

Memorandum

To: ISO Board of Governors
From: Yakout Mansour, President and Chief Executive Officer
Date: September 1, 2010
Re: **CEO Report**

This memorandum does not require Board action.

1. STATUS OF RENEWABLE INTEGRATION & ASSOCIATED TRANSMISSION INFRASTRUCTURE

The ISO and its partners continue to make significant strides in advancing the goal of meeting a 33% RPS by 2020. Specific achievements in the past several months include:

- **Completion of a 20% RPS operational assessment report** – This report builds on the findings documented in our 2007 report to reflect the impact of more accurate information about the capability of the existing generation fleet and updated information about the probable composition of the renewable resource portfolio. The report is part of our operational readiness for the 20% stage. The report reaffirms the capability of the existing conventional generation fleet in supporting the penetration of the 20% renewable resources. However, in comparison to the previous report, doing so would require more cycling of conventional generation resources through increased start-ups and shut-downs primarily due to the higher level of solar based resources. Moreover, the market revenues earned from these resources is projected to decline due to lower prices and lower dispatch levels. These findings suggest that new market products or sources of revenue may be necessary. The ISO has initiated a stakeholder process to evaluate this based on the recent findings.
- **Completion of generation interconnection studies** – The ISO and its PTOs recently completed interconnection studies for 8,215 MW of renewable generation projects, 3,451 MW of which are American Recovery and Reinvestment Act projects. These studies were completed three months ahead of schedule in order to accommodate the development timelines for the ARRA projects. Work is currently underway to complete the interconnection agreements for the ARRA projects by the end of September.
- **Temporary waiver of financial security deposits** – Under the ISO large generation interconnection process, interconnecting generators are required to post security for their cost

share of the transmission network upgrades necessary to interconnect. Under the current tariff, this requirement applies even when the PTO agrees to up-front finance these upgrades. The security requirement is redundant in these cases and poses very significant costs on generation developers for major upgrades that in some cases will not be in service for years. Given this, the ISO filed a request with FERC to waive the security posting requirements for the transition cluster (the first cluster to be processed) in cases where the PTO agrees to up-front finance the interconnecting project's network upgrades. On August 13, 2010, FERC approved this request. This change will help developers close financing and enhance the ability of those projects that are candidates for ARRA funds to meet looming deadlines.

- **Partial deliverability of new generation resources** – Some of the generation projects in the ISO interconnection process require multiple network upgrades with different estimated completion dates to make them fully deliverable. In the past, these resources have not been designated with any deliverability capability until the last network upgrade is completed. Some renewable developers have asked whether it would be possible for the ISO to designate their project as partially deliverable once it is online and an intermediary required network upgrade is completed. The ISO has agreed to this and recently issued a technical bulletin describing the process for requesting a partial deliverability assessment.
- **Transmission development** – Significant progress has also been made in approving and developing the transmission needed to support a 33% RPS. Two recent significant achievements in this area are:
 - **Valley-Colorado River 2** - The CPUC recently confirmed that SCE has authority to proceed with the construction of a second Valley to Colorado River 500 kV transmission line (i.e., the California-portion of the original Palo Verde to Devers 2 line). Once completed, this line will increase the transfer capability for solar development to 4,700 MW.
 - **Sunrise Power Link** - Additionally, in mid-July the Cleveland National Forest approved the 19-mile portion of the Sunrise Powerlink that crossed forest land. This was the final permitting issue remaining for this project. SDG&E anticipates starting construction of the project this fall with an estimated completion of June 2012. Sunrise will provide access to 1,700 MW of renewable generation. Moreover, a recent California Court of Appeals ruling reaffirmed the CPUC's decision in granting the permit for construction.

All of these achievements indicate that California is well on its way to meeting a 33% RPS goal by 2020. While more work remains, the unprecedented level of commitment and cooperation by everyone (the ISO, developers, regulators, utilities, and the Governor's office) gives us confidence that we have what it takes to finish the job.

2. MOODY'S UPGRADE

Moody's Investor Service has upgraded the ISO's issuer credit rating to A1 from A2, and assigned a "stable" outlook to the rating. Moody's cited steady improvement in the ISO's financial position and the successful implementation of the Market Redesign and Technology Upgrade as reasons for their

upgrade. This comes on the heels of Standard & Poor's and Fitch reaffirming the ISO's credit ratings earlier this summer at A and A+ respectively. These solid ratings are a testament to the sound financial management at the ISO, the stability of the California electricity market, and the long term viability of the key players. The upgrade will allow the ISO more cost-effective solutions on financial transactions in the future.

3. OPERATIONS UPDATE

Summer operating conditions have generally been mild this year with abnormally cool temperatures throughout the state. July and August temperatures were generally below average, resulting in lower peak demand and energy consumption. We recorded four days in July when demand exceeded 40,000 MW compared to twelve days last year and nine days in the year before. The record summer peak so far this year, however, stands at 47,350 MW which is higher than the last two years' records.

Fires are an ever present danger to the system and this summer has been no exception. On July 29 a wildfire in the Palmdale area of Southern California, the Crown Fire, burned under the 3-500kV lines forming Path 26 causing outages of the entire path three times through the day including the peak hour period. This resulted in operating the grid as virtually two independent north and south regions. This condition has not been experienced since March 21, 2003. As a result of applying lessons learned from the 2003 incident and close collaboration with Southern California Edison, this event was managed effectively with virtually no impact to the bulk electric system.

On August 24, another fire resulted in two of the three lines going out of service. Our control room personnel were able to anticipate and prepare the system for the loss and we were able to reliably operate with the remaining line in service during that event.

It should be noted that our market systems have been tested in real life for the first time under a high peak demand and severe grid scenario while continuing to perform as expected.

4. NEW ORGANIZATION LEADERSHIP

We announced the new organizational changes at the executive level last month as per the attached press release. The new organization combines all the operating functions of the grid and the ISO under one executive, Steve Berberich, in his new role as the Chief Operating Officer. We combined all the corporate administrative functions under one executive, Nancy Saracino in her new role as the Chief Administrative Officer. Finally, all technology support related functions have been combined under Petar Ristanovic in his role as the Vice President of Technology. Without a doubt, we have the dream team to lead the ISO into the future with all its challenges and opportunities. Moreover, the new organization is yet another step on our strategic continuum in meeting a significant increase in work load and challenges through continuing efforts of organizational realignment, process enhancements, technology upgrade, and skill development, all of which resulted in meeting the increased challenges over the last several years at a virtually flat budget.