California Independent
System Operator

Memorandum

To: Board of Governors

From: William J. Regan, Jr., Chief Financial Officer

Philip Leiber, Treasurer & Director of Financial Planning

cc: ISO Officers

Date: January 18, 2007

Re: ***Briefing on*** **2007 Proposed Bond Issuance and Decision on Reimbursement Resolution**

This memorandum requires Board action.

Executive Summary

This memorandum provides an overview of a proposed bond issuance that would provide $50 million in funding to complete MRTU. Management recommends the issuance of variable rate demand bonds of the same type as currently outstanding CAISO debt. The bonds would be amortized over six years and would permit a bundled GMC rate consistent with the target of $0.76 or less. The total face value of the bonds would be approximately $60 million, including $50 million for MRTU, $1-2 million for issuance costs, $2-3 million for other capital expenditures, and $5-6 million for a debt service reserve fund. Bond issuance would be targeted for April 2007. Board approval of the bond issuance is not required at this time. Management will keep the Board apprised of any important developments regarding the proposed transaction as it progresses and will request Board approval of the bond issuance at the March meeting. Board approval of a "reimbursement resolution" is requested at this time to permit bond funds to be used to reimburse CAISO for capital spending funded by GMC Operating Reserve funds prior to the availability of bond funds.

Background and Proposed Financing

CAISO requires additional funding to complete the MRTU program. The funding requirement of $50 million represents the difference between the $189.2 million current project estimate and the $139.1 million estimate that was the basis for the December 2004 bond offering. Of the approximately $110 million in funding that was obtained from the 2004 bond offering, approximately $15 million currently remains, and this will be depleted by early April.

The objectives of the proposed bond offering are to:

- Provide bond proceeds to meet the known funding requirement for completion of MRTU Release 1;
- Structure debt service to meet our goal of maintaining a stable to declining bundled GMC rate of $0.76 or less over the next several years;
- Match the "benefits" and "burdens" of CAISO spending by recovering the costs of CAISO system infrastructure from the users of the infrastructure over a period of time that approximates the reasonably expected useful life of those assets;
- Obtain a low-cost, low risk funding source; and
- Have funding available near the date when the existing 2004 bond proceeds are fully spent.

Recommended Bond Structure

Management has discussed financing alternatives with underwriters who have assisted CAISO in past transactions, and Management recommends the issuance of variable rate demand bonds of the same type currently outstanding (Series 2000 and 2004) to meet the objectives outlined above. The bonds will have a term of approximately six years, with an amortization schedule that will, in conjunction with other projected ISO spending, provide for a bundled GMC rate consistent with the target of $0.76 cents or less. Projected interest costs will be approximately 4%, and the ISO will retain about 35-40% variable interest rate exposure as with existing debt. The bonds will also have a debt service reserve fund, as CAISO's 2004 bonds have. As a result, CAISO will issue bonds with a face value of approximately $60 million ($50 million proceeds for MRTU, $2-3 million for other capital expenditures (potentially additional 2007 capital expenditures or funding toward the yet to be determined 2008 capital budget), $1-2 million for costs of issuance, and approximately $5-6 million as a DSRF).

Financing Team and Schedule

CAISO Management will assemble a financing team to assist in the successful execution of the transaction, including one or more underwriters, bond insurance provider, bank(s) providing a standby bond purchase agreement, a conduit issuer, interest rate swap counterparty, pricing agent and Legal Representation including Bond Counsel and Issuer Counsel.

Management is currently targeting the bond issuance for April 2007. A Section 204 regulatory filing will be made with FERC in February requesting authorization for bond issuance, and the Board will be requested to approve the transaction in March (with recognition that FERC will not approve the filing until CAISO's Board has first approved the transaction).

Conclusion and Proposed Board Resolution

As noted, Management is working diligently to obtain the necessary bond funding by April 2007, when existing bond funds are projected to be depleted. However, in the event that CAISO is required to spend funds from its GMC operating reserve during 2007 for items to be paid for with bond funds prior to the availability of the bond funds, the following resolution will enable the CAISO to reimburse the GMC operating reserve from the 2007 bond proceeds when they become available. Without such a resolution, CAISO's ability to use bond proceeds to pay for expenditures 60 days prior to the bond issuance date is limited. Accordingly, Management requests approval of a reimbursement resolution as specified below:

RESOLUTION DECLARING OFFICIAL INTENT OF
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION
TO REIMBURSE CERTAIN EXPENDITURES FROM PROCEEDS OF INDEBTEDNESS
ADOPTED JANUARY 25, 2007

WHEREAS, California Independent System Operator Corporation (the "Corporation") expects to pay certain expenditures (the "Expenditures") in connection with the capital budget for its Market Redesign and Technology Upgrade program (collectively, the "Project") prior to and in anticipation of the issuance of indebtedness for the purpose of financing the capital expenditures on a long-term basis;

WHEREAS, the Corporation reasonably expects that debt obligations will be issued in one or more series and that certain of the proceeds of such debt obligations will be issued to pay or reimburse the Expenditures for the Project in the amount of $55,000,000; and

WHEREAS, Section 1.150-2 of the Treasury Regulations requires the Corporation to declare its official intent to reimburse itself for prior expenditures for the Project with proceeds of debt obligations;

NOW, THEREFORE, THE CORPORATION hereby resolves:

1. ***The Corporation finds and determines that the foregoing recitals are true and correct.***
2. ***The Corporation hereby declares its official intent to use proceeds of indebtedness to pay or reimburse itself for Expenditures in an amount not expected to exceed $55,000,000.***
3. ***This Resolution shall take effect from and after its adoption.***