UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Powerex Corporation (f/k/a British Columbia Power Exchange Corp.)	))))	**Docket No. EL03-166-000**
Powerex Corporation (f/k/a British Columbia Power Exchange Corp.)	)))	**Docket No. EL03-199-000 (Not Consolidated)**

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

To: Presiding Administrative Law Judge Carmen A. Cintron
Presiding Administrative Law Judge Isaac D. Benkin

On October 31, 2003, Powerex Corporation ("Powerex") 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 Powerex 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"), and in *Enron Power Marketing, Inc. and Enron Energy Services, Inc., et al.*, 103 FERC ¶ 61,346 (2003) (the "Partnership Show Cause Order" or the "Partnership 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 Powerex to show cause why it should not be found to have engaged in False Import, Circular Scheduling, Paper Trading, Cut Schedules (Cutting Non-Firm), Scheduling Counterflows on Out-of-Service Lines, and Load Shift as those practices were described in the Order. The Partnership Show Cause Order required Powerex to show cause why it should not be found to have acted in concert with Enron and Public Service Company of New Mexico to engage in activities that could have constituted Gaming Practices (as those practices were described in the Order). In the Agreement, Powerex and Staff propose that there is no need for the Commission to pursue its investigations under the orders.

II. Discussion

The CAISO objects to the Agreement on the general grounds that all issues involved should be subject to hearing proceedings in which more thorough findings of fact can be made, given the extremely large volume of sales made by Powerex in the CAISO and California Power Exchange ("PX") markets, and the interrelationships between various gaming and anomalous bidding practices for which Powerex is subject to the show cause orders and further Staff investigations.

A. False Import

Staff states that "[b]ecause Staff has concluded that it has seen no evidence to indicate that the Powerex transactions in question meet the

Commission's definition of False Import, it is of the opinion that no monies are necessary to settle any and all allegations concerning possible or alleged False Import transactions." Agreement at ¶ 3.4. The Agreement, in this respect, appears to rest on Staff's interpretation of the Gaming Show Cause Order. In Staff's view, a False Import transaction requires that a seller (i) engage in a transaction involving export of energy from and re-import of energy into the State of California, (ii) involve a third party in the export-plus-import chain, and (iii) sell the allegedly imported power to the CAISO at a price above the then-applicable price cap in the CAISO's Real Time Market. Moreover, Staff's position is that the Commission made subject to the Gaming Show Cause Order only those False Imports that occurred between May 1, 2000 and October 2, 2000. The CAISO disagrees with this interpretation. In our Request for Rehearing and/or Clarification of the Gaming Order, filed on July 25, 2003, we asked the Commission to clarify that the investigation into potential False Import transactions would include all exports scheduled on a Day-Ahead or Hour-Ahead basis that could be associated with a subsequent sale of real time energy as an import, which is the screen the CAISO's Department of Market Analysis used to identify potential False Import transactions in the ISO Report.[1] As we explained therein, limiting the scope of inquiry to only those transactions that involved an export from the State of California, a third party, and a sale to the CAISO above

[1] On July 11, 2003, the California Parties filed a motion for expedited clarification of the Order, in which they also requested that the Commission clarify that the investigation into potential False Import transactions would include all transactions where power was exported or claimed to be exported from the CAISO system via any market other than real-time, and then re-imported in real time. "California Parties' Motion for Expedited Clarification of Order to Show Cause Concerning Gaming and/or Anomalous Market Behavior," Docket Nos. EL03-137, *et al.* (filed July 11, 2003), at 5-13.

the then-applicable price cap would be inconsistent with the Commission's rationale for concluding that False Import transactions constitute a Gaming Practice in the first place. The rationale was that they involved a misrepresentation to the CAISO that the applicable power had been imported from outside the CAISO system when, in fact, the generation was California generation that had never left the CAISO system. We also noted that the Commission compiled its list of entities that appear to have engaged in False Import based on those entities that were named in the ISO Report as possibly having engaged in Ricochet (i.e., False Import) transactions. We therefore urge the Commission, at this time, not to approve the Agreement with respect to the issue of False Import. Instead, we respectfully request that the Commission decline to rule on the portion of the Agreement concerning False Import until it renders a decision on the appropriate scope of the investigation into the practice of False Import in response to the requests for rehearing and/or motions for clarification of the Order that are currently pending before it.[2]

B. Circular Scheduling

The CAISO objects to approval of the Agreement with regard to the Circular Scheduling issue.

