REPORT

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Federal Energy Regulatory Commission

The Commission’s Response to the California Electricity Crisis and Timeline for Distribution of Refunds

December 27, 2005
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**Executive Summary**
This report was prepared by the Staff of the Federal Energy Regulatory Commission (Commission) in response to section 1824 of the Energy Policy Act of 2005, (EPAct 2005),¹ which requires the Commission to seek to conclude its investigation of unreasonable charges during the California electricity crisis as soon as possible, ensure that refunds owed to California are paid, and submit to the United States Congress by December 31, 2005 a report describing actions taken and timetables for further action. The report describes the actions the Commission has taken to remedy, through refunds and settlements, unjust and unreasonable prices charged during the California electricity crisis, and the timeline for conclusion of remaining outstanding matters.

To date, the Commission staff has facilitated settlements resulting in over $6.3 billion. This includes amounts related to the settlement of issues regarding allegations of market manipulation in the West during the period January 2, 2000 to June 20, 2001 (herein referred to as the “Market Manipulation Proceeding”) as well as settlements involving the investigation of the justness and reasonableness of wholesale electric rates for sales into the California Independent System Operator Corporation (California ISO) and California Power Exchange (Cal PX or PX) markets for the period October 2, 2000 through June 20, 2001 (referred to herein as the “California Refund Proceeding”). Thus, a sizeable portion of refunds have been returned via settlements; and the Commission has completed all but one of the 60 investigations regarding market manipulation. No one can dispute that the California Refund Proceeding has gone on far too long. The lack of closure contributes to the uncertainty in California - - some refunds are still owed and owing; investment, and recovery of that investment, is unclear; and the state of the transmission grid and electricity markets remains vulnerable.²

The Commission and its Staff have worked diligently with the California parties (and others) to address the many issues in the California Refund Proceeding, to reach settlements, and to address flawed rules that were in place in the California ISO electric energy markets during the California energy crisis; and we remain committed to doing so to help ensure that there is not a repeat of the California crisis.

² Since June 2001 (the end of the California electricity crisis), the California ISO has experienced 12 system emergencies where load had to be interrupted and customers were without electricity. On August 25, 2005, for example, the loss of a major western transmission line caused a power outage in Southern California. The more recent system emergency occurred on September 12 at 12:32 p.m. when the Los Angeles area experienced a power outage that affected approximately 2,000,000 people (2,200 MW) because of a maintenance error at a substation that is a major source of power to the city.
Congress recently provided the Commission with tools not previously available to it. The Federal Power Act (FPA)\(^3\) did not address market manipulation and there was little in the way of penalty authority. The Commission’s civil penalty authority was available only in very limited circumstances under Part II of the FPA and not at all for violation of the Natural Gas Act (NGA).\(^4\) For violations not subject to civil penalties, the only available civil remedies were refunds, disgorgement of unjust profits or revocation of market-based rate authority in the electric wholesale markets. The Commission used these very tools to remedy the abuses in the California markets. However, EPAct 2005 added a prohibition on market manipulation and provided the Commission enhanced civil penalty authority with regard to instances of market manipulation. If the express prohibition of market manipulation had been in place then, it is very possible that it would have deterred market participants from manipulating the market because they would have known the serious consequences of their actions. Although this would not have eliminated all the price increases due to the shortages that existed in California at that time, it certainly could have lessened the severity of the crisis. Regardless of the past, upon implementation of these new authorities, the Commission is better poised to address market abuses should they occur in the future.\(^5\)

Bringing closure to the California Refund and the Market Manipulation Proceedings is a priority. While the Market Manipulation Proceedings are coming to a close, work remains on the California Refund Proceeding, despite the efforts of the Commission and many others to resolve this proceeding. Final action on the issuance of orders depends on actions by parties other than the Commission, such as the California Independent System Operator (California ISO) and the federal courts. For that reason, it is not possible to provide a date certain at this time for the conclusion of the California Refund Proceeding. The California Refund Proceeding is a contentious proceeding with over 100 active parties and many factual elements that are disputed time and again. The evidentiary hearing took 18 months to complete and the hearing record consists of 5,945 pages. The supporting exhibits encompass over 20 shelf feet with more than a yard of briefs addressing the stipulated issues. In August 2005, the Commission issued an order


