UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Sempra Energy Trading Corporation	))	**Docket No. EL03-173-000**
	)	
Sempra Energy Trading Corporation	))	**Docket No. EL03-201-000 (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, Sempra Energy Trading Corporation ("SET") 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 SET 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 SET to show cause why it should not be found to have engaged in False Import, Circular Scheduling, Paper Trading, Cut Schedules (Cutting Non-Firm), and Scheduling Counterflows on Out-of-Service Lines, as those practices were described in the Order. The Partnership Show Cause Order required SET to show cause why it should not be found to have acted in concert with Coral Power, LLC, Eugene Water & Electric Board, and/or 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, SET and Staff propose that there is no need for the Commission to pursue its investigations under the orders.

II. Discussion

A. False Import

Staff asserts that "based on the Commission's definition of False Import transactions and review of the CAISO July 15, 2003 report, Staff determined that there is no basis upon which to proceeding further with its investigation in False Import as it relates to SET." Agreement at ¶ 3.2. 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 CAISO 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 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

[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.

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]

The Agreement also states that Staff is satisfied that there is no reason to proceeding further with its investigation into arrangements that SET had with the Eugene Water & Electric Board and Public Service Company of New Mexico, which consisted of "parking" agreements that the Commission stated in the Partnership Show Cause Order may have been used to engage in False Import. Agreement at ¶ 3.3. Staff reaches this conclusion in part "because the July 15, 2003 ISO Data show that SET did not engage in False Import." For the reasons stated above, the ISO disputes this conclusion, and therefore, objects to the removal of SET from the Partnership Show Cause Proceeding as well.

B. Circular Scheduling

The CAISO objects to approval of the Agreement with regard to the Circular Scheduling issue. The Agreements states that SET agrees to pay

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[2] The CAISO's screens showed that, between January 1, 2000 and June 20, 2001, SET engaged in transactions totaling 41,603 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").

$440,104 to settle with respect to this issue. However, this amount represents only about one third of the total revenue that the ISO Reports identified SET as having received for potential Circular Scheduling transactions. With respect to the remaining revenue, the Agreements states that "Staff independently reviewed the information [provided by SET and included as Attachment 3[3] of the Agreement] and is satisfied that $808,293 of the revenue amount related to Circular Schedules were incorrectly identified by the ISO."

The CAISO has reviewed Attachment 3 to the Agreement, which appears to be sole basis for Staff's conclusion that two-thirds of the revenue associated with potential circular scheduling by SET was incorrectly identified by the ISO. This Attachment, which consists of an affidavit by a Sempra employee and a spreadsheet, however, does not even come close to establishing that the transactions identified by the ISO are not circular schedules. First, information provided in Attachment 3 does not provide sufficient documentation to show that "these transactions were independent transactions, with different sources and sinks," as concluded by Staff. Agreement at 9. Attachment 3 merely lists a code for a counterparty for each transaction (e.g. PNM, PAC, etc.). This evidence is far from definitive. At a minimum, an examination of these transactions should include information such as "e-tags" submitted by SET to different control areas for these schedules, and purchase agreements or other commercial documentation of these transactions.

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[3] Attachment 3 to the Agreement consists of the same spreadsheet that SET filed as Attachment D to its response to the Gaming Show Cause Order in Docket EL03-173-000.

In addition, as indicated in evidence submitted by the California Parties in the 100 Days Evidence proceeding, CAISO Operations staff suspected SET of engaging in circular scheduling in this “Southwest Loop” during the period in question. Exhs. CA-132 ; CA-129; *see also* Exh. CA-1 at 127, 139. These circumstances, combined with the fact that SET had denied engaging in Circular Schedules in its previous responses to the Commission and continues to deny having engaged in circular scheduling, leads the CAISO to conclude that this issue should be the subject of a more detailed evidentiary hearing to adduce material facts concerning the “Southwest Loop” schedules. Additional evidence that can and should be produced by SET in such a hearing would include “e-tags” submitted by SET to different control areas for these schedules, and purchases of transmission outside the ISO control area which may be used to link the import/export schedules identified by the ISO into a circular loop of schedules (*e.g.* transmission between the Salt River Project and Arizona Public Service control areas).

