

September 5, 2001

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

**Re: California Independent System Operator Corporation,
Docket No. ER01-____-000
Temporary Modification of the ISO Payments Calendar
And Request for Waiver of Notice Requirements**

Dear Secretary Boergers:

Pursuant to Section 205 of the Federal Power Act ("FPA"), 16 U.S.C. § 824d, and Sections 35.11 and 35.13 of the Commission's regulations, 18 C.F.R. §§ 35.11, 35.13, the California Independent System Operator Corporation ("ISO")¹ respectfully submits for filing an original and six copies of an amendment ("Amendment No. 40") to the ISO Tariff. Amendment No. 40 would modify the ISO Tariff to implement a temporary modification to the ISO's settlement practices necessitated by the crisis in the California wholesale energy markets.

Enclosed, for the information of the Commission, is a copy of a notice to Market Participants issued on August 1, 2001 ("August 1 Market Notice") by the California Independent System Operator Corporation ("ISO") explaining the need for a temporary modification to the ISO Payments Calendar for the trading month beginning with May 2001. As further explained in the enclosed notices to Market Participants issued on August 30, 2001 ("August 30 Market Notice") and September 4, 2001 ("September 4 Market Notice"), the ISO has determined that it is necessary to continue this

¹ Capitalized terms not otherwise defined herein are defined in the Master Definitions Supplement, ISO Tariff Appendix A, as filed August 15, 1997, and subsequently revised.

temporary modification to the ISO Payments Calendar until the ISO provides further notice that it is reverting back to the payment practice that has been in place since the effective date of the settlement-related provisions of Amendment No. 25 to the ISO Tariff. Specifically, as explained in the attached Market Notices, various factors, including the need for market reruns and the resulting potential for large adjustments between the issuance of preliminary and final invoices, required that the ISO defer making disbursements for transactions in the ISO's markets until after payments were received on the final invoices beginning with trade month May 2001. The ISO has also determined that, beginning with trade month July 2001, the ISO will temporarily suspend issuance of preliminary invoices, so that there will be a single invoice and a single ISO disbursement each month.

For approximately the first two years of ISO operations, the ISO's market settlement procedures provided for one disbursement of payments for each month's ISO market transactions to Scheduling Coordinators ("SCs") on behalf of the Market Participants they represent. This disbursement was made after the ISO issued, and received payment for, invoices based on the Final Settlement Statement for that month. Since the trade month of June 2000, however, with the implementation of the settlement-related provisions of Amendment No. 25, the ISO has bifurcated its payments to SCs. An initial payment is made based on the Preliminary Settlement Statement invoices and the receipts received by the ISO in response to them, and a final payment is made based on receipts received in response to the Final Settlement Statement invoice.² The invoice and payment dates are set forth in the ISO Payments Calendar, which is developed by the ISO each year.

This "two invoice" approach is premised on a number of assumptions that have not proven to be true in recent months, and especially beginning with the trade month of May 2001, including that all SCs will comply with their obligation to make full payments to the ISO on both the preliminary and final invoices and that adjustments between Preliminary and Final Settlement Statements will generally reflect minor "true-ups" rather than substantial shifts in the payments due to or from individual SCs.

As the Commission is aware, due to the crisis in the California wholesale energy markets, the now-defunct California Power Exchange ("PX") and several investor-owned utilities in California have defaulted on major payments due in the ISO's markets. As a result, the ISO has been unable to distribute the full amount of funds due to ISO Creditors, instead

² As the Commission has noted in numerous orders, the ISO is a revenue-neutral, not-for-profit entity. See, e.g., *California Independent System Operator Corp.*, 94 FERC ¶ 61,266 at 61,927-28 (2000). Both the original and the modified ISO market settlement procedures provide for the ISO simply to be a conduit for payments made and received in the various markets overseen by the ISO.

paying a fraction of the funds due. In response to these events, a number of SCs have engaged in practices that are contrary to their payment obligations under the ISO Tariff. These practices include “netting” payments owed by an SC for one month’s market transactions against amounts due to that SC for transactions attributable to a different month. In addition, some SCs have failed to make full payment on preliminary invoices or, because of pending disputes, to remit payments for adjustments expected to be made on final invoices, due to their belief that they will not fully recover on their final invoices adjustments to amounts “overpaid” on their preliminary invoices, notwithstanding their obligation to make all payments due on an invoice even if the payment is disputed. The ISO has reminded these SCs of their obligations under the ISO Tariff as well as under their SC Agreements, but to date, this inappropriate “netting” practice continues. Until other corrective action can be considered and implemented, it is at least necessary to curb the opportunity for continuation of this disregard of Tariff and contractual obligations. That, in part, is why the ISO suspended payment based on preliminary invoices.

