

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

Modesto Irrigation District

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Docket No. EL03-159-000

**COMMENTS OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR
CORPORATION ON AGREEMENT AND STIPULATION**

To: Presiding Administrative Law Judge Carmen A. Cintron

On November 3, 2003, Modesto Irrigation District Corporation (“MID”) and the Federal Energy Regulatory Commission Trial Staff (“Staff”) submitted an Agreement and Stipulation (“Agreement”) to the Commission in full and final resolution of all issues related to MID that were set for hearing on June 25, 2003 in *American Electric Power Service Corp., et al.*, 103 FERC ¶ 61,345 (2003) (the “Gaming Show Cause Order” or the “Gaming Order”). Pursuant to Rule 602 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.602 (2003), the California Independent System Operator Corporation (“CAISO”) timely submits these comments on the Agreement.

I. Background

The Gaming Show Cause Order required MID to show cause why it should not be found to have engaged in Paper Trading and Circular Scheduling, as those practices were described in the Order. In the Agreement, MID and Staff propose to settle for no money as to Paper Trading. They propose to settle for \$14,302 as to Circular Scheduling, representing total congestion revenues from

potential Circular Schedules identified in the June 2003 ISO Report as relating to MID.

II. Discussion

A. Paper Trading

The CAISO opposes the proposal to allow MID to settle as to the practice of Paper Trading for no money. The CAISO's June, 2003 *Supplemental Analysis of Trading and Scheduling Strategies Described in Enron Memos* ("June Report") identified MID as having potentially received \$4.7 million in revenues from Paper Trading practices, and the CAISO's Market Notice of July 3, 2003 indicated that payments to MID for Ancillary Services had been rescinded because the generating capacity that was to provide the Ancillary Services had not been available. Despite the Commission's apparent reliance on these very materials in issuing the Show Cause Order, the Agreement states that "based upon information reviewed in the Staff Investigation Staff is satisfied that MID has sufficient reserve capacity to sell ancillary Services to the CAISO in each hour in which it may have re-purchased Ancillary Services in the Hour-Ahead market." Agreement at ¶ 3.4

Staff is saying, simply enough, that *it* has satisfied itself that the data supports the conclusion that MID did not engage in Paper Trading. However, MID has been subjected to no discovery nor cross-examination on this issue. Although the supporting documentation upon which Staff relied is provided with the Agreement, the volume and nature of this information, combined with the

limited time available for review by the ISO, prevented the ISO from being able to conduct a complete and meaningful review of this information in the time allotted for filing comments on the Agreement. Moreover, the amount of revenues that MID may have received from potential Paper Trading activity itself suggests the need for a trial-type procedure that affords all parties the opportunity to conduct discovery and develop a complete record. As shown the Table 5 of the June 2003 Report, the ISO identified \$4.7 million of potential unjust revenues from Paper Trading by MID, with MID ranking second among all Market Participants during the period January through October 2002 in terms of total potential revenues received from Paper Trading. Under these circumstances, it would be inappropriate for the Commission to approve the proposed settlement of Paper Trading with respect to MID for no money. To do so would be tantamount to make a finding on the merits without having really investigated those merits through the procedure that the Commission initiated in the Gaming Show Cause Order.

In opposing the Agreement on the issue of Paper Trading, the CAISO does not mean to cast any aspersions on Staff's good faith or its competence. To the contrary, the CAISO has complete faith in both. In many circumstances, the Commission rightly relies upon Staff investigations to make decisions whether to initiate proceedings or even take enforcement action. But in this situation, the Commission initiated a trial-type proceeding before a Presiding Judge, and Staff's suggestion of settlement for no money would amount to a short-circuiting of that procedure. In the Gaming Show Cause Order, the

Commission invited Identified Entities to settle with Staff rather than go through the full proceeding. Order at P. 73. It did not, however, suggest that the entire process of responding to the Order, followed by discovery and cross-examination, could be cut off so long as an Identified Entity could convince Staff that the Identified Entity was “clean,” -- during a very short period when Staff was dealing with many dozens of Identified Entities and without the use of any compulsory process.

