



CALIFORNIA ISO

ORIGINAL

California Independent
System Operator

December 1, 2003

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

PUBLIC

FEDERAL ENERGY
REGULATORY COMMISSION

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FILED
OFFICE OF THE
SECRETARY

**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**, 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,

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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

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

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. 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. DECEMBER 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 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

² November 27 Order at P 9.

³ 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. Current Project Timeline

Phase IB: The ISO made its compliance filing regarding Amendment 54 on November 21, 2003, in response to the Commission's order of October 22, 2003.⁴

System testing for the Phase IB elements is 95 percent complete with the remaining five percent scheduled for completion by mid-December 2003. Phase 1B pre-market simulation was completed on November 14, 2003, with market simulation beginning on November 17, 2003. During the first week of market simulation, the ISO and participants completed the following tests: (1) execution of a Day-Ahead Market; (2) execution of an Hour-Ahead Market; (3) submission of Day-Ahead Schedules, Hour-Ahead Schedules, and supplemental bids; (4) execution of the new real-time dispatch scheme; and (5) transfer of market data to settlements.

The ISO posted the Phase 1B Market Simulation schedule of tests to its website on October 29, 2003 and sent out a Market Notice providing Market

⁴ *California Independent System Operator Corp.*, 105 FERC ¶ 61,091 (2003).

Participants with the website link. The schedule, in calendar format, outlines on a daily basis: (1) pre-market simulation preparation; (2) testing activity to expect each day during market simulation; and (3) a schedule of upcoming training classes for Scheduling Coordinators that did not participate in market simulation. The calendar will be updated and reposted to the website throughout the market simulation period.

The Phase 1B team prepared daily test plans that are "road maps" for market simulation participants. The test plans generally outline what is being dispatched and when (e.g., generating units, ties, load, or some combination). Test plans for the first two weeks were distributed to participants on November 14th and will be sent out in two-week increments throughout the market simulation period. Any revised test plans will be redistributed to market simulation participants.

The ISO circulated the draft Market Simulation Exit Criteria to market simulation participants on November 19, 2003 for review. The document outlines the proposed criteria that must be met in order to deem the Phase 1B market simulation successful. Market simulation participants had until November 25, 2003 to provide comments, and the document now will be finalized and posted to the ISO website. Each week the Phase 1B team, in conjunction with market simulation participants, will assess the previous week's market simulation results against the Exit Criteria. A final determination of the "go-live" date, currently scheduled for February 1, 2004, will be assessed towards the end of market simulation.

Integrated Forward Market/Locational Marginal Pricing: The ISO participated in the Commission's technical conference on November 6, 2003, with the focus on the ISO's Comprehensive Market Redesign Proposal and major outstanding design issues requiring resolution prior to implementation. These major design issues include allocation of Congestion Revenue Rights, treatment of Existing Transmission Contracts, Local Market Power Mitigation, Residual Unit Commitment, and Resource Adequacy. The majority of stakeholders acknowledge that the remaining design issues required resolution in order for the ISO to proceed with timely implementation of the ISO's market re-design.

The ISO continues contract negotiations with the preferred vendors selected for both the Integrated Forward Market/Locational Marginal Pricing ("IFM/LMP") and Congestion Revenue Rights ("CRR") functionality. The ISO can now seek approval to finalize and award the contracts from the ISO Board of Governors as soon as contract negotiations are satisfactorily concluded. The ISO anticipates requesting authority to sign the IFM/LMP contract at the December 4, 2003 Board of Governors meeting.

The Market Surveillance Committee ("MSC") hosted a conference call on November 12, 2003, to receive feedback from Market Participants about the pros and cons of a single-step implementation of IFM/LMP. MSC members presented and approved the Committee's opinion, which incorporated stakeholder feedback on the MD02 single-step implementation and LMP testing at the November 18, 2003 meeting. The MSC's opinion recommends that the ISO should move

forward with a single-step IFM/LMP implementation with the following recommendations:

1. The ISO should use final energy schedules during the testing period to produce LMPs. These schedules would provide the best possible information about LMPs before the LMP market goes into operation;
2. The ISO should allocate CRRs among the LSEs for short durations during the initial implementation of the LMP market until everyone is knowledgeable about the new market; and
3. The ISO should provide all Market Participants with sufficient flexibility in adapting their data, scheduling, and bidding systems to the new LMP market.

B. Market Redesign 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 ISO Board of Governors ("Board"), the amounts that have been approved through the internal ISO accounting process, and actual expenditures to date.

C. Key Issues

1. Settlements and Market Clearing Request for Proposals

The Settlements and Market Clearing Request for Proposal ("Settlements RFP") Evaluation team continues discussions with the top ranking vendor to

address key requirements prior to final vendor selection. Additional interviews, demonstrations and performance benchmarking meetings are scheduled through the end of November 2003. Awarding of a contract is now projected for late-January 2004, pending approval by the ISO Board of Governors.

2. Phase 1B Technical Issues

The weekly conference calls leading up to the beginning of market simulation on November 17, 2003, focused on responding to market simulation participants' questions. The Phase 1B team replaced the weekly market simulation conference calls with the daily market simulation bridge calls to respond to any market simulation participants' questions.

3. 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. A final LMP price dispersion study report, which will include simulation of a full year of LMPs using the market bids submitted in the ISO's current zonal market, will be completed at the end of 2003 and published early in 2004. This report will be followed by monthly reports with additional results for months subsequent to the period examined in the end-of-year report.

