

October 19, 1999

The Honorable David P. Boergers
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: AES Redondo Beach, L.L.C.	Docket Nos.	ER98-2843-___
AES Huntington Beach, L.L.C.	Docket Nos.	ER98-2844-___
AES Alamitos, L.L.C.	Docket Nos.	ER98-2883-___
El Segundo Power, LLC	Docket Nos.	ER98-2971-___
Long Beach Generation, LLC	Docket Nos.	ER98-2972-___
Ocean Vista Power Generation, L.L.C.	Docket Nos.	ER98-2977-___
Mountain Vista Power Generation, L.L.C.		
Alta Power Generation, L.L.C.		
Oeste Power Generation, L.L.C.		
Ormond Beach Power Generation, L.L.C.		
Williams Energy Service Company	Docket No.	ER98-3106-___
Duke Energy Oakland, L.L.C.	Docket No.	ER98-3416-___
Duke Energy Morro Bay, L.L.C.	Docket No.	ER98-3417-___
Duke Energy Moss Landing, L.L.C.	Docket No.	ER98-3418-___
Southern California Edison Company	Docket No.	EL98-62-___
Sempra Energy Trading Corp.	Docket No.	ER98-4497-___
San Diego Gas & Electric Co.	Docket No.	ER98-4498-___
California Independent System Operator Corp.	Docket No.	ER99-1971-___

Dear Secretary Boergers:

Enclosed please find an original and fourteen copies of the "Report on Redesign of California Real-Time Energy and Ancillary Services Markets" prepared in compliance with the Commission's October 28, 1998 and May 26, 1999 orders in the above-captioned dockets.

AES Redondo Beach, L.L.C., et al., 85 FERC ¶ 61,123 (1998) ("October 28 Order"), *order on reh'g*, 87 FERC ¶ 61,208 (1999) ("May 26 Order"), and submitted on this date by the California Independent System Operator Corporation ("ISO") on behalf of Frank Wolak, Chairman of the ISO Market Surveillance Committee ("MSC").

In the October 28 Order, the Commission directed the ISO to conduct a stakeholder process to address various issues concerning the ISO's Ancillary Service markets and to submit a comprehensive proposal for the redesign of those markets to the Commission by March 1, 1999. The October 28 Order also directed both the MSC and the Market Monitoring Committee ("MMC") of the California Power Exchange ("PX") to monitor the Ancillary Service markets with respect to implementation of the restructuring reforms proposed in the ISO's March 1, 1999 filing and to file reports on the redesigned market structure by October 15, 1999 which would independently advise the Commission on the viability of the revised market structure and whether continuation or elimination of the ISO's Ancillary Service purchase price cap authority is appropriate. 85 FERC at 61,464. In an order issued in a separate proceeding on January 27, 1999, the Commission expanded the issues to be addressed in these reports, directing the MSC and MMC to monitor the Imbalance Energy market with respect to the implementation of the ISO's reforms and to address the Imbalance Energy market in their respective reports to be filed with the Commission by October 15, 1999. *California Independent System Operator Corp.*, 86 FERC ¶ 61,059 at 61,202 (1999).

On March 1, 1999, the ISO submitted Amendment No. 14 to the ISO Tariff in the above-captioned proceeding, which principally consisted of Phase I of the ISO's redesign of its Ancillary Service markets. Because many of the Ancillary Service market reforms proposed in Amendment No. 14 (including revisions to two reforms which had previously been approved by the Commission in its order on Amendment No. 13, *California Independent System Operator*

Corp., 86 FERC ¶ 61,122 (1999)) were dependent upon software modifications, the ISO requested that these reforms go into effect after issuance of market notices that the modified software was ready for implementation.

In its May 26 Order in this proceeding, the Commission accepted Amendment No. 14 with certain modifications, thereby approving the ISO's proposed redesign of the Ancillary Service markets. The Commission directed the MSC and MMC to monitor the ISO's experience with these market reforms and evaluate them in the reports to be submitted by October 15, 1999. The Commission also indicated that the MSC should include the following items in its report:

- an evaluation of the ISO's implementation of the Rational Buyer proposal via a Cost-Comparing Sequential Auction, including a discussion of whether this approach could result in an inverse price relationship that would provide incentives for owners of generation capacity to submit higher bids for lower quality service and an evaluation of at least two alternative approaches identified by the Commission (May 26 Order, 87 FERC at 61,809);
- an evaluation of whether the ISO's proposal that Rational Buyer adjustments to the procurement of Ancillary Services have no impact on a Scheduling Coordinator's MW obligations for each Ancillary Service results in inefficient self-provision, based on the MSC's monitoring of market experience under this provision (May 26 Order, 87 FERC at 61,809-10);
- an analysis of experience under the ISO's market reforms that could inform the ISO in its decision whether to request additional purchase price cap authority beyond November 15, 1999, (May 26 Order, 87 FERC at 61,818); and
- an analysis of the effects of the Reliability Must-Run ("RMR") dispatch order on PX Day-Ahead energy prices, especially in light of the Amendment No. 14 reforms and reforms set forth in the settlement of issues related to RMR Contracts filed in Docket Nos. ER98-441 *et al.* on April 2, 1999 (May 26 Order, 87 FERC at 61,819).

On October 15, 1999, the ISO submitted a letter on behalf of the MSC in the above-captioned dockets to inform the Commission and the participants in this proceeding that the report being prepared pursuant to the orders discussed above was still undergoing review and revision and would not be completed until the start of the following week. The ISO now submits

the "Report on Redesign of California Real-Time Energy and Ancillary Services Markets" prepared by Frank Wolak, Chairman of the MSC. The other two members of the MSC, Robert Nordhaus and Carl Shapiro, have informed the ISO that they concur in general with the report's findings and conclusions with respect to the ISO's Ancillary Services and real-time Energy markets and specifically concur with the report's recommendations concerning maintenance of the ISO's purchase price cap authority and reform of RMR dispatch. This position is reflected in a letter dated October 19, 1999 from Robert Nordhaus and Carl Shapiro to Jan Smutny-Jones, Chair of the ISO Governing Board, which is attached to this transmittal letter. The ISO will provide the Commission and the participants in this proceeding with any additional comments on the enclosed report provided by the other members of the MSC.

The MSC has requested that the ISO inform the Commission that the enclosed report does not provide a complete analysis of the impact of the Ancillary Service market reforms on overall market performance due to the limited amount of market experience with these reforms. Most of the market reforms, including the Rational Buyer reform, were not implemented until mid-August, and three significant components of these reforms were delayed due to software problems. The reform which permits trades of Ancillary Services capacity between Scheduling Coordinators was implemented in mid-September. The two remaining reforms - the automation of instructions to participants in the Imbalance Energy markets and the "no pay" reform, under which payments would be withheld for Ancillary Service capacity that was used for the uninstructed generation of Energy - have not been implemented to date.

The MSC has indicated that the lack of market experience with these reforms was compounded by limitations on the availability of data to conduct certain analyses with respect to the market reforms. "Settlement quality" meter data for the ISO's markets is not available until 60 days after the operating day on which the data is collected. A number of the analyses which

the MSC indicated it would need to conduct to fully evaluate the impact of the market reforms require the use of such "settlement quality" data. Such data will not be available for the operating days on which most of the market reforms were implemented until the middle or end of October.

The MSC has informed the ISO that, although the enclosed report does not include a complete assessment of the impact of market reforms on the ISO's Ancillary Services and Imbalance Energy markets, the report does provide an assessment of overall market performance this year compared to last year. Based on this assessment and additional analyses, the MSC also provides comment on the continued necessity of purchase price caps for both the Ancillary Services and Imbalance Energy markets.

The enclosed report also contains preliminary assessments of recently-submitted settlements in the ongoing RMR proceedings and a discussion of additional RMR issues, including the pre-dispatch of RMR generation. The MSC informs the ISO, however, that a full analysis of the effects of RMR dispatch order on PX Day-Ahead energy prices will require the use of settlement quality metered data after any dispatch reforms the ISO intends to propose are put in effect.

In addition, the MSC has informed the ISO that the report does not include a full evaluation of the ISO's experience with the Rational Buyer reform because there is insufficient market experience under Rational Buyer to permit the MSC to make a complete assessment of its impact.

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A form of notice, in hard copy and electronic form, is included in this filing. Also enclosed is an additional copy of this filing to be date-stamped and returned to the messenger. Thank you for your attention to this matter.

Respectfully submitted,

Edward Berlin
David B. Rubin
Sean A. Atkins
Attorneys for the California Independent
System Operator Corporation

cc: Service List