



March 3, 2003

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**

**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, has 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,

Charles F. Robinson
Anthony Ivancovich
The California Independent System
Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630

Attorneys for the California Independent
System Operator Corporation

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

California Independent System Operator Corporation)	Docket No. ER02-1656-000
)	
)	
Investigation of Wholesale Rates of Public Utility Sellers of Energy and Ancillary Services in the Western Systems Coordinating Council)	Docket No. EL01-68-017
)	
)	

**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 ISO’s Market Redesign (“MD02”). The Commission directed the ISO to file a full MD02 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 MD02 elements; (2) the ISO's progress in developing MD02 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 MD02 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. The ISO filed its second monthly Status Report on February 3, 2003. 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 MD02 implementation.

I. MARCH STATUS REPORT

Section A includes a narrative of the significant changes to the MD02 Program Plan – High Level schedule activity that occurred since the filing of the prior month's Status Report. Section B includes a narrative regarding the MD02 budget along with an updated Budget Tracking and Status Report.³ 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 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

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 narrative includes only non-confidential information.

identifies the ISO's key MD02 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. Current Project Timeline

Phase IB: In the February 3, 2003 Status Report, the ISO reported that the implementation of Phase 1B⁴ was behind its June 1, 2003 implementation date by approximately six weeks. During the month of February, the vendor has indicated that the expected scheduled final software delivery date of April 15, 2003 is now delayed until May 31, 2003. This new delivery date will significantly impact the overall implementation date of Phase 1B. The ISO is currently evaluating whether an adjustment to scope⁵ would shorten the delivery date. Even if the delivery date for the final code can be moved forward, it looks unlikely that the ISO will be able to implement Phase 1B prior to October 1, 2003.

Phases II and III: In early February, the ISO resolved the remaining Design Walkthrough issues⁶ internally. This was a necessary step in order to describe functionality required for the Integrated Forward Market /Locational

⁴ 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 ten-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.

⁵ While many elements of the Phase 1B software are critical to the required functionality, other elements are designed to enhance the efficiency of the ISO work effort (eg eliminate manual work-arounds) and could be deferred. If postponement of the non-critical elements would result in earlier delivery of the code, the ISO would consider their deferment.

⁶ These are issues/questions that were raised by ISO staff at the internal MD02 Design Walkthroughs.

Marginal Pricing using the Full Network Model Request for Proposals (“IFM/LMP RFP”). Additionally, the ISO met with stakeholders on February 12th to review positions on policy issues posted to the Stakeholder On-Line Forum and discuss non-consensus positions. See detailed discussion of the February 12th stakeholder meeting in Section C.3 *infra*. The MD02 Program Management Office (“PMO”) sent out for internal review a draft IFM/LMP RFP on February 19th, Comments on the IFM/LMP RFP were returned on February 23rd. After release of the IFM/LMP RFP, vendors will have approximately four weeks to respond to the IFM/LMP RFP. The ISO will schedule a bidders conference in the middle of those four weeks. The ISO will not be able to assess the overall impact on the Phase II and Phase III implementation dates until vendor responses for software systems are received, a bidder is selected, and the ISO has agreed on a development schedule with the successful bidder. Moreover, the final schedule will depend on an evaluation of the ISO’s LMP analysis (see discussion in Section C.4) and the Commission’s approval of the ISO’s revised market design proposal once it is filed. The delay of Phase IB does not impact the design and analysis stages of Phase II and Phase III because primarily different groups of ISO staff are deployed in the separate efforts.

B. MD02 Budget Update

Attachment A -- the Budget Status and Tracking Report (which remains confidential) -- compares actual expenditures to forecast expenditures. Specifically, Attachment A shows the budgeted amounts, the amounts authorized by the Board of Governors, the amounts that have been approved through the

internal ISO accounting process, and actual expenditures to date. There have been no significant changes to the MD02 budget since filing the first Status Report, and expenditures continue to remain within the projected cost of the overall program. Additional funds for the purpose of continuing development work for MD02 projects will be authorized by the Board of Governors.

C. Key Issues

1. Integrated Forward Market/Locational Marginal Pricing RFP

The ISO released its IFM/LMP RFP on February 28th as scheduled. The ISO will keep the Commission apprised of the vendor selection process in subsequent Status Reports.