Finally, SET has failed to provide any explanation for virtually all of the potential circular schedules identified by the CAISO involving the “Southwest Loop,” which consist of simultaneous imports/exports between the CAISO and the southwest. Schedules fitting this “Southwest Loop” pattern are particularly suspect as potential circular schedules, for two reasons. First, there is no readily apparent legitimate business justification for such schedules, because both the import and export start and end in the same region outside of the CAISO (the

southwest), so that there is no clear reason why such transactions would need to have been scheduled through the CAISO's system in the first place.

Although Staff apparently only relied on the affidavit and spreadsheet included as Attachment 3 to the Agreement, SET provided additional arguments as to why it should not have been found to engage in Circular Scheduling practices in its response to the Show Cause Order, filed in Docket No. EL03-173-000 on October 31, 2003 ("Show Cause Reponse"). The CAISO believes it appropriate to respond to those arguments herein.

Referring to the description of Circular Schedules in the Gaming Show Cause Order at paragraph 43, which states no power actually flows in a Circular Schedule since the schedule returns the same amount of scheduled power back to the point of origin, SET argues in its Show Cause Response that "no party has identified transactions arranged by SET outside the ISO control area for the purpose of creating a circular schedule" and that "the ISO data do not show, and cannot show, whether the transactions in Attachment C were 'looped' outside the ISO control area." Show Cause Response at 11. The Gaming Show Cause Order identified specific pairs of schedules that meet the Circular Schedule criteria based on data available to the CAISO, and it is not sufficient for SET to state that since the CAISO data, alone, does prove that these specific schedules are circular, then they must not be circular. The Commission has already identified these schedule pairs as potential Circular Schedules and based on that determination, placed the burden on SET to show cause why these schedule

pairs do not constitute Circular Schedules. SET's attempt to shift that burden back onto the CAISO should be rejected.[4]

SET also contends, in its Show Cause Response, that in almost half the instances of Circular Scheduling identified by the Commission, power did actually flow and thus, these transactions do not meet one of the criteria for a finding of Circular Scheduling as set forth in the Gaming Show Cause Order. Show Cause Response at 11-12. SET provided, in Attachment D to the Show Cause Response, a list of trading partners for the transactions identified as Circular Schedules and noted that the power did actually flow. However, such information by itself does not demonstrate that SET did not engage in Circular Scheduling. SET's list of trading partners should be supported with purchase agreements or other documentation that correspond to the scheduled quantity in order to validate that these schedules had legitimate sources and sinks that would not constitute circular schedules. Second, due to loop flows which can be created and exacerbated by circular schedules, simply showing that energy was scheduled in a certain pattern does not show that power actually flowed in that pattern. All import and export schedules are deemed delivered by the CAISO settlement procedure unless the schedule is cut, with notification provided to the CAISO, sufficiently prior to real time operations. The CAISO settles with neighboring control areas on actual flow across tie points (on an aggregated basis), and it is up to the each control area to determine (and settle based n)

[4] As noted above, additional evidence that can and should be produced by SET in the context of an evidentiary hearing include "e-tags" submitted by SET to different control areas for these schedules, and purchases of transmission outside the ISO control area which may be used to link the import/export schedules identified by the ISO into a circular loop of schedules.

whether or not the power needed to meet these schedules was actually provided by the scheduling party. Therefore, whether or not the power actually flowed as a result of a circular schedule cannot be determined merely by settlement documents that show a delivered schedule over a tie point into or out of the CAISO control area.

For these reasons, the CAISO maintains that SET has not provided, in either the Agreement or its Show Cause Response, sufficient evidence to support the claim that the transactions identified by the Commission are not Circular Schedules. The Commission should therefore reject the Agreement as to the issue of Circular Scheduling.