B. Circular Scheduling

The CAISO objects to approval of the Agreement with regard to the Circular Scheduling issue. Pursuant to the Agreement, MID would pay the full amount of congestion revenues from potential Circular Schedules identified in the June 2003 Report. However, the testimony of Dr. Fox-Penner, Exh. CA-1 at 134-137, submitted by the California Parties in the 100-day discovery proceeding (Docket Nos. EL00-95-075, *et al.*) discusses potential Circular Scheduling activity by MID that was not captured in the ISO’s analysis as set forth in the June 2003 Report. These activities were further addressed in MID’s September 2, 2003 response to the Show Cause Order (“Show Cause Response”).¹ The Agreement does not account for this potential Circular Scheduling activity.

The potential Circular Schedules discussed in the testimony of Dr. Fox-Penner and MID’s Show Cause Response were not identified in the ISO’s analysis because this potential Circular Scheduling activity involves one “leg” of

¹ Affidavit of Mr. Roger Van Hoy (“August 23 Affidavit”) and Attachment MID-4 included with MID’s Response to Show Cause Order

the suspect transaction being scheduled under MID's Scheduling Coordinator ID, while the "return leg" of the transaction is scheduled under the Scheduling Coordinator ID of another entity (*i.e.* California-Oregon Transmission Project or "COTP"). As noted in the June 2003 ISO Report, a major limitation of the ISO's analysis with respect to the practice of Circular Scheduling was that it was limited to matching of schedules submitted under the same Scheduling Coordinator ID. June 2003 Report at 16-17.

However, as described in the attached Affidavit of Dr. Eric W. Hildebrandt, using the information provided by the California Parties and MID, Dr. Hildebrandt has performed an initial query of ISO scheduling data in order to match schedules submitted under the Scheduling Coordinator IDs for MID and COTP. This analysis indicates that during the period January 2000 through June 2001, MID may have received approximately \$4.6 million in revenue from the potential Circular Scheduling practices outlined in the Fox-Penner testimony and MID's Show Cause Response.² In addition, as noted in Dr. Hildebrandt's affidavit, simply because "both of MID's schedules were within the CAISO control area," it does not follow that "the CAISO was fully aware of both MID's counter-schedule and MID's offsetting schedule," and that "no part of this transaction was hidden from the CAISO," as claimed in the affidavit of Mr. Roger Van Hoy, included with MID's Show Cause Response. MID-1 at 16:2-5. On the contrary, the circular nature of the "counter-schedule" and "off-setting schedule" described in Mr. Van

² The results of this analysis are included in Exhibits 1 and 2 to the Affidavit of Dr. Eric W. Hildebrandt. However, because of computer difficulties, the ISO is unable to file these Exhibits today. The ISO will file those Exhibits with the Commission tomorrow, and provide a copy to the Presiding Judge.

Hoy's affidavit was in fact hidden from the CAISO due to the fact that one of these schedules was submitted directly by MID, while the other "off-setting schedule" was submitted using COTP as the Scheduling Coordinator.

The Agreement does not address any of the potential Circular Scheduling activities raised by the California Parties and discussed by MID in its Show Cause Response. Because these activities may have resulted in MID having received millions of dollars in unjust revenues, the CAISO respectfully requests that the Commission reject the Agreement's proposed resolution of the issue of Circular Scheduling, permitting the opportunity for discovery and further testimony on this issue pursuant to the hearing process adopted by the Commission in the Gaming Show Cause Order.

III. Conclusion

For the reasons stated, the CAISO opposes the Agreement, and respectfully requests that the Commission reject the Agreement.

Respectfully submitted,

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Dated: November 24, 2003

CERTIFICATE OF SERVICE

In accordance with the order issued by the Presiding Administrative Law Judge I hereby certify that I have this day served the foregoing document by posting an electronic copy on the Listserv for this proceeding, as maintained by the Commission.

