

Memorandum

To: ISO Board of Governors
From: Steve Berberich, President and Chief Executive Officer
Date: July 5, 2012
Re: **CEO Report**

This memorandum does not require Board action.

Summer Grid Outlook

The ISO continues to work with state energy leadership to coordinate our efforts in response to the San Onofre Nuclear Generating Station (SONGS) outage. All major items that we had identified to address contingencies are now in place, and I would like to thank the Governor's Office, Air Resources Board, EPA Region IX, the California Energy Commission and the California Public Utilities Commission for all their collaborative efforts to ensure the reliable flow of power in Southern California. I would also like to thank AES and Edison Mission Energy for their cooperation in bringing back Huntington Beach units 3 & 4 from retirement. Those units are currently operating under a capacity procurement mechanism designation and are being dispatched as little as possible.

Sunrise Powerlink and Barre-Ellis Upgrade

Congratulations are in order to San Diego Gas and Electric in completing the Sunrise Powerlink. Sunrise Powerlink will provide access to abundant renewables in Imperial County and provide enhanced reliability in Southern California during the SONGS outage by increasing the import limit by several hundred megawatts. We deeply appreciate SDG&E's willingness to safely accelerate the project as much as possible to help address limitations on imports into Southern California.

On a related note, special thanks also goes to Southern California Edison for the acceleration of the Barre- Ellis transmission upgrade that also supports additional import capability into Southern California. That upgrade was originally planned for 2013 but was accelerated a year with help from the California Department of Transportation.

Planning for the Future

With the potential long-term outage of SONGS, we are actively engaged in contingency planning for summer 2013 and beyond and expect to have recommendations for summer 2013 later this summer. We are also looking at the grid configuration if both nuclear plants were to be unavailable in the long run. The solutions are likely to include a mix of additional generation, additional transmission, distributed generation, conservation and demand response. There will have to be an “all of the above” solution to replace approximately 4,500 megawatts of generation from the system. Further, the solution for the replacement of SONGS is especially complex because of the key role it plays in local reliability in the southern Los Angeles basin and San Diego. We expect to have an initial long-term plan by year end and to include the scenario in our next annual transmission plan.

Flexible Capacity

The ISO continues to provide study results in the CPUC long term procurement proceeding outlining the key generation attributes needed on the system with high penetrations of renewables. We are seeking new efficient, clean, flexible generation that will provide local resource adequacy, provide operating flexibility on the system, and be there when the wind doesn't blow and the sun doesn't shine. Unfortunately, time is running short to put the needed flexible capacity in place in time given the long lead time for generation. We look forward to working with the CPUC to ensure a highly capable generation fleet.

Renewable Generation

Since the last Board meeting, new solar and wind output peaks were achieved in the ISO balancing area. On July 2, 2012 solar output peaked at 965 MW. On July 1, 2012 wind output peaked at 3,346 MW.

Cap and Trade Implementation

California's cap and trade program is scheduled to begin in January 2013. As enforcement nears, concerns are increasing about its potential impact on California electricity imports, which at times provide up to 25% of California's electricity needs. We plan to work closely with affected entities and the California Air Resources Board to make sure that the cap and trade program does not create a disincentive for those who sell to California and the State continues to have access to this important source of electricity.

Energy Imbalance Market

The Western Interconnect outside of California has been discussing an energy imbalance market for some time. That market would provide benefits to ratepayers throughout the region by lowering energy costs and facilitating renewable integration. The ISO has offered to host that market with a proposal allowing users to pay for use of our existing technology and market platform. The proposal dramatically reduces risk, upfront capital investment, and startup time with a mechanism that allows users to “test the water” without

major investment. Our current market participants would benefit by reduced costs for our infrastructure.

Annual Budget Process

The ISO has begun its annual budgeting process in consultation with stakeholders. Our strategy continues to be to maintain a stable grid management charge and keep flat budgets and fiscal discipline in our operations. This will entail us to continue to find efficiencies while absorbing continued upward pressures in operating costs.