In addition, the volatile nature of the ISO’s markets in the months leading up to May 2001, as well as the evolving Commission directives with respect to the mitigation of market power and the establishment of prices in those markets, has created the need for the markets during those months to be “rerun” far more frequently than was ever contemplated to be necessary. These market reruns can result in significant shifts in the payments owed to and from SCs between the issuance of preliminary and final invoices each month. Leading up to the May 2001 trade month, more and more SCs were late on partial payments on the preliminary invoices, in some cases to shield themselves from shifts of this nature.

The net result of these factors is that money is often unavailable, even on a *pro rata* payment basis, to reimburse those SCs that paid their preliminary invoices in full and then were due payments back on the final invoices. This occurs both when SCs do not pay their full real obligations through their preliminary invoices and when other SCs, who received overpayments on a preliminary invoice, decline to return those overpayments, choosing instead to “net” out other amounts owed or to retain funds that are associated with a pending dispute. In other words, the “two invoice” approach has had the unfortunate consequence of rewarding those SCs who act in contravention of their obligations under the ISO Tariff and their SC Agreements while penalizing those SCs who follow the rules. Such a result is plainly contrary to the essence of the ISO’s market settlement procedures – the timely *and equitable* disbursement of payments in the ISO’s markets. It is for this reason that the ISO temporarily modified the payment dates in the ISO Payments Calendar and deferred the market disbursements beginning with trade month May 2001 until receipt of all payments on both preliminary and

final invoices for that month. This deferral will permit the ISO to make the most equitable distribution of the funds it has received and, accordingly, was the only way that the ISO could act in conformity with the spirit of the Tariff. Since the ISO will temporarily suspend payments on the preliminary invoices, the ISO has also determined that it will also suspend issuance of preliminary invoices and the associated SC payment obligation for the period that this modification to the ISO Payments Calendar is in effect.

The ISO emphasizes that this is a temporary modification necessitated by the current extraordinary circumstances in the California wholesale markets. To the extent the ISO determines that permanent modifications to the ISO Payments Calendar or the ISO's market settlement procedures are warranted, the ISO will file any necessary changes to the settlement provisions of its Tariff for Commission approval. For now, however, the ISO requests that the changes reflected in the attached Tariff modification language be made effective, on a temporary basis, commencing with August 1, 2001 (when preliminary payments for the trade month May 2001 would have been disbursed), and continuing until either the ISO issues a subsequent Market Notice, to be filed with the Commission, of its intent to revert, as of a date specified, to the previous payment practice, or until the Commission accepts and makes effective a permanent change to the practice. The ISO respectfully requests waiver of the prior notice provisions of Section 205(d) of the FPA, 16 U.S.C. § 824d(d), and Section 35.3 of the Commission's regulations, 18 C.F.R. § 35.3, to permit these Tariff revisions to be made effective, as requested, in order to permit the ISO to continue to make the most equitable distribution of the funds it has received and act in conformity with the spirit of the Tariff.

Communications regarding this filing should be addressed to the following individuals, whose names should be placed on the official service list established by the Secretary with respect to this submittal:

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The ISO has served copies of this letter, and all attachments, on the Public Utilities Commission of the State of California, the California Energy Commission, the California Electricity Oversight Board, and on all parties with effective Scheduling Coordinator Service Agreements under the ISO Tariff. In

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addition, the ISO is posting this transmittal letter and all attachments on the ISO's Home Page.

The following documents, in addition to this letter, support this filing:

Attachment A	Revised Tariff Sheets
Attachment B	Black-lined Tariff provisions
Attachment C	August 1 Market Notice
Attachment D	August 30 Market Notice
Attachment E	September 4 Market Notice
Attachment F	Notice of this filing, suitable for publication in the Federal Register (also provided in electronic format).

Two extra copies of this filing are also enclosed. Please stamp these copies with the date and time filed and return it to the messenger.

Please feel free to contact the undersigned if you have any questions concerning this matter.

Yours truly,

David B. Rubin
Sean A. Atkins

Counsel for the California Independent
System Operator Corporation

Enclosures

ATTACHMENT A

ATTACHMENT B

ATTACHMENT C

ATTACHMENT D

ATTACHMENT E

ATTACHMENT F