\(^5\) On October 20, 2005, the Commission, in order to implement the anti-manipulation provisions of FPA section 222, issued a Notice of Proposed Rulemaking to adopt new rules. *See Prohibition of Energy Market Manipulation*, 113 FERC ¶ 61,067 (2005). On October 20, 2005, the Commission issued an Enforcement Policy Statement to provide guidance to the industry on the approach it will take to future enforcement. *See Enforcement of Statutes, Orders, Rules, and Regulations*, 113 FERC ¶ 61,068 (2005).
that revised the procedural schedule for the California Refund Proceeding to accelerate the issuance of refunds. As we continue to work through the final stages of the California Refund Proceeding, we must balance the need for quick resolution against the rights of parties to due process. It is very important that the Commission-adopted procedures for addressing refund issues strictly adhere to the due process principles, to ensure that the Commission’s determinations withstand judicial scrutiny on due process grounds. Otherwise, we may have to revisit decisions already made, which could delay issuance of refunds by years. We are committed to progressing as quickly as the law will allow.

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INTRODUCTION

Section 1824 of the Energy Policy Act of 2005 (EPAct 2005) requires the Commission to conclude its investigation of unreasonable charges during the California electricity crisis as soon as possible, to ensure that refunds owed to California are paid, and to submit to the United States Congress by December 31, 2005 a report describing actions taken and timetables for further action. This Report provides a brief background of the structure of the California markets at the time of the crisis, explains the actions taken by the Commission, and reports on the status of the Commission’s proceedings.

STRUCTURE OF CALIFORNIA MARKETS

Electric restructuring in California was initiated by the California Public Utilities Commission (CPUC) and followed by legislative enactment of Restructuring Legislation, under Assembly Bill 1890 (AB1890). California’s restructuring provided for the establishment of two new entities – the Power Exchange (PX) and the California Independent System Operator (California ISO). The California ISO is responsible for operating and maintaining the grid, which includes resolving congestion, purchasing power to maintain reliability, and determining the need for transmission upgrades. The PX was created to function as the principal power market. The PX acted as a clearing house for daily and hourly markets; established prices for a day-head market based on demand quantities and prices it received from parties trading through the PX; and submitted balanced schedules to the California ISO. It remained in this role until January 2001 when it ceased operations.

To participate in the California ISO market, an entity had to be approved as a Scheduling Coordinator. A Scheduling Coordinator is responsible for submitting a balanced schedule to the California ISO on behalf of itself or the market participants for which it serves as Scheduling Coordinator. The PX was a Scheduling Coordinator on behalf of many market participants. Thus, the California ISO and PX were central figures in the California markets - providing the vehicle through which energy was bought and sold, holding collateral for market participants, and settling accounts. As such, the California ISO and PX are intricately involved in the resolution of the proceedings before

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7 The legislation was unanimously approved by the California Legislature.

8 The Commission found the PX to be jurisdictional because it exerted active control over the sales of electric energy at wholesale in interstate commerce and was engaged in sales for resale. See Pacific Gas and Electric Company, 77 FERC ¶ 61,204 (1996).

9 See PX’s Notice of Suspension of Trading, Docket No. EL00-95-000, January 30, 2001.
the Commission.

THE COMMISSION’S RESPONSE TO THE CALIFORNIA ELECTRICITY CRISIS

On August 23, 2000, the Commission initiated a formal investigation (referred to herein as the “California Refund Proceeding”) to determine the justness and reasonableness of rates for sales into the California ISO and PX markets. That investigation also examined whether the tariffs and institutional structures and bylaws of the California ISO and PX were adversely affecting the efficient operation of competitive wholesale electric power markets in California and needed to be modified. This proceeding arose as a result of price spikes in the California ISO and PX markets during the summer of 2000. The Commission set a “refund effective date,” i.e., the first day for which refunds could be allowed, of October 2, 2000, the earliest day permitted under the Federal Power Act (FPA) at that time. The Commission may also be able to order disgorgement of unjust profits for the period between January 1, 2000 and October 2, 2000.