The Agreement indicates that the basis for Staff's findings on circular scheduling is that "Staff has found no evidence to indicate that the Powerex

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[2] The CAISO's screens showed that, between January 1, 2000 and June 20, 2001, Powerex engaged in transactions totaling 99,396 MW that potentially constituted "False Import," "Ricochet," or "megawatt laundering." *See* "Supplemental Analysis of Trading and Scheduling Strategies Described in Enron Memos," Submitted to Federal Energy Regulatory Commission Staff in Response to Final Report on Price Manipulation in The Western Market by Department of Market Analysis, California ISO, June 2003, at 25 ("Supplemental Analysis").

transactions in question meet the Commission's definition of Circular Scheduling." Agreement at ¶ 3.7. The CAISO believes that Powerex's potential involvement in circular scheduling should be subject to further scrutiny on the grounds that transactions identified by the ISO Report would not include any circular schedules created by Powerex that utilized schedules submitted through other Scheduling Coordinators and entities such as the Los Angeles Department of Water and Power ("LADWP"), which may schedule power for entities such as Powerex using their Existing Transmission Rights ("ETCs"). Evidence previously submitted in these proceedings indicates that Powerex may have used schedules submitted under LADWP transmission rights to create circular schedules in the same manner as Enron. *See* Exhibits CA-81 and CA-83. Since none of these transactions could have been identified through the CAISO's analysis (which relied upon matching imports and export schedules submitted by the same Scheduling Coordinator), and Staff's investigation has not included any attempt to investigate this issue, the CAISO believes Powerex's involvement in this type of Circular Scheduling should be subject to additional fact-finding through hearing procedures.

C. Paper Trading

The CAISO objects to approval of the Agreement on the issue of Paper Trading, on the grounds that this issue should be subject, in conjunction with other gaming and bidding practices, to hearing proceedings in which more thorough findings of fact can be made.

D. Cut Schedules (Cutting Non-Firm)

With respect to the issue of Cut Schedules (Cutting Non-Firm), the Agreement states that Staff, based on its review of information provided by Powerex, is satisfied that the transactions flagged by the ISO as potentially Cut Schedules were incorrectly identified by the CAISO. Therefore, the Agreement concludes that there is no basis for proceeding with an investigation of Cutting Non-Firm. The CAISO objects to approval of the Agreement concerning this issue.

First, Staff's findings are based on the mistaken conclusion that schedules must be categorized as "Non-Firm" in order to fall under this gaming category. Agreement at ¶ 3.5. As noted in the Show Cause Response submitted by Sempra Energy Trading Corporation in Docket Nos. EL03-137-000, *et al.* on October 31, 2003 ("SET Show Cause Response"), "the crucial element that characterizes this Gaming Practice, according to the Commission, is the submission of a schedule that the market participant never intended to deliver or knew it would not be able to deliver." SET Show Cause Response at 8. This crucial characteristic of Cut Schedules is reflected in all CAISO reports and analysis, and has been clearly explained by the CAISO in previous discussion with Staff. Specifically, the ISO Report explains that:

> Enron successfully used this strategy to earn a total of $54,000 in congestion payments on three separate days between June 14 and July 20, 2000. The next day, on July 21, 2000, this practice was proscribed by the ISO under a Market notice issued under the MMIP, and this practice has not occurred since a market notice was issued. No other SCs appear to have successfully used this

> strategy prior to the incidents with Enron in June-July 2000 with the possible exception of Duke.[3]

A subsequent portion of the ISO Report clearly explains that Cut Schedules included only a few non-firm schedules, and were primarily comprised of other types of schedules (firm or wheeling) that were cut after earning counterflow congestion payments. As the ISO Report stated:

> A more general type of scheduling practice described in the Enron memos is where SCs submit schedules in the Day-Ahead and/or Hour-Ahead Congestion Markets, providing counter-flows on a congested path. These Schedules receive Congestion charges, which are ultimately paid by SCs with Schedules in the congested direction, as counter-flow revenue in the Day-Ahead and/or Hour-Ahead Congestion Markets. Under current ISO scheduling and settlement practices, SCs may subsequently cut the counter-flow Schedules just prior to real-time, but still receive the counter-flow revenues for Schedules submitted in the Day-Ahead and/or Hour-Ahead Congestion Markets.
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> This creates a gaming opportunity, in that SCs may earn Congestion revenues for counterflow schedules in the Day-Ahead and Hour-Ahead Markets, and then cancel these Schedules prior to real time. The practice of cutting non-firm Schedules was proscribed by the ISO on July 21, 2000 in accordance with the Market Monitoring and Information Protocol Section of the ISO Tariff and does not appear to have occurred since that time. However, a similar gaming opportunity continued to exist insofar as the same basic strategy could be employed by cutting wheel-through Schedules and/or firm Energy Schedules.[4]

Thus, the ISO Report clearly indicated that the CAISO analysis provided to the Commission was not limited to cutting of "non-firm" schedules, and that Staff has incorrectly concluded that "transactions related to the Cutting Non-Firm allegation were incorrectly identified by the ISO." More importantly, the Commission

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[3] "Analysis of Trading and Scheduling Strategies Described in Enron Memos," Department of Market Analysis, October 4, 2002, at 7.

