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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

San Diego Gas & Electric Company, **Complainant** **v.** **Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator Corporation and the California Power Exchange,** **Respondents.**	))))))))))	**Docket Nos. EL00-95-000** **EL00-95-045** **EL00-95-075**
Investigation of Practices of the California Independent System Operator and the California Power Exchange	)))))	**EL00-98-000** **EL00-98-042** **EL00-98-063**

CALIFORNIA PARTIES' SUPPLEMENTAL EVIDENCE OF MARKET MANIPULATION BY SELLERS, PROPOSED FINDINGS OF FACT, AND <u>REQUEST FOR REFUNDS AND OTHER RELIEF</u>

March 3, 2003

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Pursuant to the Commission's November 20, 2002, Order on Motion for Discovery Order,[1] the People of the State of California, *ex rel*. Bill Lockyer, Attorney General, the California Electricity Oversight Board, the Public Utilities Commission of the State of California, Pacific Gas and Electric Company (PG&E), and Southern California Edison Company (Edison) (collectively, the California Parties) hereby submit their supplemental evidence of market manipulation by sellers, proposed findings of fact, and request for refunds and other relief. This filing consists of this pleading, the sworn testimony of nine expert

[1] *San Diego Gas & Elec. Co.,* 101 FERC ¶ 61,186 (2002) (*November 20th Order*).

witnesses, and a total of 348 exhibits, including deposition transcripts,[2] tapes of trader telephone recordings, e-mails, analyses of California Independent System Operator Corporation (ISO) and California Power Exchange Corporation (PX) data, and other relevant evidence, together with the charts and indices the Commission required.

I. INTRODUCTION AND OVERVIEW

From May 2000 through June 2001, the total cost of electricity needed to serve California was more than $44 billion.[3] This compares to less than $25 billion total for the years 1998, 1999, and 2002, combined. This extraordinary increase in cost imposed great hardship on the State's citizens and businesses, crippled the State's two largest utilities, and took the State's budget from a multi-billion dollar surplus to a multi-billion dollar deficit, thereby robbing schools, police forces, and many other essential services of needed funds. Ultimately, it caused a life-threatening power crisis that sent the nation's most populous state into rolling blackouts.

As the California Parties explain herein, the cause of this unprecedented crisis is now known. Beginning in the Spring of 2000, market conditions created an environment that was ripe for abuse by sellers, who then drove prices far above competitive levels through a pervasive pattern of market manipulation. This market abuse by sellers -- and the resulting disastrous effects on prices and reliability -- continued until the Commission stopped it, suddenly and permanently, by instituting a region-wide must-offer requirement and price cap just before the Summer of 2001. So complete was the effect of the Commission's regional mitigation rules on seller conduct that, since those rules were instituted, prices have returned, and remained at, pre-

[2] Due to the limited amount of time available to prepare this pleading following the close of discovery, a few of the deposition transcripts are not yet final. The California Parties will file the final, versions of these transcripts when they become available.

[3] This includes only the portion of California located within the California ISO grid.

2000 levels. Even on the hottest days of the summer (with system demand more than 25 percent higher than during rolling blackouts in the winter of 2000), system emergencies have been few and rolling blackouts non-existent.

This pervasive pattern of seller market manipulation, which began in the Spring of 2000 and ended in the spring of 2001, resulted in prices that were in violation of the Federal Power Act (FPA), which requires that all rates be just and reasonable.[4] It also involved conduct that was in violation of filed tariffs and Commission rules. This conduct thus resulted in the inequitable and unjust enrichment of all sellers in the market.

We know definitively that Enron manipulated the market and violated market rules, as two of its top traders have already pled guilty. As Timothy Belden, Enron's chief West-Coast trader, admitted in his sworn plea agreement:

> I and other individuals at Enron agreed to devise and implement a series of fraudulent schemes through these [ISO and PX] markets. We designed the schemes to obtain increased revenue for Enron from wholesale electricity customers and other market participants in the state of California. . . . As a result of these false schedules, we were able to manipulate prices in certain markets, arbitrage price differences between the markets, obtain "congestion management" payments in excess of what we would have received with accurate schedules, and receive prices for electricity above price caps set by the ISO and the Federal Energy Regulatory Commission.[5]

But Enron was not alone. In fact, there was a general perception among sellers that the rules didn't apply -- that market-based pricing meant that anything goes. Based on this view, sellers engaged in conduct that would be shocking in a fully deregulated market -- and that is

[4] 16 U.S.C. § 824d (a) (2000) (requiring all wholesale electricity and transmission "rates and charges" to be "just and reasonable," and declaring that "any such rate or charge that is not just and reasonable is . . . unlawful").