C. Paper Trading

In the Agreement, SET agrees to settle the issue of Paper Trading for a payment of $6,798,412. Agreement at ¶ 3.7. According to the Agreement, however, SET has demonstrated to Staff that an additional $213,740 in revenue from potential Paper Trading transactions identified in the ISO Reports were incorrectly attributed to SET. The CAISO objects to the Agreement's proposed settlement of this issue. Although the proposed settlement calls for SET to pay approximately $6.8 million of the net profits identified in the ISO Report, the ISO believes, given the magnitude of these revenues and SET's failure to admit any wrongdoing, along with the Commission's statement in the Gaming Show Cause Order that the Presiding Judge was free to consider non-monetary penalties

where appropriate, that this issue should be subject to further examination in the context of a hearing process that allows for fact-finding and discovery.

In addition, the CAISO provides the following comments concerning the arguments made by SET in its Show Cause Response with respect to the Paper Trading strategy. First, SET states that it is "confident that, based on its trading practices, SET always had the ability to meet its commitments," and references the Scheduling Coordinator Certification of External Imports of Ancillary Services filed with the CAISO, which is a certification of a Schedule Coordinator's ability to meet obligations to deliver Spinning Reserve, Non-Spinning Reserve, and/or Replacement Reserve to the CAISO. Show Cause Response at 15. This certification, however, does not have a testing component for imported resources and, instead, is simply a general agreement that the party will meet Ancillary Service obligations. The issue of Paper Trading in the context of the Gaming Show Cause Order is an hour-to-hour transactional issue that is not resolved by SET's confidence in its own trading practices nor the broader certification/agreement that SET can and will meet any obligations it has made to the CAISO. A thorough accounting of SET's resources in each hour concerning sell-back transactions that may represent Paper Trading would be necessary to determine whether or not SET actually was in a position to honor the obligations it made to the CAISO in the Day-Ahead Ancillary Service markets.

SET also argues that its own compliance with dispatch instructions is an indication that it always had resources to back the obligations it made to the CAISO in the Day-Ahead Ancillary Service markets, and references the small

share of rescinded Ancillary Service capacity payments attributed to SET. Show Cause Response at 16. This explanation overlooks the fact that the premise behind Paper Trading, as described by the Commission, is the closing of the day-ahead position in the hour-ahead market, in order to make a profit when resources did not actually exist to meet the Ancillary Service obligation in real-time. Instances of Paper Trading can not be screened out based on the rate of compliance with real-time energy instructions because SET's position would have already been closed via a buy-back in the hour-ahead market, making it impossible for the CAISO, in real time, to call upon these resources that had already been "sold back." Thus, the compliance figures cited by SET do not in any way demonstrate that SET did not engage in Paper Trading.

Finally, SET continues to argue that the transactions indicated as potential Paper Trading by the CAISO in its July 15, 2003 Report show only that SET engaged in legitimate arbitrage. Show Cause Response at 16-17. In fact, the transactions flagged by the CAISO indicate Ancillary Service buy-backs that are candidates for Paper Trading transactions. The difference between "legitimate arbitrage" and illegitimate arbitrage (or Paper Trading) can be determined only through evidence that SET did or did not have sufficient resources to back the Ancillary Service commitments that it made to the CAISO in the Day-Ahead Market. SET has not provided any such evidence in its Show Cause Response, with the Agreement, nor separately to the CAISO for verification.

D. Cutting Non-Firm

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

First, Staff mistakenly concludes that schedules must be categorized as "Non-Firm" in order to qualify as gaming practices. Agreement at ¶ 3.5. As noted in SET's own Show Cause Response, however, "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." 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 CAISO Report explains [with respect to cut non-firm schedules]:

> 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.[5]

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

A subsequent portion of the CAISO Report clearly explains that Cut Schedules identified in that report 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 CAISO 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.
>
> 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.[6]

Thus, the CAISO 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 proceeded to issue Show Cause Orders to all entities listed in the CAISO Reports with regard to Cut Schedules, after being provided with a clear

[6] "Supplemental Analysis Trading and Scheduling Strategies Described in Enron Memos," Department of Market Analysis, June, 2003 ("Supplemental Analysis") at 26.

explanation that the analysis summarized in that report reflected analysis that not limited to cutting of “non-firm” schedules.[7] 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” of “Wheels.” Thus, it is unreasonable for Staff to conclude that the Commission intended for the Show Cause proceeding to be limited to those transactions that involved the cutting of non-firm schedules.