In November 2000, the Commission issued an order in the California Refund Proceeding based on the results of a Commission Staff fact-finding investigation of the California power markets which had begun in July 2000 and

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12 The Court of Appeals for the Ninth Circuit ruled in Lockyer v. FERC, 383 F.3d 1006 (2004), that the FPA allows market-based rates for public utilities lacking market power and that the Commission has authority under the FPA to order retroactive remedies for sellers that failed to comply with the Commission’s reporting requirements. The Ninth Circuit interpreted the FPA to provide the Commission with broader authority than the Commission believed the Act provided. Parties have sought rehearing of the court’s opinion, but the court has not acted; the Commission is still awaiting the issuance of a court mandate returning the record to the Commission.


14 Staff Report to the Federal Energy Regulatory Commission on Western Markets
which concluded that a number of factors contributed to the California electricity crisis of 2000 and 2001. These included: flawed market rules; inadequate addition of generating facilities in the preceding years; a drop in available hydropower due to drought conditions; a rupture of a major pipeline supplying natural gas into California; strong growth in the economy and in electricity demand; unusually high temperatures; an increase in unplanned outages of extremely old generating facilities; and market manipulation by some sellers.

The Commission took a number of significant steps in an effort to end the crisis: correcting market rules that were contributing to the crisis, mitigating prices, adopting prospective mitigation rules, and providing for an after-the-fact determination of refunds attributable to prices above just and reasonable levels. By way of example, in December 2000 the Commission eliminated the AB 1890 legislative requirement that the investor-owned utilities in California sell all of their generation into and buy all of their generation from the PX. The Commission also required sellers to report and justify sales above certain prices, as well as to offer for sale to California markets all power available from their facilities (referred to as the “must offer” requirement). Because of the regional impact of the 2000-2001 crises, the Commission extended the “must offer” requirement to generators throughout the West in June 2001. Similarly, it imposed price mitigation throughout the West.

In February 2002, the Commission established a fact-finding investigation of potential market manipulation of electric and natural gas prices in the West. The investigation was time- and resource-intensive involving extensive data gathering and

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16 Id.


19 Id.
analysis. Staff received in excess of 70 boxes of written materials and an equivalent of more than 900 compact discs of electronic data. In March 2003, the Commission Staff released a Final Report, finding evidence of significant market manipulation in Western energy markets during 2000 and 2001. The Final Report also concluded that published indices of natural gas prices in or near California were not reliable. This spawned additional formal investigations of sellers, and the Commission pursued disgorgements of unjust profits of sellers that engaged in market manipulation (referred to herein as the “Market Manipulation Proceedings”). As part of the Market Manipulation Proceedings, Commission Staff conducted an investigation of potential anomalous bidding behavior and practices in the PX and California ISO markets, and instances of illegal gaming and physical withholding.

a. California Refund Proceeding

Having found that electricity spot prices in the California ISO and PX markets were unjust and unreasonable, the Commission in July 2001 ordered refunds based upon a mitigated market price. The Commission set forth a formula to use in calculating the mitigated market price and established an evidentiary hearing proceeding before an Administrative Law Judge (ALJ) to, among other things, compile the data needed for the formula which relied on heat rates of generating units and natural gas prices as published by indices. The evidentiary hearing took 18 months to complete and involved more than 100 parties. The complete hearing record spans 5,945 pages. The supporting exhibits sponsored by more than 100 active parties and Staff takes up more than 20 shelf feet and there is more than a yard of briefs which address the stipulated issues. In December 2002, the ALJ issued an initial decision on the formula and found that power suppliers owed an estimated $1.8 billion in refunds and that the California ISO and PX owed suppliers cash payments of $3 billion.