[5] Exh. No. CA-229 at 3, Plea Agreement No. CR-02-0313 (N.D. Cal. 2002).

almost incomprehensible in a market for the sale of a product essential to health and safety, a product necessary to the production of virtually all other products, and a product that was placed by law under the pervasive regulatory authority of this Commission.

As shown in the attached testimony, deposition transcripts, e-mails and other evidence, sellers engaged in the following conduct that, taken together, caused the California electricity crisis:

- <u>Withholding of Generation</u>: To varying degrees, the major independent generating companies in California (AES/Williams, Duke, Dynegy, Mirant, and Reliant) engaged in the deliberate and systematic withholding of energy from the market, driving up prices by creating false shortages and scarcity. This withholding took multiple forms. Some of these generators falsely reported to the ISO that generating units were forced out of service for mechanical reasons when the plant's own records show that the plant was capable of normal operation. On over 20 occasions, totaling over 350 hours, generators placed units on "reserve shutdown" -- that is, they simply shut the plant down for what they asserted to be economic reasons when no maintenance was required -- all during times when the ISO had declared a system emergency. Dynegy, Mirant, Reliant, and AES/Williams also withheld by simply not bidding their output into the market even though their plants were fully operational -- again, often during system emergencies. Finally, these generators withheld generation from the market by bidding so high, and so far in excess of their costs, that they deliberately priced themselves out of the market. These withholding strategies -- often involving more than the 1,000 MW of capacity the Commission found shocking in the recent revelations concerning Reliant's withholding -- succeeded in keeping the market in a near-constant state of shortage and the ISO in a near-constant state of panic as it was forced to fight against time to obtain the power needed to keep the lights on. In addition to being naked exercises of market power, these practices violated the ISO Tariff as they involve giving the ISO false outage information, failing to operate generation to relieve system emergencies, and engaging in the anomalous bidding or withholding of generation.

- <u>Bidding to Exercise Market Power</u>. Generators and other suppliers submitted bids into the PX and ISO energy markets the only purpose of which was to exercise market power. This includes so-called "hockey stick" and other bids that increase based on conditions unrelated to the seller's costs. Often, generators and suppliers bid far higher after the ISO declared a system emergency, knowing that the ISO would need all available power and would be willing to pay any price to get it. These exercises of market power were so pervasive that they were the rule among suppliers, not the exception. This conduct not only increased prices far above competitive levels, but also violated the ISO Tariff, which prohibits generators from acting in a manner that fails to relieve system emergencies, as well as prohibiting anomalous and harmful bidding practices.[6]

- Scheduling of Bogus Load. Suppliers intentionally submitted false load schedules to increase scarcity and prices in the day-ahead market and to move resources into the more easily manipulated real-time markets. The Enron Memos referred to this strategy as Fat Boy or Inc-ing Load and called it the "oldest trick in the book." The ISO Tariff, however, requires that schedules be balanced and be based on actual "forecast" demand to be served by the schedule, not fictional demand. The evidence indicates strongly that, in addition to Enron, numerous other market participants have pursued this trading strategy, including Sempra, Powerex, Mirant, Dynegy, Reliant, Hafslund Energy, and, among others, the cities of Anaheim, Glendale (in cooperation with Enron), Pasadena and Redding (in apparent cooperation with Enron).

- Ricochet-type Export-Import Games. Generators and power marketers created artificial scarcity and reliability concerns by exporting vast amounts of power out of California on a day-ahead basis, only to import the same power back into California in an attempt to sell at inflated prices into the real-time markets or under Out-of-Market (OOM) agreements with the ISO or the State of California acting through the California Energy Resources Scheduling Division (CERS) of the California Department of Water Resources (CDWR). This export-import strategy, also referred to as Ricochet or "Megawatt Laundering" in the Enron Memos, increased day-ahead market prices, caused significant reliability concerns, forced the ISO and CERS into costly OOM purchases, and facilitated manipulation of the ISO's real-time markets in an attempt to evade Commission-authorized price caps. The Commission Staff has already determined that this practice is an exercise of market power.[7] These activities also violated the ISO Tariff as they were premised on a

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[6] Sellers have long attempted to divert attention from their misconduct by alleging that so called "load under-scheduling" by buyers contributed to the higher prices and the market's dysfunction. The California Parties' evidence conclusively shows that this "blame the victim" strategy is not only false, but that sellers engineered the issue by causing the underscheduling problem entirely themselves. It was pervasive seller withholding in the PX markets that forced buyers to buy, and the ISO to scramble to find, power at the last minute. Buyers cannot buy, at any price, what sellers refuse to offer. In fact, had buyers offered to pay up to the PX price cap for all of their demand, as the sellers apparently propose, the ISO would still have been short power in real-time during 201 out of 208 emergency hours in the summer of 2000 as a result of seller underoffering, but the cost of electricity to California would have increased by more than $6.5 billion.

