



CALIFORNIA ISO

California Independent
System Operator

January 12, 2004

The Honorable Magalie Roman Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

**Re: California Independent System Operator Corporation,
Docket No. ER02-1656-009, 010 and 011 and Investigation of
Wholesale Rates of Public Utility Sellers of Energy and
Ancillary Services in the Western Systems Coordinating
Council, Docket No. EL01-68-017**

Dear Secretary Salas:

Enclosed for filing in the above-captioned dockets, please find the Status Report of the California Independent System Operator Corporation ("ISO") that will be released to the public.

Simultaneous with the instant filing, the ISO is submitting a version of the Status Report that contains confidential information. In the instant version of the Status Report, the confidential information, *i.e.*, Attachment A and Attachment B, have been redacted. In all other respects, the version of the Status Report to be released publicly is identical to the version of the Status Report that contains confidential information.

Respectfully submitted,

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**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

California Independent System) Docket No. ER02-1656-000
Operator Corporation)
)

Investigation of Wholesale Rates of Public)
Utility Sellers of Energy and Ancillary) Docket No. EL01-68-017
Services in the Western Systems)
Coordinating Council)

**STATUS REPORT OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

The California Independent System Operator Corporation ("ISO")¹ respectfully submits this monthly progress report ("Report") in compliance with the Commission's November 27, 2002 "Order Clarifying The California Market Redesign Implementation Schedule", 101 FERC ¶ 61,266 (2002) ("November 27 Order"), issued in the above-referenced dockets.

The November 27 Order required the ISO to file reports on the first Monday of each month, beginning in January 2003, to update the Commission on the ISO's progress in designing and implementing the market redesign effort. The Commission directed the ISO to file a full market redesign implementation plan, including a detailed timeline with the sequential and concurrent nature of the design elements, the software and vendors (once selected) to be used and the cost estimates for each element. The November 27 Order required that the first report include explanations of the following: (1) any alternative methods of

developing market redesign elements; (2) the ISO's progress in developing the market redesign elements; (3) the action required to establish such elements; and (4) a detailed breakdown of the total start-up costs.² The Commission directed the ISO to update the market redesign implementation plan on a monthly basis, indicating the progress made and the upcoming steps.

On January 10, 2003, the ISO filed its first Status Report in compliance with the November 27 Order. Subsequent to the first filing, the ISO continues to file monthly Status Reports with the Commission on the first Monday of each month.³ The instant Report is intended to satisfy the monthly reporting requirement in the November 27 Order, update the information included in prior Status Reports and generally advise the Commission of the current status of the market redesign implementation effort.

I. JANUARY STATUS REPORT

Section A includes a narrative of the significant changes to the "Program Plan – High Level" schedule activity that have occurred since the filing of the prior month's Status Report. Section B includes a narrative regarding the budget along with an updated Budget Tracking and Status Report⁴. The Budget Tracking and Status Report is contained in Attachment A. Attachment A continues to remain confidential at least until the ISO has negotiated and

¹ Capitalized terms not otherwise defined herein are used in the sense given in the Master Definitions Supplement, Appendix A to the ISO Tariff.

² November 27, Order at P 9.

³ The ISO filed a Request for Extension of Time to File a Comprehensive Status Report on Monday, January 12, 2004 with the Commission on December 12, 2003. The filing can be found on the ISO website at:

<http://www.caiso.com/docs/2003/12/12/200312121317535335.pdf>

⁴ The narrative includes only non-confidential information.

contracted with bidders for significant portions of the required functionality. In that regard, it would not be commercially prudent to reveal estimates of vendor costs prior to negotiation and contracting with successful bidders. Section C identifies the ISO's key market redesign implementation issues including the previous month's accomplishments, major milestones, upcoming activities, issue resolution with stakeholders and items requiring timely resolution by the Commission in order to meet the project schedule.

A. Overall MD02 Implementation Project Status

In response to concerns raised by the Board of Governors at its December 4, 2003 meeting and issues identified by ISO Management, there have been some changes in the constitution at the program management level of the MD02 Implementation Project. ISO Management has brought in a consultant to be the Program Manager. The individual has over 30 years of experience working in the electric energy industry, including experience with putting in market and settlement systems at the NYISO, PJM and internationally. The consultant brings strong project execution and management skills coupled with a thorough understanding of deregulated markets and the systems required to operate markets.

ISO Management has also brought a consultant on board to provide an independent review of the financial aspects of the project. This consultant will report directly to the project's Executive Sponsors and the Board. Additionally, to ensure adequate checks and balances within the project, the ISO has an expanded quality review function, which will also report to the project's Executive

Sponsors. These changes will result in standardized and consistent reporting to ISO Management and the Board on expenditures, schedule and deliverables of the MD02 Implementation Project.