4. Congestion Revenue Rights Study

The ISO continues efforts to design a second Congestion Revenue Rights ("CRR") Study. A second CRR Study, expected to begin in December, will

assess the level of CRR allocations required to minimize Market Participant exposure to congestion charges under MD02. In addition to the second CRR Study effort, ISO staff is developing educational materials in response to Market Participants' request for a common level of understanding concerning CRRs. The educational materials will be a series of short courses, which will be offered in early January 2004.

The ISO staff continues to work with the California Public Utilities Commission ("CPUC") to ensure coordination with their long-term responsibilities concerning CRR allocation.

5. CPUC Procurement Proceedings

The CPUC issued a Proposed Decision by Administrative Law Judge ("ALJ") Walwyn and an Alternate Proposed Decision by CPUC President Michael R. Peevey in the Procurement Proceedings on November 18, 2003. Both decisions addressed resource adequacy, reserve margins, and approved utility procurement plans for 2004 that will continue to ensure short-term reliability for all utility electric service to customers. Following is a brief summary of the proposed decisions:

President Peevey's Assigned Commissioner's Ruling

The Assigned Commissioner's Ruling largely supported the positions taken and recommendations advocated by the ISO in the Procurement Proceeding. Specifically, the Assigned Commissioner's Ruling supports establishment of a 17% reserve margin (+/- 2%) and provides that the utilities begin procuring to that level beginning in early 2005. The ruling also agrees with

the ISO's recommendation that the utilities procured at least 90% of their capacity needs a year out and 100% of their needs a month out. In addition, the Assigned Commissioner's Ruling also recommends continuation of the CPUC's established 5% limitation on utility spot purchases in order to limit utility reliance on purchases out of the ISO's spot markets.

The Assigned Commissioner's Ruling also recommends that the ISO implement the requirements set forth in the recommendation. Specifically, the ruling states that the ISO should implement the requirements through its tariff and apply them to all entities that use the ISO Controlled Grid. Furthermore, the ruling agrees with the ISO that resources procured by the utilities must be "deliverable" and directs the ISO to propose a definition of "deliverability" at an upcoming workshop. The proposed decision also agrees with the ISO that there need to be clear consequences for utilities that fail to procure adequate resources and agrees with the ISO's recommendation that a surcharge be applied to utilities that buy out of the market in real time. The proposed decision states that the surcharge should be limited to staged emergencies and once again asks the ISO to propose a surcharge level at the upcoming procurement workshop. The decision also states that the ISO should notify the CPUC with regard to routine lack of compliance with the requirements. To that end, the decision supports the ISO's recommendation for monthly compliance reports to the ISO and Commission and directs the utilities to develop and propose an approach that is "least burdensome and consistent with existing requirements."

The proposed decision also recommends workshops to standardize, to the extent practicable, load forecasting and resource counting methodologies or conventions. The decision indicates that full credit be given to resources consistent with the deliverability criteria specified therein (including the state's long-term contracts). The proposed decision also notes that the resource adequacy framework will begin in 2005, prior to MD02 implementation.

Administrative Law Judge's Proposed Decision

The proposed decision of ALJ Walwyn also moves toward a defined state resource adequacy requirement, although with generally less stringent requirements than Commissioner Peevey's draft. The ALJ Proposed Decision would implement a 15% reserve requirement by the end of 2006, with interim benchmarks to be developed. The Proposed Decision specifically finds "there are ample resources for California to meet demand for 2004 as well as adequate resources for California to meet peak demand through 2007." The ALJ Decision requires utilities to contract for 90% of their capacity needs a year in advance, although this requirement could be adjusted if it significantly increases costs or fosters market power. (There is no capacity requirement sooner than a year in advance.) The 5% limit on spot purchases to meet energy needs would continue, and the issue of "deliverability" is identified for further study and public comments following the upcoming procurement workshop.

Significantly, the ALJ Proposed Decision expressly rejects ISO implementation of these requirements as "inconsistent with both FERC and the ISO's stated policies of giving deference to the State to address resource

adequacy issues.” The utilities could impose a reserve surcharge to cover the cost of reserves for the Energy Service Providers (“ESPs”) within their respective service territories, although ESPs and other Load Serving Entities would be able to opt-out of this surcharge if they could prove they had acquired adequate reserves. The decision also recommends workshops to standardize methodologies for counting resources and indicates that full capacity credit be given to resources under long-term state contracts.

These proposed decisions are just that, and thus there is a strong possibility that significant modifications to the proposed rulings could be offered prior to a CPUC. In fact, now that both the ALJ and the assigned Commissioner have issued their rulings, it is possible that other Commissioners may offer alternative proposed rulings.

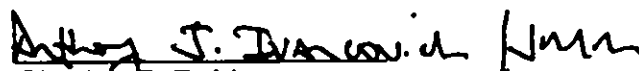
Written initial comments are due December 8, 2003, reply comments are due on December 18, 2003, and a final decision is scheduled for December 18, 2003. The ISO currently is reviewing the two draft decisions to identify the key provisions regarding resource adequacy.

In addition, the initial public workshop to address several technical details on deliverability and other resource adequacy issues is scheduled for December 10, 2003. The CPUC has requested that the ISO take part in this workshop, and the ISO fully intends to be an active participant in this initial and any subsequent workshops.

II. CONCLUSION

In Section I of this Report, the ISO has responded to the Commission's request for specific information on progress, critical issues, budgeting, 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,


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Dated: December 1, 2003

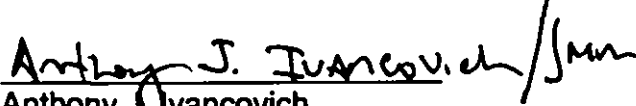
ATTACHMENT A

**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 and 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 1st day of December 2003.


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