[7] *August 2002 Initial Staff Report,* Docket PA02-2, slip op. at 94.

false export schedules submitted to evade ISO price caps. Numerous market participants appear to have pursued this trading strategy, including Enron, Powerex, Sempra, Mirant, and Williams. Some sellers, such as Reliant, appear to have undertaken efforts specifically to hide Ricochet transactions. Others -- such as Sempra and Dynegy, Coral and Glendale, and Constellation and Los Angeles Department of Water & Power -- cooperated with the result of making detection more difficult. The implementation of this trading strategy also often required knowing, willing participation from surrounding utilities who provided "parking" services; these participants include Public Service Company of New Mexico, Eugene Water, El Paso Electric, PacifiCorp, and Snohomish, among others. The evidence also shows that Powerex exported California power into Canada during time periods when the ISO operated under emergency conditions, which violated Powerex's export license.

- <u>Death Star and Other Congestion Games</u>. Numerous market participants pursued Enron-type congestion games, such as circular export-import schedules (Death Star). These trading games resulted in payments for congestion relief by creating fictitious congestion, as well as fictitious counter-flows, without actually moving any power or relieving any congestion. In addition to circular export-import loops, such congestion games included cut export schedules and offsetting ISO-internal schedules. These games resulted in reliability problems, higher zonal prices, and payments for the relief of congestion that both never existed and, consequently, was never relieved. They also were predicated on the submission of counter-flow schedules that the seller never intended to deliver to loads that did not exist, and as such violated the ISO Tariff. Available evidence reveals the entities involved or participating in such congestion games include Enron, Coral, Sempra, Mirant, the Modesto Irrigation District (MID), Duke and Powerex. Apparently willing partners in these congestion games include the Cities of Redding and Glendale, LADWP, and the Northern California Power Agency.

- <u>Double-Selling of Ancillary Service Capacity from ISO-Internal Generation</u>. Analysis of the data obtained in discovery shows that some generators sold reserves, but then failed to keep those reserves unloaded and available for the ISO. That is, generators sold capacity to the ISO for use as reserves and subsequently sold the <u>same</u> capacity into the ISO's real-time energy market as "uninstructed deviations." This created reliability problems both because the awarded Ancillary Service capacity was not available to the ISO when needed and because the ISO was forced to deal with excessive uninstructed energy. But as a result of this practice, the generators inappropriately received payments for both (1) the Ancillary Service capacity that they did not keep unloaded and (2) the uninstructed energy produced out of those Ancillary Services commitments. The practice is expressly prohibited by the ISO Tariff (Amendment 13) but the ISO did not begin fully enforcing the rule until

September 10, 2000. During the Summer of 2000, Mirant, Reliant, and Dynegy engaged in substantial amounts of "double-selling."

- Selling of Non-Existent Ancillary Services. Several sellers increased costs and created reliability problems by selling Ancillary Services from resources that were either already committed to other sales or incapable of providing the Ancillary Services in the day-ahead market, but hiding the non-existence of the services by buying the awarded services back in the hour-ahead market. This practice violates the ISO Tariff because sellers of Ancillary Services within the ISO control area required to identify the resources that will, in fact, provide the Ancillary Services sold and all sellers of Ancillary Services are required to ensure that the capacity is available if needed. Enron tellingly referred to this strategy as Get Shorty (since a "short" sale refers to the sale of a stock, commodity, or service that the seller does not own). Sellers similarly sold and fully repurchased Ancillary Services without any intent to deliver the services they sold, thus increasing costs and degrading reliability. Entities involved in such sale and repurchase of Ancillary Services that either were non-existent or never intended to be delivered were Enron, Sempra, Coral (likely in cooperation with Glendale), MID, Avista, the City of Azusa and Williams.