2. Congestion Revenue Rights RFP

The ISO released the Congestion Revenue Rights ("CRR") Auction System RFP on December 2, 2002 and responses were received on January 10, 2003. During the months of January and February, the ISO evaluated vendor responses and selected a preferred vendor. Board approval is required prior to contracting with the vendor.

3. Continuation of the Stakeholder Process to Resolve Technical and Policy Issues

In last month's Status Report, the ISO indicated that "all but nine issues were resolved with JAD Participants..." At the February 12th stakeholder meeting, stakeholders expressed their concerns about the ISO's characterization of issues being resolved, given that stakeholders considered many issues still to be unresolved. The ISO clarified that its characterization of an issue as being

“resolved” or “closed” did not mean that further stakeholder dialogue on the issue was foreclosed. On the contrary, the ISO indicated that it “resolved” many of the issues merely by incorporating optionality/functionality into the IFM/LMP RFP, or recognizing that they were inputs or outputs to the IFM/LMP functionality and as such can be resolved independently. This will allow further discussions with stakeholders to determine the functionality that ultimately is implemented. The ISO understands stakeholder concerns, and discussions are underway regarding the most effective means of soliciting stakeholder input on policy issues in the future.

4. Locational Marginal Pricing Studies

Certain stakeholders and Members of the California State Legislature have raised concerns regarding the ISO’s proposal to implement LMP. The ISO has received formal letters from the leadership of the Senate Energy Committee and a member of the Assembly. While both of these letters implore the ISO to slow down its LMP implementation efforts, the ISO is engaged in a dialogue to understand the basis of their concerns. These letters, and the response by the Chairman of the ISO Board of Governors are provided in Attachment B.

At the February ISO Board of Governor’s meeting, the Board directed ISO Staff to continue with its ongoing LMP study effort in order to fully evaluate the effect of locational marginal pricing on energy prices in the State of California. This effort includes procurement of a LMP study tool that more accurately models the conditions of the grid, as it will operate under the proposed MD02 design. The Board also directed that a cost/benefit analysis of LMP be undertaken. The

ISO is currently developing the scope of the cost/benefit as well as investigating the timing and cost of such a study.

5. Settlement System Replacement

The ISO completed a feasibility study on the need for replacement of the current settlements system. Based on the results of this study, the Board directed ISO Staff to continue development of the RFP for replacement of the settlements system, including the functionality necessary to settle the markets as proposed under MD02 Phases II-III. Board approval is required prior to contracting for a new settlements system.

6. Master File Redesign and Market Transaction System

Master File Redesign and Market Transaction System are underlying data management systems required in the ISO's data architecture so that the ISO can manage market and operating information more reliably and efficiently, and provide improved data quality, integrity and audit controls. Similarly, work will continue on the Scheduling Infrastructure (SI) changes and the replacement of the system that manages existing transmission contracts (ETC) allocation. The Board directed ISO Staff to continue development efforts on both of these systems.

7. MD02 Conceptual Filing With The Commission

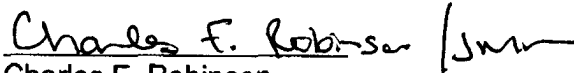
The Board directed ISO Staff to continue development activity necessary to incorporate changes to the May 1st MD02 Comprehensive Market Design proposal. These revisions to the original MD02 filing are the result of stakeholder policy input and the outcome of Joint Application Development sessions, as well

as internal ISO-generated changes. The ISO will not file its amended MD02 conceptual proposal with the Commission until the ISO has an opportunity to discuss its content and purpose with stakeholders and key policymakers, and the ISO Board authorizes the filing. The ISO continues to strive toward a comprehensive approach of implementing an integrated forward market (which simultaneously optimizes the procurement of energy, ancillary service and resolution of congestion) and locational marginal pricing using the full network model at a later date. This second element is subject to change depending on the outcome of further analysis and Board action on that analysis.

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 MD02 implementation effort. The ISO appreciates having the opportunity to comment and report on the progress being made in MD02.

