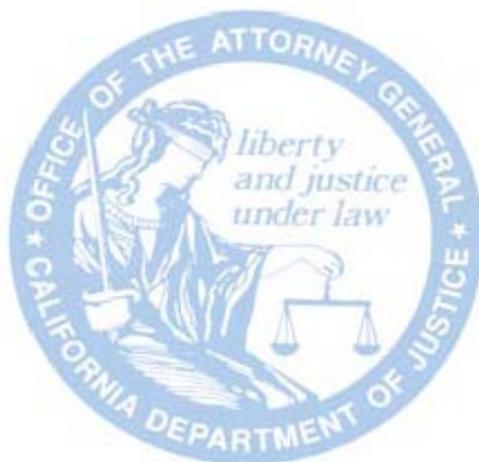


The California Energy Crisis 2000-2001

Update on Post-Crisis Developments

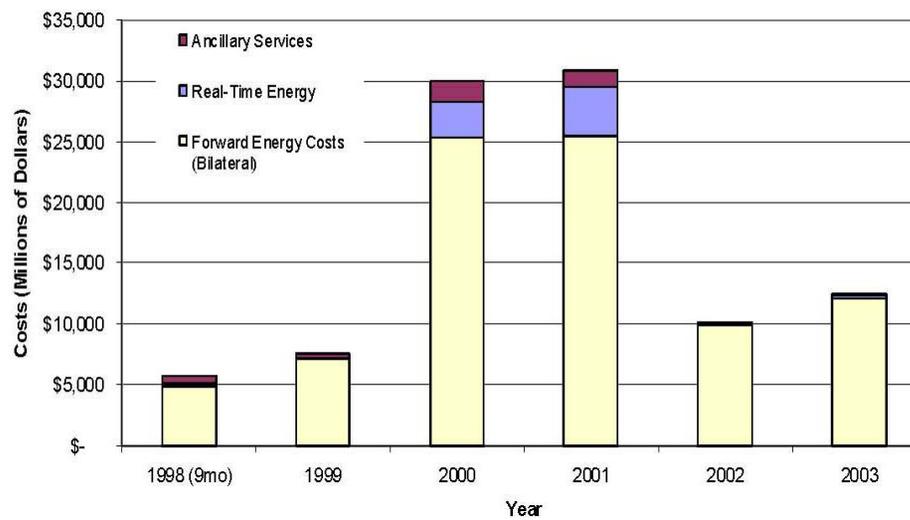
Briefing for the Little Hoover Commission, September 26, 2011

Martin Goyette, Office of the Attorney General



THE CRISIS

- AB 1890 sets up deregulated California energy market system - 1996
- Unprecedented market disruption, May 2000 - June 2001
 - Electricity prices spike and remain at triple previous levels
 - Pervasive market manipulation - Enron et al.
 - Deregulated market system breaks down, Power Exchange bankrupt
- Massive harm to State of California:
 - Major utilities insolvent - can't supply power
 - State forced to buy electricity to keep lights on - Department of Water Resources (DWR) begins emergency power purchases in January 2001
 - DWR signs 58 long term contracts totaling \$42 billion to reduce vulnerability to volatile, exorbitant spot market
 - Total cost of energy goes from \$7.4 billion in 1999 to over \$27.1 billion in 2000 and \$26 billion in 2001 -- \$40 billion extra due to market manipulation



RESPONSES TO THE CRISIS

- **Investigation** uncovers rampant market manipulation
- **Legal actions** seek over \$9 billion refunds on short term energy overcharges and reduction of inflated long term contract prices - efforts continuing
- **Settlements** and contract renegotiations so far provide over \$10 billion in benefit to California ratepayers - efforts continuing
- **AG White Paper** - law enforcement perspective and recommendations

Investigation

AG Energy Task Force established on urgent basis in late 2000

15 attorneys and investigators assigned, energy market experts hired

Subpoenas to 70 energy sellers, enforced in court

Reviews millions of pages of documents, questions hundreds of witnesses.

Cooperation with other investigating agencies, including PUC, ISO, EOB, US Attorney

Discovery of "smoking gun" evidence of gaming by Enron and others, manipulation of energy prices by shutting down power plants and withholding power during emergencies.

