-in-progress, other	20,702	7,899	(14,038)	14,563
	137,365	62,064	(19,562)	179,867
Depreciable fixed assets:				
Information systems:				
Scheduling infrastructure, scheduling applications, balance of business systems and other systems	135,751	8,558	(706)	143,603
Metering and data acquisition and other systems	76,393	6,020	(7,052)	75,361
Energy management system	16,490	1,771	(1,581)	16,680
Leasehold improvements	13,405	1,854	-	15,259
Furniture and fixtures	9,433	1,293	-	10,726
	251,472	19,496	(9,339)	261,629
Less: accumulated depreciation	(222,930)	(14,978)	9,339	(228,569)
	28,542	4,518	-	33,060
Total fixed assets, net	$ 165,907	$ 66,582	$ (19,562)	$ 212,927

Work-in-progress includes capitalized interest of $9.7 million and $5.2 million at December 31, 2008 and 2007, respectively. The MRTU assets are composed of several components, which are transferred to depreciable fixed assets as they are put into production. The internally developed software related to MRTU was substantially complete and capitalization ceased on December 1, 2008.

5. Employee Note Receivable

The Company has provided $500,000 in financing to an officer of the Company in connection with the purchase of his primary residence. The loan is collateralized by a subordinated deed of trust on the property, accrues interest at 6.5 percent per annum, compounded annually, and requires annual payments of $68,000 per year. Portions of the note may be forgiven by the Company based on the officer's continuing employment as set forth in the employment agreement. The balance due at December 31, 2008 and 2007 of $473,909 and $511,839, respectively, including accrued interest, is included in other assets in the accompanying balance sheets.

6. Generator Noncompliance Fines

In 2000 and 2001, the Company billed generator noncompliance fines to market participants totaling $122.1 million. Through December 31, 2008, collection of these fines totaled $60.7 million. Generally, these fines were assessed at twice the highest price paid in the Company's markets for energy and were applied against the amount of energy the participating generator failed to supply as directed by the Company during specific emergency conditions as defined in the tariff. These fines will be retroactively adjusted as a result of the FERC Refund Case, as described in Note 12, in which the prices used to calculate the fines are subject to adjustment, with any surplus collections being refunded to market participants with interest.

Based on estimates of the mitigated energy prices in the FERC Refund Case, the Company recorded fine revenues totaling $29.5 million through 2004 which results in a refund liability of $31.2 million. The ultimate settlement of fines is expected after the conclusion of the proceedings in the FERC Refund Case and the ultimate financial settlement of the California Power Exchange (Cal PX). While there are significant uncertainties associated with this process, management believes it is unlikely that there will be any future reduction in generator fines that will ultimately be realized by the Company.

In accordance with FERC rulings, the Company accrues interest on the portion of fines collected in excess of the estimated realizable amount (except as noted below) which are to be refunded to market participants when the amounts are ultimately settled. Such interest expense amounted to $4.7 million and $6.2 million in 2008 and 2007, respectively. At December 31, 2008 and 2007, accrued interest payable related to these fines totaled $25.5 million and $20.8 million, respectively.

The correction of base level transactions included in the preparatory rerun resulted in an upward adjustment to fines amounting to $20.5 million. The current treatment of interest accrued by the Company excludes the calculation of interest on the preparatory rerun corrections, based on the position that interest would only accrue upon the preparatory rerun being invoiced. The Company believes that preparatory rerun corrections should be eligible for interest from the due date of the original trade month being corrected in the same manner as interest on corrections for mitigated market-clearing prices in the refund rerun. The Company included this position in a status report that was filed at FERC in March 2007, and in November 2008, requested a FERC ruling on this issue. FERC has yet to rule on this issue. If approved, the effect would be to reduce interest payable by $12.2 and $10.2 million at December 31, 2008 and 2007, respectively. The Company has not recorded any interest income or receivable relating to this matter since the realization is not assured and there has been no ruling on the issue from FERC.

At December 31, 2008 and 2007, the estimated net realizable amount of fines is $29.5 million. Included in current liabilities at December 31, 2008 and 2007, is an estimated refund liability to market participants of $56.7 million and $52.0 million representing the difference between the $60.7 million in collections and the estimated fines to be retained, plus accrued interest.