Respectfully submitted,


Charles F. Robinson
Anthony J. Ivancovich
Counsel for the California Independent
Operator Corporation

Dated: March 3, 2003

ATTACHMENT A

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

ATTACHMENT B

STATE CAPITOL
P.O. BOX 942849
SACRAMENTO, CA 94249-0004
(916) 319-2004

DISTRICT OFFICE
3300 DOUGLAS BLVD #430
ROSEVILLE, CA 95661
(916) 774-4430

Assembly California Legislature



TIM LESLIE
ASSEMBLY MEMBER FOURTH DISTRICT

COMMITTEES
RULES
AGRICULTURE
BANKING & FINANCE
TRANSPORTATION
WATER, PARKS & WILDLIFE

RECEIVED

FEB 13 2003

OFFICE OF THE CEO
TERRY M. WINTER

February 12, 2003

Mr. Michael Kahn, Chairman
Cal-ISO Board of Governors
PO Box 639014
Folsom, CA 95673-9014

Dear Chairman Kahn:

I encourage the Board of Governors of the Independent System Operator (ISO) to direct the ISO's President/CEO and staff to immediately withdraw its application for approval of the "Market Design 2002" (MD02) proposal currently before the Federal Energy Regulatory Commission (FERC). While everyone agrees that market reform is necessary, hasty and ill-informed market reforms have already cost consumers in the West billions of dollars. In California alone consumers were burdened with roughly \$40 billion in increased electricity costs - in what was a \$7 billion a year industry. Our economy cannot risk another similar experiment.

MD02 has been accelerated months, if not years, in advance of the Standard Market Design (SMD) rulemaking currently being considered by FERC and the United States Congress. It is even farther in advance of Regional Transmission (RTO) efforts in neighboring regions. A rushed, isolated approach to California market reform is certainly not in the best interest of this state or our consumers.

Other regions, such as the Pennsylvania-New Jersey-Maryland Interconnection (PJM), have implemented reforms cautiously and incrementally. To the extent that these structures have succeeded, they have built upon historic practices and regional infrastructure, and have had lengthy trial periods with cost-based bid mitigation measures. The ISO should work with our regional partners in the same way.

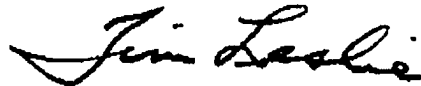
The experience of the last few years demonstrates that the Western Interconnection is one natural market - unique in its needs and abilities. The SMD and RTO efforts recognize that and are working, through a collaborative process, to make market reform work for everyone. It is the height of irresponsibility that Cal-ISO would

pursue a \$50 million system change, with no certainty of consumer benefit, which runs ahead of that process

MD02 places California in the dangerous position of repeating the errors made by the state at the time of the ISO's start-up: making hasty changes to fundamental market rules that ignored prevailing practices and our partners in the West, and spending tens of millions of dollars to do it. We should not repeat those mistakes.

Again, I encourage you and the ISO Board to direct the ISO President/CEO and staff to immediately withdraw ISO's application for approval of the MD02 proposal currently before FERC. I would also appreciate your immediate acknowledgment and response to this request

Sincerely,



TIM LESLIE
Assemblyman, Fourth District

TL ma

Cc The Honorable Gray Davis, Governor of California
The Honorable Bill Lockyer, California Attorney General
Assemblymember Sarah Reyes, Chair, Assembly Utilities and Commerce
Senator Debra Bowen, Chair, Senate Energy, Utilities and Communications
Members of the Electricity Oversight Board
Members of the California Public Utilities Commission
Members of the California Energy Commission
Members of the California Power Authority
Ms Nancy Sutley, Office of the Governor



California Legislature
Senate Energy, Utilities and Communications Committee

DEBRA BOWEN, Chairwoman

BILL MORROW, Vice Chair
RICHARD ALARCÓN
JIM BATTIN
JOSEPH DJINN
TOM McCLINTOCK
KEVIN MURRAY
BYRON D. SHER
JOHN VASCONCELLOS

February 18, 2003

Michael Kahn, Chairman
California Independent System Operator
Embarcadero Center West
275 Battery Street, 23rd floor
San Francisco, CA 94111

Dear Chairman Kahn:

We are concerned about the uncertainty associated with certain elements of the Independent System Operator's (ISO) proposed market design (MD02). In particular, the ISO proposes to institute a "locational marginal pricing" (LMP) regime for pricing congestion on a transmission system with congestion problems that are already well-known and unresolved. We've asked ISO staff about the costs and benefits of LMP and found that ISO staff are unable to predict either the costs or benefits with any certainty.