B. Phase IB Status

Overall: Phase IB involves implementing software that (1) contains an economic dispatch algorithm to clear overlapping Real-Time Energy bids continuously so that there will be a single price in each five-minute interval, and (2) allows, *inter alia*, generators to modify unit availability in Real-Time and enable the ISO to impose penalties for uninstructed deviations.

The original schedule had an implementation date of February 1, 2004. However, the ISO believes that it is prudent to delay the February 1, 2004, start date to no sooner than April 1, 2004 based on the following factors 1) an extended focused market simulation; 2) ISO's readiness assessment; 3) adequate training; 4) completion of system application development and testing; and 5) an assessment of participants' readiness.

Market Simulation: On December 19, 2003, the ISO and participants completed five weeks of market simulation, including the following tests 1) execution of a Day-Ahead Market, 2) execution of an Hour-Ahead Market, 3) submission of DA schedules, HA schedules and supplemental bids, 4) execution of the new real-time dispatch scheme and 5) calculation and publication of settlements statements. The market simulations have averaged nine participants. The ISO anticipates increased participation during the month of January 2004. Some of the factors for the light participation included identified

system issues not being resolved in a timely manner by the ISO and varying degrees of participant readiness.

To increase participation, the ISO made a concerted effort to reach out to a targeted group of participants. During the week of December 15, 2003, the ISO conducted one-on-one conference calls with 23 key market participants for the simulation exercise in order to; 1) discuss specific dispatch scenarios to be run during market simulation; 2) obtain feedback from each participant about their own readiness assessment for implementing Phase IB; and 3) obtain general feedback about how the ISO could improve market simulation. Based on this outreach effort, beginning January 5, 2004, the ISO started conducting customized dispatch scenarios with participants at their designated date and time. The market simulation will run for three weeks, followed by one week of down time to allow both participants and the ISO to update their systems so changes can be tested when market simulation resumes. At this time, the ISO anticipates continuing market simulation through February 2004.

In addition to the conference calls in mid-December, the ISO conducted its own overall readiness assessment through the evaluation of the Phase IB schedule, resource allocation, risks and impacts. The ISO identified two critical areas, training and system application development and testing.

Training: The ISO is currently preparing for the final and most intensive level of training -- hands-on operator training. Certain preconditions must be met prior to starting this training, including 1) operator screens being in place; 2) operating procedures updated to reflect Phase IB modifications; 3) operator roles

and responsibilities clearly defined; and 4) a training environment adequate for detailed hands-on training. The above preconditions are currently close to, or have recently been, completed. The ISO's current assessment is that the hands-on training will begin on February 23, 2004 and conclude on March 31, 2004.

System Application Development and Testing: The balance of system application development and testing, including load and performance testing, cannot be completed until mid-March 2004. Some of the key areas of system development include the Real-Time Market Application and Real-Time Economic Dispatch application, some post-processes and user interface tools.

Phase IB Weekly Conference Calls: The ISO held a conference call on December 19, 2003, to provide market participants with an update about Phase IB. Some of the topics included the ISO's one-on-one conference calls with market simulation participants, extension of a more focused market simulation beginning January 5, 2004, and the need for a delay of the February 1st implementation date. The ISO will continue to hold weekly conference calls every Friday until Phase IB is implemented. The conference calls are open to all Market Participants and are structured to keep stakeholders informed about the progress of Phase IB implementation.

Market Simulation Exit Criteria: The ISO reviewed the final draft of the Market Simulation Exit Criteria with participants on December 12, 2003. The Phase IB team incorporated the remaining comments and ISO Management

approved the Exit Criteria the last week of December 2003.⁵ Beginning January 5, 2004 and continuing throughout market simulation, the Phase IB team, in conjunction with market simulation participants, will assess the previous week's market simulation results against the Exit Criteria. The purpose of the Exit Criteria is for both the ISO and participants to determine when market simulation can be deemed complete and successful.

C. Integrated Forward Market/Locational Marginal Pricing Status

The extended process of the RFP selection, negotiation and proof of concept reached its conclusion when the ISO Board of Governors approved ISO Management's request to finalize and sign contracts with two vendors during a special Board session on December 29, 2003. The first contract is for the purpose of procuring software, installation, licenses and maintenance of a software system to execute an optimized forward energy market using a full network model, produce locational marginal prices and execute a real-time dispatch using a full network model to produce nodal prices. The second contract is for upgrading the architecture infrastructure to support market design changes.⁶

D. Market Redesign Budget Update

Attachment A -- the Budget Status and Tracking Report (which remains confidential) -- compares actual expenditures to forecast expenditures.

⁵ The Phase IB Market Simulation Exit Criteria can be found on the ISO website at: <http://www.caiso.com/docs/2003/12/05/200312051312593496.pdf>

⁶ The selected vendors are listed in Attachment B and will remain confidential until the vendors make their formal announcements.