Three months later, in March 2003, the Commission issued an order largely

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20 This number is an approximation derived from 1200 gigabytes of data submitted, as reported in Final Report on Price Manipulation in Western Energy Markets: Fact Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices, Docket No. PA02-2-000 (March 26, 2003) (Final Report).

21 See id.


adopting many of the ALJ's findings.\textsuperscript{24} However, based on the finding in the Final Report that, because of manipulation, the published fuel price indices were not reliable, the Commission revised the formula for determining the mitigated market prices and required the use of marginal fuel costs (\textit{i.e.}, reported natural gas prices in production fields plus pipeline transportation costs) instead of fuel price indices. This had the overall effect of increasing refund liabilities and potentially causing certain individual sellers to under-recover their costs of providing electricity for sale to California spot markets.

The FPA mandates that the Commission cannot set rates at confiscatory levels. Suppliers of energy or service must be allowed to recover legitimate and verifiable costs incurred in providing the energy or service, plus a reasonable rate of return. If the refund liabilities exceed the costs incurred by sellers in producing and/or delivering energy, the refund amounts may be challenged in courts. If refunds are found to be confiscatory, the Commission would have to revisit the refund issues, which would delay issuance of refunds by years. For these reasons, in accordance with its statutory obligation to prevent setting confiscatory rates, the Commission stated it would allow sellers the opportunity to recover their actual costs in excess of revenues received as a result of the mitigated market price. The Commission will permit sellers who are able to demonstrate such legitimate costs to offset these costs against their refund liability. The Commission: (1) established a separate expense category for demonstrable emissions costs, including NO\textsubscript{X} costs and other environmental mitigation fees, which sellers may subtract from their respective refund obligations;\textsuperscript{25} (2) provided generators the opportunity to claim an allowance for demonstrated fuel costs in excess of the amount allowed under the mitigated market price formula;\textsuperscript{26} and (3) provided an opportunity for all sellers to submit evidence demonstrating that the refund methodology creates an overall revenue shortfall for their transactions made during the refund period.\textsuperscript{27} The purpose of this has been to ensure that no seller’s mitigated revenues fall below the cost the seller incurred to serve


\textsuperscript{26} \textit{See supra} n. 24.

California markets. Each of these opportunities spawned additional proceedings.

The California ISO, in addition to rectifying settlement data, has also calculated the mitigated market clearing prices based on Commission orders. The California ISO and PX will both be required to resettle obligations with market participants as a result of the Commission’s proceedings.

Accordingly, the refund calculation and resolution process consists generally of four stages: (1) settling past accounts in order to have an accurate baseline from which to calculate refunds; (2) establishing just and reasonable market clearing prices through use of a formula (mitigated market price); (3) providing opportunity for sellers to demonstrate under-recovery of actual costs; and (4) final accounting and payment. Each of these parts is data and information intensive and continues to generate controversy. The status of each of these is discussed further below.

b. Market Manipulation Proceedings (Disgorgement Proceedings)

In addition to the California Refund Proceeding described above, in February 2002, the Commission directed its Staff to investigate whether Enron Power Marketing, Inc. (Enron), or any other entity participating in the wholesale energy markets in the West, had manipulated prices for electricity or natural gas or otherwise exercised undue influence over wholesale electricity or natural gas prices since January 1, 2000. The Commission Staff conducted an extensive investigation, issuing numerous data requests and subpoenas, and conducting depositions.

In March 2003, the Commission Staff released the Final Report, finding evidence of significant market manipulation in Western energy markets during 2000 and 2001. Key findings were that markets for natural gas and electricity in California are inextricably linked and that the artificially inflated increases in spot gas prices contributed to the rise in electricity prices. The problems in the natural gas market appeared to stem, in part, from efforts to manipulate price indices compiled by trade publications. In addition, the Final Report concluded that many trading strategies used by Enron and other companies violated anti-gaming provisions of the Commission-approved tariffs for the California ISO and PX. This report resulted in additional formal

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30 See supra n. 20.
investigations of sellers’ gaming activities, and the Commission, which at that time lacked civil penalty authority, asserted authority to order disgorgement of unjust profits resulting from market manipulation, in addition to the refunds at issue in the California Refund Proceeding.

