

Memorandum

To: ISO Board of Governors
From: Yakout Mansour, President and Chief Executive Officer
Date: September 5, 2007
Re: *CEO Report - Updated*

This item does not require Board action.

Below are highlights of events affecting the California ISO since the date of the last meeting with the Board of Governors.

Market Redesign & Technology Upgrade (MRTU) Program

We recently announced a new date for the introduction of the new MRTU markets -- March 31, 2008 (for an initial trade date of April 1). This addition of 60 days to the schedule ensures that sufficient time is allotted for market simulations and the testing of the new systems at the ISO and by market participants.

The revised date is not indicative of any significant problems. In fact, the progress on many program elements has been successful and on schedule as highlighted below:

- The allocation process for Congestion Revenue Rights (CRR) kicked off on August 3, making it the first MRTU project to be implemented.
- Our most significant tariff filing to date for MRTU was filed on schedule with the Federal Energy Regulatory Commission (FERC) on August 3. This was a huge undertaking that responded to nearly all the program compliance items required by FERC.
- More than 90 percent of the systems associated with MRTU have been completed and delivered, and have passed multiple stages of testing at the modular and functionality levels.

We believe that sufficient time for comprehensive testing, training, and market simulation is necessary to maintain an acceptable level of project risk. Therefore, the new go-live date is intended to re-establish the timetable for testing, market simulations and readiness. The ISO Board of Governors has affirmed its support of Management's determination to change the MRTU go-live date.

Regulatory

There are two significant regulatory milestones regarding policy matters and filing requirements with FERC related to MRTU. Due to the complexity of these matters and the dedicated efforts required to achieve these milestones, the ISO team members and stakeholders who worked diligently on these filings deserve our highest appreciation for the quality and effectiveness of their effort, and our congratulations on achieving these critical successes in the FERC process.

The first milestone reflects FERC's July 6 order issued on Congestion Revenue Rights (CRRs), marking a major regulatory success on the road to MRTU implementation and representing the culmination of 10 months of intense efforts, including a series of stakeholder meetings, two Board decisions, and several rounds of FERC filings and replies. This order responds to numerous proposals made by the ISO since January, 2007. Most importantly, this order approves all of the major elements and most of the finer details of the ISO's proposals, thus clearing the way for the successful go-live of the first annual allocation process to assign transmission rights.

On August 3, the ISO reached another significant regulatory milestone by filing tariff changes with FERC to implement MRTU. This comprehensive filing refines and enhances the MRTU Tariff approved by the Commission in a series of orders issued since September, 2006. In its MRTU orders, the Commission directed the ISO to make various changes to the MRTU Tariff, to consider other changes based on stakeholder input, and to submit many of these compliance changes no later than 180 days prior to the MRTU implementation date.

Operations

In July, we continued to experience milder weather conditions than predicted. Since the printing of this report on August 30, I am providing an update on the week long events and responses to the first late summer heat wave in California and the great western region.

The heat wave began on August 28 and continued through September 4. During that time, we declared statewide notices for generation-restricted maintenance operation due to the higher than forecasted temperatures. This is a normal precautionary measure to avoid actions which would unnecessarily jeopardize generator availability. The ISO also issued a Flex Alert urging California residents and businesses to conserve electricity.

The peak demand for electricity on August 29 rose to 48,538 megawatts. Due to the compounding effect of multiple days with excessive heat, decreased availability of imported power, and low hydro levels, the ISO issued a Stage One Electrical Emergency (triggered by the 7 percent reserve margin) continuing to call for voluntary energy conservation. On August 30, we were headed for a forecasted peak to exceed demand of 49,500 megawatts and a possible Stage Two Electrical Emergency, so a stronger appeal for conservation was made via the media. Thanks to an estimated 1,000 megawatts in conservation, we saw a significant drop in demand just as we approached the late afternoon, which dropped the peak demand to 47,843 megawatts. On August 31, media tapered back on the conservation appeal and even though it was a Friday going into a holiday weekend, we saw the highest peak demand for this summer at 48,615 megawatts, with no Stage One or Two Electrical Emergencies.