Dated at Washington, DC, on this 24th day of November, 2003.

/s/ Michael N. Kunselman

Michael N. Kunselman

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

Modesto Irrigation District

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Docket No. EL03-159-000

**AFFIDAVIT OF DR. ERIC W. HILDEBRANDT
ON BEHALF OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

1. My name is Dr. Eric Hildebrandt and I am the Manager of Market Investigations for the California Independent System Operator Corporation ("ISO"). My business address is 151 Blue Ravine Road, Folsom, CA 95630.

2. I hold a B.S. degree in Political Economy from Colorado College, and an M.S. and a Ph.D. in Energy Management and Policy from the University of Pennsylvania. I have specialized in economic analysis and research relating to energy issues for over fifteen years, with an emphasis on performing economic analysis, market research, and planning and evaluation studies for the electric utility industry. I began my career in energy research at the Center for Energy and Environment at the University of Pennsylvania, and then worked for over six years as an economic consultant to the electric utility industry with the firms of Xenergy Inc. and Hagler Bailly Consulting in Philadelphia, Pennsylvania. Prior to joining the ISO in 1998, I worked for over three years at the Sacramento Municipal Utility District as Supervisor of Monitoring and Evaluation.

3. As Manager of Market Investigations, I have worked extensively on analyses of the overall performance and competitiveness of California's Energy¹ and Ancillary Services markets, analyses of and proposals to mitigate local market power, and development and analysis of system market power mitigation options. During the 2000-2001 period covered in this proceeding, I played a lead role in analyzing and reporting to the Commission on market conditions and outcomes in California's wholesale energy markets. Since that period, I have testified before the Commission in proceedings stemming from market conditions and activities of Market Participants during that period, and have performed and supervised others in the performance of various analyses of the types of scheduling and trading practices that may constitute gaming or anomalous market behavior. These analyses include the *Analysis of Trading and Scheduling Strategies Described in Enron Memos*, prepared in October of 2002, and the *Supplemental Analysis of Trading and Scheduling Strategies Described in Enron Memos*, prepared in June of 2003 ("June 2003 Report").

4. I have reviewed materials submitted as part of the response of Modesto Irrigation District ("MID") to the Order to Show Cause in *American Electric Power Service Corp., et al.*, 103 FERC ¶ 61,345 (2003) (the "Gaming Show Cause Order" or the "Gaming Order"), including an affidavit submitted with that response by Mr. Roger VanHoy, dated August 23, 2003 ("VanHoy Affidavit"), and

¹ Capitalized terms otherwise not defined in my testimony are defined in the ISO Tariff, Appendix A – Master Definitions Supplement.

designated as Exhibit MID-1, and a related spreadsheet designated as Exhibit MID-4 to MID's response.

5. Information in the VanHoy Affidavit and Exhibit MID-4 identify at least two potential Circular Scheduling patterns which were not identified in the June 2003 Report. See . MID-1 at 21:1-24:8 and MID-4. As noted in the June 2003 Report, a major limitation of the analysis in that report was that it was limited to matching of schedules submitted under the same Scheduling Coordinator ID or "SCID." June 2003 Report at 16-17. The additional potential Circular Scheduling patterns identified in the VanHoy Affidavit and Exhibit MID-4 were not captured in the June 2003 ISO report due to the fact that these potential Circular Schedules are comprised of one schedule, or "leg," submitted under MID's Scheduling Coordinator ID, with an "off-setting schedule" or "return leg" scheduled under the Schedule Coordinator ID of another entity (e.g. the California-Oregon Transmission Project or "COTP" or Pacific Gas Transmission Services or "PGAE").