Specifically, Attachment A shows the budgeted amounts, the amounts authorized by the ISO Board of Governors, the amounts that have been budgeted through the internal ISO process, and actual expenditures to date.

E. Key Issues

1. Settlements and Market Clearing Request for Proposals

During December 2003, the Settlements and Market Clearing Request for Proposal ("RFP") Evaluation team selected a preferred vendor for the Settlements portion of the original RFP. Based on the Settlements team's evaluation process, the ISO bifurcated the Settlements and Market Clearing RFP. To expedite the Market Clearing RFP process, the Settlements team conducted pre-qualification phone interviews with selected vendors. Based on these interviews, the ISO issued a Market Clearing RFP to seven qualified vendors on December 22, 2003, with responses due back January 16, 2004.

Contract award for both the Settlements and Market Clearing is now targeted for February 2004, following approval by the ISO Board of Governors.

2. Locational Marginal Pricing Studies

The ISO published the "Preliminary Analysis of Market-Based Price Differentials" on October 6, 2003 based on the ISO's third Locational Marginal Pricing ("LMP") Price Dispersion Study. Model development is currently being completed and validated for a final LMP price dispersion study report that will be completed and published early in 2004. This report will include simulation of a full year of LMPs using the market bids submitted in the ISO's current zonal market,

and will be followed by monthly reports with additional results for months subsequent to the period examined in the end-of-year report.

3. Congestion Revenue Rights Study

The ISO published the "Congestion Revenue Rights Sensitivity Study Report" on December 15, 2003⁷. The Sensitivity Study Report is an addendum to the "Congestion Revenue Rights Preliminary Study Report"⁸, which provides additional information for assessing congestion revenue rights ("CRR") allocations under MD02 for both the ISO and Market Participants. The ISO continues to design a second CRR Study and has developed CRR-related educational materials that will be used in classes being offered to Market Participants in early 2004.

4. CPUC Procurement Proceedings

In the December 1, 2003 Status Report, the ISO reported that the California Public Utilities Commission ("CPUC") had made significant progress towards establishing a viable resource adequacy framework in California. Specifically, the ISO indicated that on November 18, 2003, the CPUC issued a Proposed Decision by Administrative Law Judge (ALJ) Walwyn and an Alternate Proposed Decision by CPUC President Michael R. Peevey regarding utility procurement rules. As stated in the update, the ISO is largely supportive of the Peevey Alternate. The ISO also indicated that the CPUC was scheduled to rule on the proposed decisions at its December 18, 2003, meeting. However, at the

⁷ The Congestion Revenue Rights Sensitivity Study Report can be found on the ISO website at: <http://www.caiso.com/docs/2003/12/15/2003121514062310939.pdf>

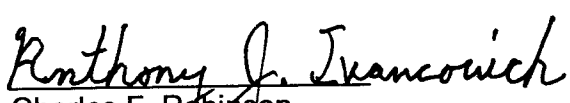
⁸ The "Congestion Revenue Rights Preliminary Study Report" was posted to the ISO's website on October 2, 2003 and can be found at: <http://www.caiso.com/docs/2003/10/02/200310021604581375.pdf>

December 18, 2003, meeting the CPUC deferred consideration of the long-term procurement rules until January 2004. The CPUC indicated that additional time was needed to consider the issues before them. President Peevey indicated his desire to address the procurement issues at the Commission's January 8, 2004, meeting. Notwithstanding the delay in addressing the long-term procurement issues, the CPUC did rule on certain key short-term (2004) procurement issues.

II. CONCLUSION

In Section I of this Report, the ISO has responded to the Commission's request for specific information on progress, critical issues, budget and alternative methods for the market redesign implementation effort. The ISO appreciates having the opportunity to comment and report on the progress being made on its market redesign.

Respectfully submitted,

 BRM
Charles F. Robinson
Anthony J. Ivancovich

Counsel for the California Independent
Operator Corporation

Dated: January 12, 2004

ATTACHMENT A

Privileged Information Has Been Redacted
Pursuant to 18 C.F.R. § 388.112

ATTACHMENT B

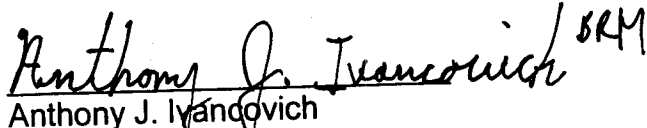
Privileged Information Has Been Redacted

Pursuant to 18 C.F.R. § 388.112

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon the Public Utilities Commission of the State of California, upon all parties of the official service lists maintained by the Secretary for Docket Nos. ER02-1656-000 and EL01-68-017.

Dated at Folsom, California, this 12th day of January 2004.


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