Legal Actions: Refund Claims at FERC

The California Parties (AG, PUC, EOB, investor-owned utilities) have filed complaints at FERC seeking \$9 billion + interest in refunds on high priced short term energy purchases, based on energy market manipulation and malfunction.

Sellers oppose refunds, claiming the right to charge whatever the market will bear, based on approval by FERC to charge market-based rates, and the "filed rate doctrine" barring challenge to FERC-approved rates.

We contend sellers violated the conditions for market-based rates, violated tariff rules, and that FERC failed to enforce rules. FERC is required by Federal Power Act to assure "just and reasonable" rates, and must provide a remedy.

- **Most short term refund claims are divided into 3 time periods by FERC rulings:**

- 1) May - September 2000 ("Summer") purchases by utilities: \$2.5 billion + interest
Status: FERC proceeding in progress
- 2) October 2000 – June 2001 ("Refund Period") purchases in organized ISO/PX markets: \$3 billion + interest
Status: Refunds ordered by FERC
- 3) January – June 2001 DWR bilateral purchases outside ISO/PX markets: \$3.5 billion + interest
Status: Refunds refused by FERC; seeking further hearing

- **Four major FERC refund actions**

SDG&E v. Sellers (Docket EL00-95)

FERC orders refunds on Oct. 2000 - June 2001 ISO/PX market ("Refund Period") purchases, measured by difference between actual prices and just and reasonable prices as measured by "mitigated market clearing price" methodology. Ninth Circuit affirms refund order.

FERC refuses refunds on Summer purchases. Ninth Circuit reverses, orders FERC to reconsider. Summer refunds now in litigation at FERC.

FERC refuses refunds on DWR bilateral purchases. Ninth Circuit affirms, finding bilateral purchases outside scope of this action, but may be sought in other FERC proceedings. AG responds by filing new FERC action, *Brown v. Powerex* (below), for refunds on DWR purchases.

Lockyer v. FERC (Docket EL01-10)

AG challenges market rates in all energy crisis transactions based on sellers' failure to report transactions and FERC's failure to enforce its own rules. FERC dismisses the complaint. Ninth Circuit reverses, finding FERC abandoned its duty to supervise energy markets:

Despite the promise of truly competitive market-based rates, the California energy market was subjected to artificial manipulation on a massive scale. With FERC abdicating its regulatory responsibility, California consumers were subjected to a variety of market machinations, such as "round trip trades" and "hockey-stick bidding," coupled with manipulative corporate strategies, such as those nicknamed "Fat Boy," "Get Shorty," and "Death Star." (383 F.3d 1006.)

On remand from the Ninth Circuit, FERC again dismisses complaint. AG seeks rehearing by FERC.

Puget Sound Energy (Docket EL02-71)

Challenge to exorbitant prices paid by DWR in bilateral transactions in the Pacific Northwest. FERC dismissed on the grounds that it was too complicated to calculate a remedy, and that DWR's purchases at Oregon border weren't in Pacific Northwest. The Ninth Circuit rejected FERC's rationales and remanded to FERC in 2009 for further hearing. We are still waiting for FERC to set a hearing on remand.

Brown v. Powerex (Docket EL09-56)

In 2009, following the Ninth Circuit holding that DWR bilateral purchases were outside the scope of the *SDG&E v. Sellers* case, the AG filed a new complaint at FERC for refunds on those purchases, based on market manipulation, exercise of undue market power, misreporting, and FERC's failure to ensure just and reasonable rates. In May 2011, FERC dismissed the case without a hearing. Our rehearing request is pending at FERC.

Other Legal Actions

Numerous antitrust and unfair business practice lawsuits against market manipulators have settled or been dismissed based on filed rate doctrine and federal pre-emption.

DWR breach of contract award - \$73 million for ratepayers.