In June 2003, the Commission found that Enron engaged in gaming activities in the form of impermissible trading strategies. The Commission revoked the market-based rate authorization of the Enron-affiliated electricity marketers, thereby terminating their ability to make any sales under market-based rates.\(^{31}\)

Also in June 2003, the Commission commenced an investigation of potential anomalous bidding behavior and practices in the PX and California ISO markets.\(^{32}\) Specifically, the Commission instructed Staff to determine whether any entities that bid above $250/MWh between May 1 and October 1, 2000, violated the anti-gaming provisions of the PX and California ISO tariffs. In these proceedings, Commission Staff was able to negotiate settlements worth more than $90 million, which are discussed in further detail below.

The Commission began two other cases in June 2003, challenging gaming strategies criticized in the Final Report.\(^{33}\) Together, the cases involved over 60 power trading companies alleged to have engaged in market manipulation either unilaterally or with other entities. All companies (except Enron) opted to settle the allegations and return the revenues they had obtained as a result of using those strategies.

To address the possibility of additional manipulation on a generic basis, soon after issuance of the Final Report, the Commission proposed new restrictions and reporting requirements (the Market Behavior Rules) on all blanket certificates for wholesale sales of natural gas and market-based rate authorizations for sales of wholesale power. After receiving public comment, the Commission adopted the Market Behavior Rules in November 2003.\(^{34}\) These rules set guidelines for the conduct of sellers with market-based rate authority, and provide remedies for anticompetitive behavior or market abuses. For example, the Market Behavior Rules prohibit actions and transactions that lack a legitimate business purpose and that are intended to, or foreseeably could, manipulate


\(^{34}\) Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, 105 FERC ¶ 61,218 (2003).
prices or markets. Certain types of conduct, such as transactions based on false information, transactions to create and relieve artificial congestion, and collusive transactions, are specifically prohibited. Sellers may not submit false or misleading information nor omit material information in any communication with the Commission, market monitors, regional transmission organizations or independent system operators. A seller found to have engaged in prohibited behavior under the Market Behavior Rules is subject to disgorgement of unjust profits and revocation of the seller’s market-based rate authority or blanket certificate authority.

The Commission’s response to the instances of market manipulation was limited by the enforcement authority it possessed at the time. The Commission sought from Congress additional regulatory tools to deter market power abuse, comparable to those possessed by other economic regulatory bodies. Congress agreed with the Commission on the importance of preventing and sanctioning market manipulation and provided in EPAct 2005 for enhanced enforcement authorities for the Commission. This legislation provided the Commission with new enforcement authorities that will help ensure that we do not have a repeat of the California energy crisis.

Specifically, EPAct 2005 added to the FPA an explicit prohibition on the use of manipulative or deceptive devices in connection with the purchase or sale of electric energy or transmission service subject to the jurisdiction of the Commission, in contravention of the Commission’s rules and regulations, and increased criminal and civil penalties for violations of Part II of the FPA or any rules or orders thereunder. EPAct 2005 added similar provisions to the Natural Gas Act. The Commission recently issued proposed rules to implement these new anti-manipulation provisions and to repeal or modify its existing behavioral rules in light of the new provisions. Contemporaneously with the proposed anti-manipulation rules, the Commission issued an Enforcement Policy Statement to provide guidance to the industry on how the Commission intends to apply its new and expanded civil penalty authority.

c. Settlements

The Commission has always encouraged parties involved in contentious proceedings to work toward settlements instead of litigating, because the Commission