7. Long-term Debt and Related Agreements

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

	2008	2007
CIEDB Revenue Bonds, Series 2008		
Fixed interest rates of 4.00% - 5.00% with maturities through 2014	$ 196,970	$ -
CIEDB Variable Rate Demand Revenue Bonds (VRDBs) refunded with Series 2008 bonds	-	189,700
Unamortized net premium on Series 2008 bonds	7,402	-
Total long-term debt	204,372	189,700
Less: current portion	(31,000)	(64,600)
Total long-term debt, less current portion	$ 173,372	$ 125,100

Summarized activity of long-term debt for the year ended December 31, 2008, is as follows (in thousands):

	Beginning of Year	Issuance/ (Payments)	End of Year
CIEDB Revenue Bonds, Series 2008	$ -	$ 196,970	$ 196,970
CIEDB VRDBs			
Series 2007	60,000	(60,000)	-
Series 2004	84,400	(84,400)	-
Series 2000	45,300	(45,300)	-
Total long-term debt	$ 189,700	$ 7,270	$ 196,970

Summarized activity of long-term debt for the year ended December 31, 2007, is as follows (in thousands):

	Beginning of Year	Issuance/ (Payments)	End of Year
CIEDB VRDBs			
Series 2007	$ -	$ 60,000	$ 60,000
Series 2004	103,400	(19,000)	84,400
Series 2000	85,000	(39,700)	45,300
Total long-term debt	$ 188,400	$ 1,300	$ 189,700

Scheduled future debt service payments as of December 31, 2008 are as follows (in thousands):

	Principal	Interest	Total
2009	$ 31,000	$ 8,399	$ 39,399
2010	39,100	6,444	45,544
2011	42,250	4,331	46,581
2012	25,130	3,075	28,205
2013	36,025	1,273	37,298
2014	23,465	88	23,553
	$ 196,970	$ 23,610	$ 220,580

Long-term debt and related agreements
In June 2008, the Company issued $197.0 million of fixed rate revenue bonds (the Series 2008 Bonds) through the CIEDB, at a premium of $9.2 million. The proceeds of the issuance were used to refund all variable rate demand bonds outstanding at the time of issuance, fund debt service reserves related to the issued debt, and pay certain debt issuance costs. The remaining proceeds will be used to fund computer hardware and software systems, other facilities and equipment, and other planned capital projects.

The Series 2008 Bonds are supported by a pledge of the Company's revenues and operating reserves. The premium on the bonds is being amortized over the life of the Series 2008 Bonds.

All of the Company's VRDBs were refunded during 2008 with a portion of the proceeds from the Series 2008 Bonds. In connection with this refunding, the related stand by bond purchase agreement and bond insurance were terminated. The Company recognized a loss on refunding related to these bonds of $1.0 million. The loss is being amortized over the remaining life of the original bonds, which were scheduled to mature at various dates through 2013.

Interest Rate Swaps
Concurrent with the issuance of the VRDBs, the Company entered into variable-to-fixed rate interest swaps. The swaps were used to reduce interest rate risk on the Company's debt obligations. The swaps were terminated in connection with the refunding of the bonds in 2008, at an amount that approximated the fair value on the date of termination.

The swaps had a total notional amount of $137.6 million at December 31, 2007. The fair value of the swaps at December 31, 2007, was a net payable of approximately $1.4 million and is recorded on the balance sheet as a derivative liability. The change in the fair value of the swaps of $1.8 million for the year ended December 31, 2007, is included as reductions to interest expense on the statements of revenues, expenses, and changes in net assets.

Interest expense
Overall interest expense recorded by the Company related to long-term debt includes interest paid on the bonds, payments and receipts under the swaps, bond remarketing costs, bond insurance and liquidity costs and amortization of bond issuance costs, bond premium and loss on refunding.

8. Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate the value:

Investments
The fair values of investments, including cash equivalents, except as noted below, are based upon quoted market prices. Fair values for GICs and forward delivery agreements are based on discounted cash flows using prevailing interest rates for similar instruments.