- Sharing of Non-Public Generation Outage Information. A number of the largest sellers, including Dynegy, Duke, and Williams, purchased a service from a company called Industrial Information Resources, Inc. (IIR). IIR provided to these sellers detailed, non-public information, on a daily basis, regarding their competitors' planned and on-going generation outages. All of the plant outage information that IIR provided was obtained from the plant personnel of the companies experiencing the outage, some of which were simultaneously receiving information, through IIR, about their competitors' outages. Sellers would also call IIR with specific questions regarding specific plant outages and IIR would then call plant personnel on their behalf and report back what the plant personnel told them. The sellers receiving and sharing competitor outage information from IIR then used this information in setting prices and making decisions as to where and how much to sell. These sellers engaged in this conduct despite the fact that the ISO Tariff prohibits market participants from reviewing other market participants' generation outage programs and despite the companies' own internal rules and guidelines that prohibited any discussion with competitors regarding those companies' generation outages. This improper sharing of generation outage information resulted in higher prices for energy and Ancillary Services by facilitating market manipulation by sellers and the coordination of their conduct.

- Collusion among sellers. The discovery effort has yielded specific evidence of widespread collusion among many sellers, power marketers and public power entities. Evidence documents that a number of market participants, including many public power entities, were jointly implementing or facilitating Enron-type trading strategies. In addition to written and verbal agreements providing for joint action, there were a number of information sharing channels, such as trader conversations, industry groups, and information services through which competitive market information was shared.

- Manipulation of NOx Emission Market. Evidence suggests that sellers manipulated the market for NOx emissions in the South Coast Air Quality Management District through a series of wash trades that created the appearance of a dramatic price increase that may have been fabricated. NOx emission costs are often cited by generators as one of the principal cause of the California power crisis. New evidence, however, suggests that Dynegy, together with AES and others, entered into a series of trades of NOx credits in July and August 2000 by which Dynegy would sell a large quality of credits and then simultaneously buy back a smaller quantity of credits at a higher per credit price. The net effect of the transactions was that virtually no money changed hands, but Dynegy effectively gave to AES and its other counterparties free credits. The trader also resulted in the reporting of a sale at an inflated price, increasing the apparent cost of NOx credits, and, therefore, the apparent marginal cost of electric energy. Additional investigation is needed to determine the full extent and effect of this behavior.

This evidence, while substantial and compelling, is just the tip of the iceberg. As this investigation has shown, there is a snake under almost every rock one turns. But the limitations in this 100-day process have made it impossible to discover the full extent of seller misconduct or to determine each and every wrongdoer or wrongful act.[8] Our findings here are representative, not exhaustive. And false statements by sellers before Congress, in the PA02-2 investigation, and elsewhere have made the process more difficult.[9] The California Parties

[8] For example, as the Commission knows from its Staff investigation in Docket No. PA02-2-000, much of the critical evidence is contained in recordings of trader phone lines. The California Parties were denied access to existing transcripts and notes of such recordings, and due to seller recalcitrance and the limits of time, the California Parties were only able to review a small fraction of the tapes to which the Discovery Master ruled that they were entitled.

[9] For example, Reliant's representation to the ISO Board on June 28, 2000, its testimony before Congress on September 11, 2000 and on April 11, 2001. and its November 22, 2000 submission to this Commission have all been proven either inaccurate or at minimum, grossly misleading in light of the

(continued)

proposed the 100-day discovery period as a first step to determine whether the evidence developed warranted additional procedures.[10] The evidence of seller market manipulation uncovered in this proceeding, together with the publicly disclosed revelations -- from the Enron pleas to the Reliant settlement -- that have continued to mount, are sufficient to warrant a full remedy. But, if the Commission believes that more evidence is needed, it must institute additional procedures.

As the evidence shows, the wrongful conduct of sellers, taken together, drove prices to extraordinary levels that bore no relationship to market fundamentals or to the prices that would have resulted if applicable tariffs and market rules had been followed. In the single-price auctions run by the ISO and PX, it is not possible to isolate the harmful effects of any one violation or any one bad actor. When sellers withhold supply from the day-ahead market, not only do day-ahead prices increase, but the ISO is required to purchase more reserves. Congestion games not only increase transmission costs, but they also increase zonal energy prices. Withholding of generation by multiple sellers, through multiple withholding strategies, acts jointly to drive up market-clearing prices for energy and Ancillary Service and creates the need for out-of-market (OOM) calls.

Likewise, the panic and chaos created in the ISO and PX bid-based markets by seller withholding and manipulation directly resulted in higher prices for ISO out-of-market purchases. Sellers refused to sell power for only the hour needed and began to demand terms for out-of-

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Commission's recent conclusion that Reliant managers deliberately withheld generating capacity to manipulate prices in June 2000.