The situation experienced over the last week was different from the challenges faced during last year's record-setting demands due to the lower than expected hydro conditions and lower import levels. At no time, however, was a power shortage expected at the transmission level. However, there were isolated distribution outages throughout southern California. The peak demands experienced over the last week were met with sufficient operating reserves and conservation efforts from consumers helping to "shave the peak." The success is attributable to an extremely low generator outage rate, the extensive summer preparedness efforts of the industry, and the demonstrated proficiency of

ISO operating and support staff. We applaud the cooperation and efforts from electricity generators and California's consumers' response to the *Flex Your Power* campaign in ensuring the ISO's continued reliable delivery of electricity.

Planning Project Updates

Sunrise Powerlink Transmission Project ("Sunrise")

On July 24, Commissioner Grueneich issued a ruling in the Sunrise proceeding, postponing the issuance of the draft environmental report to January 2008, and the final to June 2008. The ruling, further expressed acknowledgement and acceptance of a deferral of the in-service date.

I believe generally that rulings such as this are difficult and reflect an effort to strike the right balance between competing interests. I respect the importance and difficulty of that role and always will. However, we have taken exception to basing the ruling, in part, on what we believe is a misinterpretation of the ISO's position regarding the need and timeline for the Sunrise project. We stand firm in our belief that the Sunrise Project is needed in 2010 for the reliability of the grid in the San Diego area and the integration of renewable generation. Our counsel has filed a note of clarification with the Commission to that effect.

General

As reported at the Board's April 2007 meeting, on April 15 and 16, 2007, the ISO experienced two events that tested several systems and procedures when a contract employee activated an emergency power-off switch, and several hours later sent a threatening e-mail that led to the evacuation of the Folsom campus. The ISO hired Marsh Risk Consulting to investigate the events, the ISO's course of actions, and advise on enhancements to our security protocols and procedure. Marsh Risk Consulting has completed its investigation and has reported to the ISO and the Governing Board. As most often the case in situations like this, organizations learn a great deal and our case is no exception. While the full details of the findings cannot be discussed publicly due to the sensitive security issues involved, Marsh found that the ISO performed appropriately during the events, and concluded that the ISO has a good security program in place but highlighted several areas of improvements to the procedures, internal communications, and facilities. The ISO is studying the recommendations offered, and has already implemented certain improvements to its security system.

Financial Highlights

Year-to-date revenues through July 2007 are \$121.1M, \$7.7M higher than budget. The increase in revenues is due to the one-time refund of the SDG&E Grid Management Charge (GMC) of \$6.9M and the higher interest and other income of \$6.8M, offset by lower GMC revenues of \$6.0M. Overall, the lower GMC revenues are primarily due to milder weather conditions than predicted and the consequent decreases in projected market volumes. Year-to-date operating expenses through July 2007 are \$85.0M, \$0.2M lower than budget.

Due to the late summer heat wave, estimated GMC revenue for August and September will be higher than anticipated just a few weeks ago. In particular, the increase in revenues will be sufficient to preclude the need for a rate increase for the Core Reliability Services components in the 4th quarter. The reduction in the congestion management rate will still take effect as discussed in the Board briefing memo.

People

The California ISO is proud to welcome the following new hires. The number of vacancies to-date stands at nine.

Marcelo Da Costa, Senior Change & Configuration Analyst, IT

Kokou Agbassekou, Settlements Analyst, Operations

James McHan, Grid Asset Engineer, Planning and Infrastructure Development

Kallie Wells, Associate Market Monitoring Analyst, Market Monitoring

Assad Al-Bajjat, Settlement Design Analyst, Operations

Mercy Parker-Helget, Senior Policy Issues Representative, External Affairs

DeAna Anners, Executive Assistant, General Counsel

Vishnu Jetmalani, Senior Policy Issues Representative, External Affairs

Samuel Huber, Grid Resource Coordinator, Operations

Marvin Hahn, Transmission Dispatcher Alhambra, Operations