Long-term debt
The fair value of fixed rate long-term debt, which includes the short-term portion, was calculated using a present value method and was based on current market rates. The fair value of variable rate long-term debt, which includes the short-term portion, approximates its cost because the interest rates adjusted on a weekly basis.

Interest rate swap agreements
The fair values of interest rate swap agreements are based on quoted market prices.

The fair values of the Company's financial instruments as of December 31, 2008, are presented below (in thousands):

	Recorded Value	Fair Value
Investments, including cash and cash equivalents	$ 385,523	$ 386,424
Long-term debt	(203,772)	(207,554)

The fair values of the Company's financial instruments as of December 31, 2007, are presented below (in thousands):

	Recorded Value	Fair Value
Investments, including cash and cash equivalents	$ 349,686	$ 350,487
Long-term debt	(189,700)	(189,700)
Interest rate swap	(1,378)	(1,378)

The carrying values reported on the balance sheet for current assets and liabilities, excluding the short term portion of long-term debt as discussed above, approximate fair value.

9. Employee Benefit Plans

The Company maintains a number of plans for the benefit of its employees. 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):

	2008	2007
Executive pension restoration plan	$ 666	$ 722
Post-employment medical benefit plan	10,970	10,206
Supplemental executive retirement plan	509	369
Executive savings plan	350	421
Total employee retirement plan obligations	$ 12,495	$ 11,718

Retirement savings benefits plan
The Company sponsors a defined contribution retirement plan, the California ISO Retirement Savings Benefits Plan (the Retirement Plan), which is subject to the provisions of the Employee Retirement Income Security Act of 1974 and covers substantially all Company 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 50 percent of their eligible compensation to the Retirement Plan, subject to statutory limitations. The Company makes matching contributions up to the first six percent of 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 increment of five years of service after the employees' ten year anniversary. All matching contributions are subject to statutory limitations.

Employees' contributions to the Retirement Plan for 2008 and 2007 were $6.3 million and $6.5 million, respectively. The Company's contributions to the Retirement Plan for 2008 and 2007 were $7.1 million and $6.5 million, respectively.

Executive pension restoration plan
The Company sponsors the Executive Pension Restoration Plan, a non-qualified defined contribution plan, which allows certain officers of the Company to make contributions in excess of the 401(k) contribution limits set forth by IRS regulations. As defined in the plan document, the Company makes matching contributions up to six percent of the officers' eligible compensation, as well as retirement contributions of five percent of the officers' eligible compensation for officers with less than five years of service, or seven percent for officers 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 increment of five years of service after the officer's ten year anniversary.

The contributions and earnings thereon are held in a trust and the balances as of December 31, 2008 and 2007, were $666,000 and $722,000, respectively and are included in Other Assets with a corresponding liability in Employee Retirement Plan Obligations. The Company recognized expenses for contributions of $259,000 and $244,000 in 2008 and 2007, respectively.

Post-employment medical benefit plan

Plan description
The Company sponsors the California ISO Retiree 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. Employees, spouses, domestic partners and eligible dependents who meet these requirements will be entitled to coverage, as provided for under the terms of the plan. Depending on the retirement age and coverage elections made by the beneficiaries, the Company pays a portion (ranging from 60 to 100 percent) of the premiums. There are 20 employees and 8 retirees eligible to receive benefits pursuant to the plan as of December 31, 2008.

Funding 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. During 2008, the Company began making contributions to the trust. 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, 2008, the trust assets were $1.8 million.

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 those eligible to receive benefits (the accumulated postretirement benefit obligation). Prior to 2008, the Company's policy was to fund only the current cost of medical premiums for those receiving benefits.

Annual Other Post-employment Benefits (OPEB) Cost and Net OPEB Obligation
The Company's annual OPEB cost 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. 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 at the beginning of the year.

The Company's annual OPEB cost at December 31, is as follows (in thousands):

	2008	2007
Annual required contribution	$ 3,099	$ 2,490
Interest on net OPEB obligation	536	447
Adjustment to annual required contribution	(1,000)	(809)
Annual OPEB cost	2,635	2,128
Contributions made	(1,871)	(38)
Increase in net OPEB obligation	764	2,090
Net OPEB obligation, beginning of year	10,206	8,116
Net OPEB obligation, end of year	$ 10,970	$ 10,206

The Company's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and net OPEB obligation for the year ended December 31 (in thousands):

Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
2006	$ 1,396	2%	$ 8,116
2007	2,128	2%	10,206
2008	2,635	71%	10,970

Actuarial methods and assumptions
Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) 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 pension cost for the year ending December 31, 2008.