6. One of these additional Circular Scheduling patterns appears to involve simultaneous import and export schedules on the COI Branch Group, with one schedule being submitted in the import direction when congestion was occurring by COTP as the Scheduling Coordinator, and the other schedule being submitted in the export direction counter to congestion by MID as the Scheduling Coordinator. As explained in the VanHoy Affidavit, MID used inter-SC trades to

transfer the “virtual” energy imported under either the MID or COTP SCID to the other SCID, so that it could then become the “source” for the “virtual” energy exported to complete this loop. Exh. MID-1 at 29:4-8. In practice, MID earned congestion revenues for the schedule it submitted in the opposite direction of congestion, while MID did not incur any congestion charges for the schedule submitted by COTP in the direction of congestion since this was submitted using MID’s Existing Transmission Rights (“ETCs”). Through a relatively quick attempt to correlate import and export schedules matching this pattern, I discovered 349 pairs of such schedules, representing counterflow revenues that would have been earned by MID of about \$377,000 between January 2000 to June 2001. The results of this analysis are provided in Attachment 1. However, the limited time in which I had to conduct this analysis, and the available resources, did not allow me to perform a thorough analysis of the frequency and total revenues associated with this scheduling pattern and similar schemes that could have been employed on other tie points.

7. A second Circular Scheduling pattern identified in the VanHoy Affidavit and MID-4 involved creating a “virtual counterflow” on Path 15, the major congestion interchange within the ISO System, through a series of inter-SC trades (or transfers) of supply and demand schedules in the zones on each side of Path 15 (NP and ZP26). Exh. MID-1 at 22:5-24:9. This practice resulted in congestion revenues being paid to MID since the inter-SC trades are made by MID in a way that creates a “virtual counterflow” within the ISO’s congestion

management software in the opposite direction of congestion on Path 15, for which MID receives a congestion payment, while an off-setting “virtual flow” in the congested direction is created under the SC ID of PGAE using MID’s ETCs, for which no congestion charges are assessed. Through a relatively quick attempt to assess the frequency and revenues resulting from this activity, I discovered over 2,400 hours with such inter-SC trades, representing congestion revenues for “virtual counterflows” on Path 15 that would have earned by MID at least \$4.2 million during the January 2000 through June 2001 period. Results of this analysis are provided in Attachment 2. Again, however, time and resource limitations prevented me from conducting a more thorough analysis of the frequency and total revenues associated with this practice and similar practices that could have been employed using inter-SC trades, as described in the VanHoy Affidavit.

8. Moreover, merely because “both of MID’s schedules were within the CAISO control area,” it does not follow, as claimed by Mr. VanHoy, that “the ISO was fully aware of both MID’s counter-schedule and MID’s offsetting schedule,” and that “[n]o part of this transaction was hidden from the CAISO.” Exh. MID-1 at 16:2-5. On the contrary, the circular nature of the schedules described above, and in the VanHoy Affidavit, would be hidden from the ISO due to the fact that one of these schedules or sets of inter-SC trades was submitted directly by MID, while the other “off-setting” schedule or set of inter-SC trades was submitted using COTP or PGAE as the Scheduling Coordinator. Once such practices as

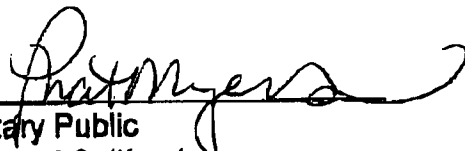
are described in materials such as the VanHoy Affidavit and evidence submitted in the 100-day discovery proceeding (e.g. Exh. CA-99 at 25), detailed data concerning these practices may be assembled through matching of scheduling and inter-SC trade data. However, given the massive volumes of such data submitted to and processed by the ISO (primarily by automated computer routines and programs), it is simply unreasonable to assume or claim that these practices were visible to the ISO operating or monitoring personnel.

I, ERIC HILDEBRANDT, being duly sworn, depose and say that the statements contained in this Affidavit are true and correct to the best of my knowledge, information, and belief.

Executed on this 24 day of November, 2003.


Eric Hildebrandt

Subscribed and sworn to before me on this 24 day of November, 2003.


Notary Public
State of California
County of Sacramento