[10] *See, e.g., Motion for Discovery Order to Implement the August 21st Order from the U.S. Court of Appeals for the 9th Cir. Allowing the Cal. Parties to Adduce Additional Evidence* at 2, filed in Docket Nos. EL00-95-000, *et al.* (Sept. 6, 2002).

market sales of greater than twenty-four hours or arranged more than twenty-four hours in advance; alternatively, sellers demanded extortionate energy exchange ratios. Furthermore, these same manipulative seller strategies served to drive up the price of power bought by the State through CERS after the PX went bankrupt and the ISO was no longer creditworthy. (This is all without considering the impact of these strategies on forward prices, which is beyond the scope of this proceeding, but was a prime motivator for many of the sellers' practices, as the Reliant transcripts released by the Commission show.)

As a result, this conduct cannot be remedied on a piecemeal basis. The only rational and meaningful remedy is one akin, albeit on a broader scale, to that which the Commission already ordered for the October 2, 2000 through June 20, 2001 period. That is, the market-clearing prices for the period from May 1, 2000 through June 20, 2001 must be reset to the level they would have found had the market's rules been obeyed and the markets not been manipulated. This remedy should apply to all spot market sales in the ISO and PX, even if the seller was able to coerce the ISO into out-of-market sales of as much as one month or into energy exchanges rather than sales for cash. It should also apply to all such sales to CERS, as CERS was filling the role originally filled by the PX or responding to sellers' refusals to sell to the ISO. Just as the Commission found in the *July 25th Order*, because all sellers charged excessive rates through the ISO and PX single-price auctions, "it is fair that all those who benefitted from this market also bear responsibility for remedying any potential unlawful transactions that might have occurred in the market."[11] Here, too, the conduct was pervasive, systematic, and unjustly enriched all sellers. The California Parties calculate that the amount of such overcharges by sellers exceeds $7.5 billion, and may be much higher.

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[11] *San Diego Gas & Elec. Co.,* 96 FERC ¶ 61,120 at 61,513 (2001) (*July 25th Order*).

A just remedy will restore sellers and buyers alike to where they would have been in a properly and lawfully functioning market. The California Parties ask no more and no less.

II. THE COMMISSION HAS BOTH THE LEGAL AUTHORITY AND THE LEGAL DUTY TO REMEDY RATES AND CHARGES THAT VIOLATE THE FEDERAL POWER ACT BOTH BEFORE AND AFTER OCTOBER 2, 2000

The Commission has recognized since November 1, 2000 that it has authority to order refunds for all unjust and unreasonable rates in the California spot markets charged on or after October 2, 2000, whether charged by investor-owned or publicly-owned utilities.[12] The Commission's prior findings, together with the evidence presented herein, plainly establishes that rates were far above just and reasonable levels. This is so for prices in the ISO and PX bid-based spot market, as well as for ISO OOM purchases and exchanges. It is also true for purchases by CERS acting in place of the PX for purposes of day-ahead procurement and in place of the ISO, at times, for OOM purchases. Thus, the Commission's authority to remedy unjust and unreasonable rates charged on or after October 2, 2000 in California's spot markets is firmly established.

It is also clear, under the facts of this case, that the Commission possesses the authority to remedy excessive charges for the period from May 1, 2000 through October 1, 2000. Indeed, in response to the pervasive fraud, the abusive use of market power, the violations of filed tariffs, and the other instances of misconduct by sellers in the California electricity market prior to October 2, 2000, the Commission must order remedies that fully address the harm done to consumers. There are two bases for such relief. First, the Commission may remedy all violations of the ISO and PX Tariffs and of the sellers' market-based rate tariffs as well as other

[12] *See, e.g., San Diego Gas & Elec. Co.,* 93 FERC ¶ 61,121 (2000) (*November 1st Order*); *July 25th Order*.

applicable legal requirements. These tariff violations include both direct violations of express tariff terms as well as any other acts of bad faith and dishonesty. Second, under the facts presented, the Commission may order equitable relief to prevent unjust enrichment by sellers.

A. The Commission Has Authority to Remedy Tariff Violations, Including Both Direct Violations of Express Tariff Provisions and Acts of Bad Faith or Dishonesty Carried Out under the Tariff

As the Commission has recognized, it has the power to order refunds for past periods where the rates charged were contrary to the filed rate.[13] Remedies based on such tariff violations are not subject to limits on retroactivity.[14] As shown herein, there are numerous instances of direct violations of sellers' market-based rate tariffs and those of the ISO and PX. These must be remedied.

The Commission has broad authority in this regard.[15] Tariff violations are not limited to misapplications of the explicit terms of the rate schedule -- although such violations, in this case, are manifold. Fraud, anticompetitive conspiracies, and other such wrongful conduct are tariff violations as well. The exercise of market power can not be countenanced simply because a rate schedule fails to include the words "no fraud or market manipulation allowed."