Valuation date	January 1, 2008
Actuarial cost method	Projected unit credit
Amortization method	Level dollar, open
Remaining amortization period	15 years
Asset valuation method	Market
Investment rate of return	5.25%
Healthcare cost trend rate	9% initial, 5% ultimate

Funding status and funding progress
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 below schedule of funding progress is the

multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities and is required supplemental information.

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Projected Unit Credit (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a/b)
1/1/2007	$ -	$ 9,463	$ 9,463	0%
1/1/2008	-	12,225	12,225	0%
1/1/2009	1,813	17,171	15,358	11%

The actuarial valuation as of January 1, 2009, 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, 2008, except for the discount rate (which changed from 5.25 percent to 4.75 percent) and the health care cost year of ultimate trend (which changed from 2012 to 2016). The changes in these assumptions increased the AAL by approximately $3.2 million.

Supplemental executive retirement plan

The Company sponsors the California ISO Supplemental Executive Retirement Plan (SERP Plan), a non-qualified defined benefit plan intended to provide selected executives of the Company with target retirement benefits based upon an executive's average earnings for the three consecutive years in the last five years of service that compensation was the highest and total number of years of service with the Company. The target benefit is to be offset by other retirement benefits, including those provided by the Company, and by any distributions from this plan made to pay the beneficiary's share of federal, state and local taxes.

The activity and related obligations associated with the plan during 2008 and 2007 is as follows (in thousands):

	2008	**2007**
Obligation, beginning of year	$ 369	$ 225
Current period actuarially determined cost	140	144
Obligation, end of year	$ 509	$ 369

The Company recognized expenses of $140,000 and $144,000 in 2008 and 2007, respectively in connection with this plan. The plan is unfunded.

Executive savings plan

The Company sponsors the Executive Savings Plan, a non-qualified 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, 2008 and 2007 was $350,000 and $421,000, respectively and is included in Other Assets, with a corresponding liability in Employee Retirement Plan Obligations. The Company recognized expenses of $92,000 and $98,000 in 2008 and 2007, respectively, in connection with this plan.

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; non-performance of duty; injuries to employees; and natural disasters. The Company participates in various commercial and mutual insurance plans that provide coverage for most claims in excess of specific dollar thresholds, which range from $10,000 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. Miscellaneous losses below insurance deductibles are expensed as incurred. In 2008 and 2007, the Company did not incur any claims in excess of the coverages 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 experience at other members of the captive insurance company. The Company's annual insurance expense is also 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 expiring at various dates through 2013, providing telecommunication equipment and services, information system equipment and services, systems infrastructure and office facilities.

The following are the future minimum payments under these agreements as of December 31, 2008 (in thousands):

2009	$ 12,197
2010	12,101
2011	11,840
2012	10,827
2013	5,181
	$ 52,146

Lease and service contract costs of approximately $12.8 million and $12.7 million were charged to operating expense in 2008 and 2007, respectively.

12. Contingencies and Settlements

GMC

The Company’s GMC rates are subject to FERC regulation. Since commencement of operations in 1998, the rates and methodologies have been the subject of challenge by various market participants in proceedings before FERC. Each year FERC has accepted the GMC rates subject to potential refunds that may be determined through subsequent FERC proceedings. As of December 31, 2008, all of the Company’s GMC rates are final and are not subject to further refund for any period except 2001, as described below.