In our minds, this raises an obvious question - why is the ISO proceeding with a multi-million dollar market design if its effect on electricity consumers is unknown? This question is particularly important given the fact that we can't afford to repeat the mistakes of the past, including subjecting consumers to transmission management practices which have proven unwieldy, expensive and vulnerable to manipulation.

Last year, the Legislature enacted SB 1753 to avoid such a repeat. Under SB 1753, the ISO is required to act consistent with the interests of the people of the state and, further, to manage the transmission grid and related energy markets in a manner that reduces, to the extent possible, overall economic cost to the state's consumers.

Michael Kahn
February 18, 2003
Page Two

We request that you suspend all tariff filings and capital expenditures relative to implementing LMP until such time as the ISO has performed a peer reviewed and validated analysis of the costs and benefits of LMP for the consumers it serves, and we have an opportunity to review that analysis. Consistent with SB 1753, any future MD02 filings and expenditures – and other ISO actions – should be predicated on a demonstrable benefit to electricity consumers.

Thank you for your consideration of this request.

Sincerely,



John Burton, President pro Tempore



Debra Bowen, Chairwoman
Senate Energy, Utilities and Communications Committee



Joseph Dunn, Chairman
Senate Select Committee to Investigate Price Manipulation of the Wholesale Energy Market



Byron Sher, Chairman
Senate Environmental Quality Committee

cc: Mike Florio
Carl Guardino



CALIFORNIA ISO

California Independent
System Operator

February 26, 2003

Via Fax and U.S. Mail

The Honorable John Burton
President pro Tempore
California State Senate
State Capitol, Room 205
Sacramento, CA 95814

The Honorable Debra Bowen, Chairwoman
Senate Energy, Utilities and Communication Committee
State Capitol, Room 4040
Sacramento, CA 95814

The Honorable Joseph Dunn, Chairman
Senate Select Committee to Investigate Price
Manipulation of the Wholesale Energy Market
State Capitol, Room 2080
Sacramento, CA 95814

The Honorable Byron Sher, Chairman
Senate Environmental Quality Committee
State Capitol, Room 2082
Sacramento, CA 95814

Dear Senators Burton, Bowen, Dunn and Sher:

I have received your letter of February 18, 2003, articulating concerns about the California Independent System Operator's ("Cal-ISO's") proposal to implement a "locational marginal pricing" ("LMP") regime in connection with its pending market redesign efforts.

The Cal-ISO Board of Governors thoroughly discussed your letter at its meeting held on February 20. I want to assure you that the Cal-ISO Board fully understands and appreciates your interest in assuring that all elements of the proposed market redesign are well-conceived and thoroughly vetted. We, along with Cal-ISO Management and staff, share your dedication to preserving the welfare of California consumers, and meeting the statutory obligations set forth in SB 1753.

To that end and in response to your letter, the Board of Governors has directed Cal-ISO staff as follows:

(1) To begin gathering information immediately and causing to be developed further analysis of the LMP proposal for your consideration;

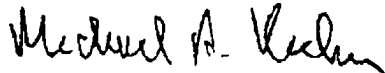
Senators Burton, Dunn, Bowen & Sher
February 26, 2003
Page Two

(2) To keep your offices informed of our progress in developing this analysis; toward that end, we have requested that a member of the Board, Mike Florio, together with Management, arrange for meetings with each of you and/or your staffs at your earliest convenience to discuss the steps we intend to take to address the concerns you have identified;

(3) To modify our MD02 Implementation program in order to allow time for the analysis you have requested and to ensure flexibility with regard to the LMP feature, such that the program could go forward without the LMP feature if the Board so determines in the future.

You have my personal commitment that we will work diligently to resolve the issues you have raised. We have requested that Mike Florio review with Management its plans for responding to your concerns. Please feel free to contact me personally or Mike Florio should you have any questions concerning our response.

Sincerely,



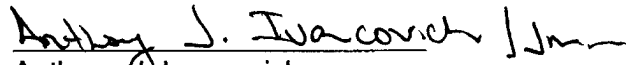
Michael A. Kahn, Chairman
California ISO Board of Governors

Cc: Mike Florio, CAISO Board of Governors
Carl Guardino, CAISO Board of Governors

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 3rd day of March, 2003.


Anthony J. Ivancovich
Anthony J. Ivancovich