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[13] *San Diego Gas & Elec. Co. v. Sellers of Energy,* 102 FERC ¶ 61,164 P 12 (2003) ("the Commission does have remedial authority to address any tariff violations that occurred prior to [October 2, 2000]"); *accord November 1st Order* at 61,381, *citing Appalachian Power Co.*, 23 FERC ¶ 61,032 at 61,088 (1987). The Commission also may order refunds as a remedy to correct legal errors. *November 1st Order* at 61,381; *United Gas Improvement Co. v. Callery Properties, Inc.,* 382 U.S. 223, 229 (1965) ("An agency, like a court, can undo what is wrongfully done by virtue of its order").

[14] *See Montana-Dakota Util. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251 (1951) (one "can claim no rate as a legal right that is other than the filed rate, whether fixed or merely accepted by the Commission").

[15] *See July 25th Order,* 96 FERC at 61,507-08 n.40 (recognizing authority to remedy tariff violations but stating that "it has not been demonstrated that any conditions or limitations of sellers' market-based rate tariffs have been violated").

The obligations of honesty in fact and fair dealing are implicit in the ISO and PX Tariffs. The Uniform Commercial Code (UCC)[16] and California law impose the obligation of good faith which, in the case of a "merchant," means "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."[17] The UCC standard applies to sales of electricity in California[18] and sellers in this case are merchants under the UCC.[19] Moreover, both the ISO and PX Tariffs require that they be governed by, and construed in accordance with, the laws of California.[20] Because the obligation of good faith applies to commercial transactions in competitive markets in California, it should apply with the same force to sales under Commission-approved tariffs that incorporate California law.

Indeed, the Ninth Circuit found that anticompetitive price postings by oil companies, as part of a contractual price-setting mechanism, although not barred by the explicit terms of their agreements, would be a breach of the duty of good faith imposed by the UCC (California

[16] UCC § 1-203; Calif. Commercial Code § 1203.

[17] UCC § 2-103(b) (emphasis added); Calif. Commercial Code § 2103(b). *See* Restatement (Second) of Contracts § 205, comment a. (1981) ("Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness").

[18] *Puget Sound Energy, Inc., v. Pacific Gas and Electric Co.,* 2002 U.S. Dist. LEXIS 1350 (N.D. CA 2002) (UCC applies to sales and exchanges of electricity under California law); *see also, Minnesota Power & Light Co.,* 52 FPC 617 (1974) (UCC standards apply to the interpretation of contracts for the sale of electricity).

[19] UCC § 1-104(1); Calif. Commercial Code § 2104(1). ("'Merchant' means a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill").

[20] California Independent System Operator Operating Agreement and Tariff, § 20.7; California Power Exchange Corp., PX Operating Agreement and Tariff § 15.6.

Commercial Code § 1203).[21] As that case suggests, the obligation of good faith is especially important in the context of prices intended to reflect a competitive market.[22]

The tariffs of the ISO and PX are complex and designed to anticipate a number of market scenarios. These circumstances provided unscrupulous sellers with opportunities to achieve and conceal improper price increases through market manipulation. In many cases, sellers violated explicit provisions; however, acts of fraud and gaming that increased prices above competitive levels, even if not violations of express tariff provisions, violated the implied obligations of good faith and fair dealing and are therefore tariff violations in and of themselves.[23]

In short, the Commission's authority to remedy tariff violations includes not only express violations of express tariff provisions but also includes all wrongful conduct committed in bad faith by sellers in perpetrating the California power crisis.

B. The Commission Has Authority to Order Equitable Remedies to Prevent Unjust Enrichment Where Sellers Have Defrauded the Commission and Exercised Market Power

Section 309 of the FPA provides the Commission with power to "perform any and all acts," and to issue such rules and orders as it finds "necessary or appropriate" to carry out the provisions of the FPA.[24] Thus, in addition to its authority to remedy tariff violations, the Commission has broad authority to order equitable remedies, including disgorgement of unjust

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[21] *Cal. v. Chevron Corp.,* 872 F.2d 1410 (9th Cir. 1989), *cert. denied,* 493 U.S. 1076 (1990).

[22] *See also, Cal. Lettuce Growers, Inc. v. Union Sugar Co.*, 45 Cal. 2d 474, 289 P.2d 785 (1955) (duty of good faith applied to contractual right to fix price for sugar beets).