Finally, SET’s Show Cause Response states that “SET did not submit schedules with the intention of subsequently cutting them or with the intention of otherwise failing to meet the commitments related to such schedules,” Show Cause Response at 9, but does not provide any evidence to establish this assertion. Rather, SET simply argues that the burden of proof should be shifted to the CAISO. Such a shift is inappropriate given that the Commission, in the Show Cause Orders, ordered SET and other parties, not the CAISO, to show cause why they had not engaged in the gaming practices identified therein. For example, SET cites the fact that the CAISO could not, based on CAISO data, explain the reason that 75% of the Cut Schedules identified by the CAISO were cut, but then proceeds to indicate that data produced by SET explain that only 3 of the schedules were cut by the CAISO.[8] Most importantly, SET’s Show Cause Response acknowledges that SET was not able to provide information that can explain why any of the other 45 schedules identified in the ISO Report were cut,

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

[8] In addition, SET neglects to mention that ISO logs contains information indicating that the other 25% of schedules identified by the ISO were cut by SET.

and "*submits that the question of which entity was responsible for cutting the schedule is necessarily an issue of material fact that should be addressed at the hearing*."[9] Finally, the CAISO notes that the congestion revenues earned by SET from Cut Schedules identified by the CAISO are relatively high ($399,000), and that SET ranks second (behind only Enron) in terms of revenues earned for potential Cut Schedules.[10]

Therefore, for the reasons stated above, the CAISO believes that SET's potential participation in the practice of Cut Schedules should be subjected to further review, which will allow collection of actual evidence relating to whether any of the schedules identified by the CAISO involve schedules which, as claimed by SET, SET never intended to deliver or SET knew it would not be able to deliver.

E. Scheduling Counterflows on Out-of-Service Lines

Staff proposes to dismiss the proceedings against SET with respect to the issue of Scheduling Counterflows on Out-of-Service Lines (Wheel Out) on the grounds that the Commission's definition of this practice is limited to situations in which the same participant first creates and then relives congestion on a line this is known to be out-of-service. Agreement at ¶ 3.6. 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 CAISO Report, upon which the Show Cause Orders were based. In fact, under Staff's overly restrictive

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[9] Show Cause Response at 9 n.22 (emphasis added).

[10] *See* Supplemental Analysis at 28.

reading, even Enron would be found never to have employed the “Wheel Out” strategy described in the Enron Memos.[11] 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 potential congestion, knowing that they may be able to earn congestion revenues for schedules they know they will not have to provide.[12]

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. Agreement at ¶ 3.6. 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

[11] In fact, under a situation that fits the interpretation used by Staff, no gaming opportunity would even exist, since a participant who first created congestion 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.

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

if there is congestion in the opposite direction for which the entity will receive a counterflow payment.

Finally, SET's Show Cause Response provides virtually no evidence relating to the key question of whether SET intentionally submitted schedules or adjustment bids on lines that SET's trader knew were out of service. *See* Show Cause Response at 12-14. Given the lack of any clear evidence that such scheduling was inadvertent or unintentional in the Show Cause Response, the CAISO believes this issue should be set for hearing to allow this key issue of material fact to be addressed.

III. Conclusion

For the reasons stated herein, the CAISO opposes the Agreement between SET and Commission Staff, with respect to the various gaming practices that are the subject of the Gaming and Partnership Show Cause Orders, and requests that the Commission reject the Agreement.

Respectfully submitted,

_*/s/ J. Phillip Jordan*_________
J. Phillip Jordan
Bradley R. Miliauskas
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W., Suite 300
Washington, DC 20007
Tel: (202) 424-7500

Charles F. Robinson,
General Counsel
Gene Waas,
Regulatory Counsel
The California Independent
System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: (916) 916-7049

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/ Michael Kunselman*__
Michael Kunselman
(202)295-8465