In 2001, the Company's GMC was unbundled into three service categories, with separate billing determinants based on load, congestion and market-related activity. In January 2004, FERC ruled on the 2001 rate filing. The ruling provided a refund to 2001 ratepayers of $1.8 million, plus interest. At December 31, 2008 and 2007, accrued interest payable related to the refund totaled $0.9 million and $0.8 million, respectively. FERC further ruled that certain transactions for 2001 through 2003 be afforded limited exemptions from parts of the GMC. In response, the Company filed a method to reallocate approximately $5.9 million plus interest among ratepayers. This reallocation will have no financial impact on the Company. In November 2005, FERC affirmed its previous decisions, but ordered the Company to file revised data. In February 2007, the Company filed revised data. FERC approved the revised filing in October 2008. In response to a subsequent request for clarification, FERC has directed the Company to submit an informational status report on June 30, 2009, if it has not filed its refund report by that date. At December 31, 2008 and 2007, total GMC refunds, including interest, of $2.7 million and $2.6 million, respectively, are included in accounts payable and accrued expenses in the accompanying balance sheets.

In connection with a settlement with SDG&E regarding GMC transactions on certain shared ownership facilities between 2001 through 2004, SDG&E paid the Company $7.1 million including interest, through GMC adjustments to regular invoices in March and April 2007. The amounts are included in GMC Revenue on the statement of revenues, expenses, and changes in net assets for 2007.

The FERC 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 Cal PX, filed for bankruptcy.

In 2003, FERC ordered mitigation of the market clearing prices in the markets administered by the Company and Cal PX for the period from October 2, 2000 through June 20, 2001 (the FERC Refund Case). In 2004, the Company completed a preparatory rerun to correct baseline data and applied mitigated prices to the revised baseline information to arrive at further adjustments to financial transactions settled in 2000 and 2001. In 2007, the Company completed calculations that applied claims by suppliers to certain FERC approved offsets against the refunds for the costs of natural gas, emissions permits and overall entity revenue shortfalls. The Company and Cal PX will calculate interest and then make compliance filings to reflect all of the calculations as well as the separate settlements reached by several of the Company's market participants that have been filed, approved by FERC, and funded. Proceedings continue at FERC and at the U.S. Court of Appeals about the details of these and other calculations.

Except for any effects on generator noncompliance fines described in Note 6, the Company believes the outcome of these refund proceedings will not have an impact on the Company as the refunded amounts will be resettled among market participants.

Market billing disputes in good faith negotiations
As part of the tariff and applicable contracts, the Company has a dispute resolution process for market participants, RMR owners and transmission owners to register disagreements as to information in the settlement statements or billing amounts for market and RMR activity. In accordance with the provisions of the tariff, once good faith efforts, known as a GFN, have been made to negotiate and resolve disputes, written claims may be submitted either to mediation or arbitration. At December 31, 2008, there are four disputes in GFN that total approximately $9.8 million which represents disagreements with the Company's financial settlement of market transactions and related tariff interpretations.

Other disputes, some of which are material in amount, have been filed with the Company. Management believes that any settlements or market adjustments relating to these disputes and the matters in GFN would be resettled against the market with no liability to the Company.
There is one material unresolved market-related dispute outstanding at December 31, 2008, for which it is possible that the claim might not be fully resettled against market participants and, as such, could result in material liability to the Company as described below.

The Company has an obligation to procure ancillary services necessary to maintain the reliability of the California grid consistent with applicable reliability criteria and to fulfill its responsibilities as a balancing authority. Following GFN, Pacific Gas and Electric Company (PG&E) filed a claim against the Company concerning charges for ancillary services procured by the Company in connection with transactions scheduled on the California Oregon Transmission Project. PG&E is seeking reimbursement from the Company for amounts paid for ancillary services and related costs during the period from April 1998 to April 1999 totaling $14.3 million plus interest. In December 2001, an arbitrator issued a ruling in favor of PG&E and after motions for rehearing and clarifications, FERC affirmed this decision. Although the Company has appealed FERC's decision, that appeal is stayed pending efforts to implement the award. In discussions with PG&E about how to bill the award, PG&E has objected to the charges that the Company intends to use. The Company and PG&E are continuing to discuss these issues. Once resolved, the Company intends to invoice market participants with corresponding charges or credits during the periods being disputed with no liability to the Company.

Indemnifications
The Company's by-laws 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 2008 and 2007.

Other matters
The Company, during the ordinary course of its operations, has been involved in various lawsuits and claims, several of which are still pending. Management and legal counsel are of the opinion that there are no other material loss contingencies that would have a material adverse impact on the financial position of the Company, except as disclosed within the notes to these financial statements.