[23] Moreover, sellers' actions also constitute a violation of the obligation -- imposed by the orders granting market-based rate authority -- to file promptly changes in "status." Such status changes include departures from the characteristics relied upon by the Commission in approving market-based pricing -- in this case, the implied characteristic of honesty in market dealings.

[24] 16 U.S.C. § 825h (2000).

enrichment, when sellers commit fraud and exercise market power. "[T]he Commission has broad authority to fashion equitable remedies in a variety of settings."[25]

Section 205 (a) of the FPA requires that "[a]ll rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission . . . shall be just and reasonable," and declares "unlawful" any rate or charge that is not just and reasonable, while Section 205 (b) forbids "undue prejudice or disadvantage" to any customer or group of customers.[26] These requirements must be administered by the Commission with due regard for its statutory responsibility to protect consumers.[27] Where prices paid to sellers are shown to be excessive as a result of market power, fraud, and other misconduct, the Commission has the power and the duty to set things right.

Both the Commission and the courts interpret FPA Section 309 (and the corresponding Section 16 of the Natural Gas Act (NGA), 15 U.S.C. § 717o (2000)), to confer on the

[25] *Transcontinental Gas Pipe Line Corp. v. FERC,* 998 F.2d 1313, 1323 (5th Cir. 1993), *quoting Columbia Gas Transmission Corp. v. FERC,* 750 F.2d 105, 109 (D.C. Cir. 1984). *See also, Mesa Petroleum Co. v. FPC,* 441 F.2d 182, 186 (5th Cir. 1971) (FPC had authority to take corrective actions).

[26] 16 U.S.C. §§ 824d (a), (b).

[27] The Commission's duty to consumers is well established. *FPC v. Sierra Pacific Power Co.,* 350 U.S. 348, 355, (1956) ("the protection of the public interest, as distinguished from the private interests of the utilities, is evidenced by the recital in § 201 of the Act that the scheme of regulation imposed is 'necessary in the public interest.'"); *Maine Public Service Company v. FPC,* 579 F.2d 659, 664 (1st Cir. 1978) ("The primary purpose of this mechanism is to protect consumers from excessive rates and charges -- any protection received by a utility is incidental"). *See also*, *FPC v. Louisiana Power & Light Co*., 406 U.S. 621, 631 (1972) (interpreting parallel sections of the NGA and holding that the NGA "granted FPC broad powers 'to protect consumers against exploitation at the hands of natural gas companies'" and that Congress meant to create a system that would leave "no 'gaps' for private interests to subvert the public welfare") (internal quotations and citations omitted); *United Distribution Cos. v. FERC*, 88 F.3d 1105, 1122 (1996) (interpreting parallel sections of the NGA and holding that the "overriding purpose" of the NGA "is 'to protect consumers against exploitation at the hands of natural gas companies'") (internal quotations and citations omitted), *cert. denied*, 520 U.S. 1224 (1997).

Commission the authority to require refunds where a seller has collected charges in excess of the just and reasonable level, either by error or through the exercise of market power. For example, in Order No. 637-A the Commission addressed the issue of its ability to remedy the possible abuse of market power by sellers in short-term natural gas release transactions.[28] Rejecting a call to make such sales subject to refund, the Commission stated that it could exercise its equitable power under Section 16 of the NGA:

> [A]n across-the-board refund condition is not necessary because, should the Commission determine in an individual case that a releasing shipper has abused its market power, the Commission has the authority under Section 16 of the NGA to take appropriate remedial action that can include remedies to prevent unjust enrichment.[29]

Courts have long recognized the broad scope of the Commission's equitable authority to "set things right" when acting within the scope of its responsibilities. In *Niagara Mohawk Power Corporation v. FPC*, the court considered a Federal Power Commission (FPC) order addressing the failure of a utility to apply for licenses before constructing dams.[30] The FPC issued the licenses but backdated them, thereby effectively requiring the utility to pay license fees for the period during which it should have had licenses, but did not.[31] The D. C. Circuit upheld the order:

> The case presents no question of Congressional power, but only a question of construction of the scope of administrative discretion entrusted to respondent Commission under the [Federal

[28] *Regulation of Natural Gas Transmission Services and Regulation of Interstate Natural Gas Transportation Services,* FERC Stats. & Regs. ¶ 31,099 (2000) (Order No. 637-A), *generally aff'd, Interstate Natural Gas Assn. v. FERC*, 285 F.3d 18 (D.C. Cir. 2001).

[29] *Id.* at 31,572.

[30] 379 F.2d 153 (D.C. Cir. 1967).

[31] *Id.* at 155.