Current litigation includes:

- PUC/EOB FERC action challenging DWR long term contracts based on market manipulation and excessive prices
- FERC action for \$45 million refunds on short term energy bought June-Dec. 2001
- U.S. District Court action challenging Powerex short term sales to DWR
- U.S. Court of Claims and Superior Court lawsuits for energy refunds
- Federal court appeals of FERC decisions

Settlements

The discovery of "smoking gun" evidence of market manipulation and aggressive litigation efforts have provided leverage for the settlement of the California Parties' short term energy refund claims with the majority of sellers, and DWR's renegotiation of most of its long term energy contracts. We continue to actively seek settlement with the remaining counterparties, based on a realistic litigation risk analysis and on terms consistent with prior settlements with similarly situated parties. However, approximately \$5 billion in refunds owed by 18 sellers and challenges to three long term contracts remain at issue. We will continue to pursue litigation with those who are not willing to discuss settlement on reasonable terms.

- **Settlements with 53 sellers so far -- settlement efforts continuing**
- **\$4+ billion recovered**
- **DWR renegotiates 35 of 58 long term contracts, saving \$7.5 billion**
- **Settlements reduce energy crisis costs to California ratepayers**

<u>Charges</u>	
05/01/2011 - 05/23/2011	
Electric Charges	
Baseline Quantity	190.90000 Kwh
Baseline Usage	103.12903 Kwh @ \$0.12233
Net Charges	
The net charges shown above include the following component(s). Please see definitions on Page 2 of the bill.	
Generation	\$3.64
Transmission	1.68
Distribution	3.72
Public Purpose Programs	1.58
Nuclear Decommissioning	0.07
DWR Bond Charge	0.52
Ongoing CTC	0.91
Energy Cost Recovery Amount	0.49
<u>Taxes and Other</u>	
Energy Commission Tax	
<u>TOTAL CHARGES</u>	

Energy crisis refund settlements reduce Generation charges for DWR-provided power, shown on a sample PG&E customer bill.

ATTORNEY GENERAL'S ENERGY WHITE PAPER

A Law Enforcement Perspective on the California Energy Crisis

The Attorney General's Energy White Paper was published in 2004, based on lessons learned by the AG's Energy Task Force in its investigation and litigation on behalf of Californians seeking compensation for the effects of the crisis. It described the breakdown of the state's deregulated energy markets and shortcomings in the laws, regulatory agencies and availability of consumer remedies for market abuses. It also offered recommendations for improving enforcement and protecting consumers in a deregulated market. It was provided to the relevant state and federal officials and legislators. Although energy market monitoring and enforcement capability has improved since the 2000-2001 crisis, problems remain, especially at the federal level. Below are summaries of key recommendations and their current status. For more detailed information, we recommend consultation with energy regulatory bodies such as the PUC and ISO.

Energy White Paper Recommendations

Federal Law: The Filed Rate Doctrine and FERC's Oversight of Market-Based Rates

The most important recommendation of the White Paper was to amend the Federal Power Act (FPA) and Natural Gas Act (NGA) to specify that the filed rate doctrine does not apply to market-based rates. This has not been done.

Another important recommendation was to amend the FPA and NGA to allow retroactive refunds, as during the energy crisis the FPA only permitted refunds on transactions beginning 60 days *after* a complaint was filed, and the NGA only allowed refunds on transactions beginning on the date of a FERC order responding to a complaint. The FPA was amended to allow refunds on transactions beginning on the date a complaint is filed, but not retroactive refunds. The NGA has not been amended.

We also recommended that FERC's market monitoring authority be increased. This recommendation was at least partially addressed by provisions of the 2005 Energy Policy Act, which expanded FERC's authority to respond to and punish fraudulent or misleading conduct, and FERC's establishment of a Division of Enforcement.

Finally, we recommended that FERC recognize the importance of consumer protection by allowing compensation of consumer representatives for a "substantial contribution" to FERC proceedings, as is provided in California with respect to PUC proceedings. This recommendation has not been adopted.

State Regulatory, Enforcement and Legal Structures

The White Paper recommended an increase in ISO market monitoring ability, and referral of certain violations to the AG. Since the crisis, the ISO has added market manipulation rules and increased its market monitoring capabilities. However, FERC has refused to permit the ISO to share commercially sensitive market information with the AG to aid potential enforcement actions.

Cooperation Among Federal and State Enforcement Agencies

We recommended amendments to federal law to require greater FERC cooperation and information sharing with state and local investigations. These recommendations have not been adopted.