[4] Supplemental Analysis at 26.

proceeded to issue Show Cause Orders to all entities listed in the ISO Report with regard to Cut Schedules, after being provided with a clear explanation that the analysis summarized in that report reflected analysis that was not limited to cutting of "non-firm" schedules.[5] In addition, the list of cut schedules provided with this report identifies only two entities which cut non-firm schedules, with all other cut schedules included in the analysis being either "Firm" or "Wheels."[6] Thus, it is unreasonable for Staff to conclude that the Commission intended for the show cause proceedings to be limited only to cutting of non-firm schedules.

E. Scheduling Counterflows on Out-of-Service Lines

Staff proposes to dismiss the proceedings with regard to this issue on the grounds that the Commission's definition of this practice is limited to situations in which the same participant first creates and then relieves congestion on a line that is known to be out-of-service. Agreement at ¶ 3.8. The CAISO objects to this proposal. Such a definition is entirely inconsistent with the "Wheel Out" strategy described in the initial Enron memos, as well as the ISO Report, upon which the show cause orders were based. In fact, under Staff's overly restrictive reading, even Enron would be found never to have employed the "Wheel Out" strategy described in the Enron Memos.[7] As clearly described in the Enron Memos, the crucial element of the "Wheel Out" strategy is that when a tie-line is known to be out, traders submit schedules in a direction that is counter to

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[5] *See id.* at 26-28.

[6] See spreadsheet named Cutcounterflows_FERCworksheet.xls.

[7] In fact, under a situation that fits the definition used by Staff, no gaming opportunity would even exist, since a participant who first created congestion in by scheduling in one direction on an open tie would incur congestion charges that would at least offset (and could even exceed) any congestion credits received for any counterflow schedules submitted by that same participant.

potential congestion, knowing that they may be able to earn congestion revenues for schedules they know they will not have to provide.[8]

In addition, Staff errs in apparently concluding that an entity may not be found to have engaged in this practice if it relieves congestion though a counterflow schedule that is created through an adjustment bid that is accepted by the CAISO's congestion management software. In practice, it makes no difference if an entity submits an initial energy schedule, or submits adjustment bids which may result in an energy schedule in the counterflow direction if accepted by the CAISO's congestion management software. In both cases, an entity may be submitting a schedule to the CAISO for energy that it never intended to deliver or knew it would not be able to deliver. In practice, the only difference between these two scheduling mechanisms is that by submitting adjustment bids, rather than directly scheduling energy, an entity can remove any risk associated with the Wheel Out strategy by ensuring that it can only benefit from congestion, since its adjustment bids will only be accepted if there is congestion in the opposite direction for which the entity will receive a counterflow payment.

Finally, the Agreement provides no evidence relating to the key question of whether Powerex intentionally submitted schedules or adjustment bids on lines that Powerex's trader knew were out of service. Given the lack of any evidence that such scheduling was inadvertent or unintentional in the SET Show Cause

[8] *See* Enron Memo dated December 6, 2000, at 6.

Response, the CAISO believes this issue should be set for hearing to allow this key issue of fact to be addressed.

F. Load Shift

The CAISO objects to approval of the Agreement on the issue of Load Shift, on the grounds that this issue should be subject, in conjunction with other gaming and bidding practices, to hearing proceedings in which more thorough findings of fact can be made.

G. Effect of Dismissal

Even if the Commission were to dismiss the Gaming Show Cause Order and Partnership Show Cause Order as to Powerex on all issues, the CAISO does not believe it would be appropriate to close the captioned dockets or to relieve Powerex of all further obligations. Rather, the dockets should remain open until the show cause proceedings have been concluded, and Powerex should remain a party subject to discovery if it has information relevant to potential gaming by other parties. There would be no prejudice to Powerex, and it would serve the interests of efficiency, especially in light of the short discovery periods in these proceedings, to avoid the cumbersome process of obtaining discovery from a non-party.

III. Conclusion

For the reasons stated, the CAISO opposes dismissal of the issues of False Import, Circular Scheduling, Paper Trading, Cut Schedules, Scheduling Counterflows on Out-of-Service Lines, and Load Shift. In any event, even if all

issues are dismissed as to Powerex, the captioned dockets should remain open and Powerex should remain a party until the show cause proceedings are concluded.

Respectfully submitted,

/s/ J. Phillip Jordan

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Dated: November 20, 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 20th day of November, 2003.

/s/ J. Phillip Jordan
J. Phillip Jordan