> Power] Act. The Commission's authority to establish effective dates of licenses earlier than the date of issuance, while not expressly set forth in the Act, is fairly implied, assuming reasonable exercise of the authority. The Act is not to be given a tight reading wherein every action of the Commission is justified only if referable to express statutory authorization. On the contrary, the Act is one that entrusts a broad subject-matter to administration by the Commission, subject to Congressional oversight, in the light of new and evolving problems and doctrines.[32]

Subsequent cases have confirmed the Commission's power to take equitable action to restore the status quo and to prevent unjust enrichment. In *Mesa Petroleum Company v. FPC*, the Court of Appeals upheld an FPC order that required a gas supplier to "return" to a purchaser the difference between what the purchaser would have paid under its contract with the supplier and the amounts it actually had to pay for replacement gas when the supplier abandoned the contract without Commission approval.[33] And in *Louisiana Public Service Commission v. FERC,* the D.C. Circuit again noted that "[t]he Commission's authority to order refunds of amounts improperly collected in violation of the filed rate derives from FPA § 309."[34]

The California electricity crisis and the fraud and market manipulation by sellers are unlike anything ever seen by the Commission or its predecessor. As shown by the evidence produced herein, the misconduct of sellers deserves a comprehensive remedy. The Commission's previous approval of sellers' market-based rates should not -- and as shown herein does not -- give sellers

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[32] *Id.* at 158 (emphasis added).

[33] 441 F.2d at 186.

[34] 174 F.3d 218, 224 n.6 (D.C. Cir. 1999) (internal citations omitted); *see also, Coastal Oil & Gas Corp. v. FERC*, 782 F.2d 1249, 1253 (5th Cir. 1986) (agency cannot impose penalty, but is not otherwise limited in devising a remedy to restore the status quo ante); *Columbia Gas Transmission Corp. v. FERC*, 750 F.2d at 109 (the "Commission has broad authority to fashion remedies so as to do equity consistent with the public interest"); *Cox v. FERC*, 581 F.2d 449, 451 (5th Cir. 1978) (upholding remedy requiring that seller return a volume of gas to the interstate market equal to the volume it had diverted to intrastate sales).

the right to commit fraud or to wantonly exercise market power. Otherwise sellers will benefit from their own egregious conduct.[35] It is, rather, by requiring sellers to return amounts that they were never entitled to charge that the Commission can enforce the filed rate doctrine.

The Commission has authority under Section 309 of the FPA to order equitable relief to set things right in the California markets for periods before October 2, 2000. This authority is in addition to the Commission's authority to remedy tariff violations. The facts presented here demand that the Commission exercise all of its authority to provide a full remedy for the egregious conduct of sellers and the previously unimaginable harm that was inflicted on buyers.

[35] The Supreme Court has reserved judgment on the question of whether the filed-rate doctrine applies in the case of fraudulent conduct. *See Arkansas Louisiana Gas Co. v. Hall,* 453 U.S. 571, 583 n.13 ("We save for another day the question of whether the filed rate doctrine applies in the face of fraudulent conduct"); *Montana-Dakota*, 341 U.S. at 253 ("We need not decide what action the Commission is empowered to take if it believes that a fraud has been committed on itself").

Material Redacted

III. CONCLUSION

The framers of the original Federal Power Act would not be surprised to have seen prices rise to five to ten times their ordinary levels due to market power and manipulation of power prices, for they had lived through periods in which the market power of utilities was not controlled by federal or state regulatory statutes. Perhaps due to this legislation and the Commission's success in enforcing it, no Commission since has been confronted with a market power and manipulation episode, and period of high prices and huge wealth transfers, anywhere near the size of the Western power crisis of 2000-2001.

With only 100 days to conduct discovery, the strategic recalcitrance of the targets of this inquiry, and mountains of data to sort through, the California Parties have unearthed far more than enough factual information to warrant Commission action. Even where the Commission finds individual facts or numbers open to interpretation, it is inconceivable that it can now ignore a pattern of unprecedented, unjust, and unreasonable prices and a pervasive, widespread, and amply documented pattern of behavior by many sellers that runs counter to market efficiency and transparency.

Armed with these facts, the Commission has an obligation under its enabling statute to assure that prices are just and reasonable and that sellers have not been unjustly enriched. Any other legal interpretation of its responsibilities, however elegantly crafted, makes a mockery of the Act itself. If the Federal Power Act was not enacted to prevent crises such as those experienced by California and the surrounding states, and to remedy the terrible effects when a crisis occurs, then what strength and validity can it possibly have?

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