35 EPAct 2005 § 1283.

36 Id. § 315.


38 Enforcement of Statutes, Orders, Rules, and Regulations, 113 FERC ¶ 61,068 (2005).
believes that settlements can be the best way to resolve disputes fairly, efficiently and cost-effectively. With respect to the California Refund Proceeding, the Commission Staff has diligently worked with parties to reach settlements in order to expedite closure of the proceeding and restore confidence in the California markets. In the Commission’s view, restoring confidence in California markets is critical to motivating future investment in transmission and generation facilities necessary to the long-term health and competitiveness of the wholesale electricity market. Commission Staff’s active involvement in settlement negotiations has facilitated a significant number of settlements. Currently, the total amount obtained through settlements with Western energy providers exceeds $6.3 billion. These settlements resolve claims relating to both market manipulation as well as refund obligations. Settlements include:

1. Settlements Resolving Solely Market Manipulation-Related Claims

(1) April 2001 - the Commission approved a settlement between its Market Oversight Staff and Williams Energy Marketing & Trading Company (Williams) and AES Southland, Inc., in which Williams agreed to pay refunds in the amount of $8 million.\(^{39}\)

(2) November 2002 - the State of California, with the assistance of Commission’s Chief ALJ, reached a settlement with Williams to restructure certain energy contracts. The settlement resulted in an estimated $1.64 billion in savings and payment.\(^{40}\)

(3) January 2003 - the Commission approved a settlement with Reliant Companies\(^{41}\) and its affiliates, obligating Reliant to pay $13.8 million.\(^{42}\)

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\(^{39}\) AES Southland, Inc., 95 FERC ¶ 61,167 (2001).


These settlements resolved allegations that the generators acted improperly in the market during the period.

(4) July 2003 - the Commission approved a settlement under which Enron agreed to reduce the prices it charged Southern California Edison Company for power from a number of Enron-owned Qualifying Facilities.\footnote{The Commission’s regulations provide in detail the technical and ownership criteria for Qualifying Facility status. See 18 C.F.R. §§ 292.203-206 (2005).} The settlement provided an immediate benefit to California ratepayers of approximately $11 million, and future rate reductions worth \textit{\$41 to \$47 million} on a net present value basis.\footnote{Investigation of Certain Enron-Affiliated Qualifying Facilities, 104 FERC ¶ 61,089 (2003).}

(5) July 2003 - the Commission approved a settlement of El Paso Electric Company’s (El Paso Electric) involvement with Enron in activities that affected prices and markets in the West. The settlement required El Paso to refund $15.5 million to the California Department of Water Resources for ultimate distribution to consumers, and suspended the company’s market-based rate authority for two years.\footnote{El Paso Electric Co., 104 FERC ¶ 61,115 (2003).}

(6) July 2003 - the Commission approved a settlement between the Commission Staff and BP Energy Company (BP Energy), which resolved all issues arising from a preliminary, non-public investigation conducted as part of the Market Manipulation Proceedings. The settlement required BP Energy to pay $3 million to fund low-income home energy assistance programs for customers in California and Arizona.\footnote{Fact-Finding Investigation into Possible Manipulation of Electric and Natural Gas Prices, 104 FERC ¶ 61,089 (2003).}


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all outstanding issues with respect to Reliant arising from the market manipulation investigation, physical withholding investigation, and anomalous bidding investigation. The settlement provided $50 million for the benefit of California and Western electricity customers.\(^{48}\)

(8) December 2003 - the Commission approved a settlement with Duke Energy, requiring Duke Energy to pay $2.5 million into a deposit fund account established by the United States Treasury on behalf of the Commission for ultimate distribution for the benefit of California and Western electricity consumers. The settlement resolved allegations that Duke Energy had engaged in anomalous bidding and improperly withheld its power supply during the energy crisis.\(^{49}\)

(9) 2003-2004 - the Commission approved settlements in which Portland General Electric Company (Portland General) and Avista Corporation (Avista) each settled with Commission Trial Staff, agreeing to pay $8.5 million and $75,000, respectively.\(^{50}\) The settlement resolved issues in the Commission’s August 13, 2002 investigation into whether any Commission rules were violated by Enron’s dealings with Portland General and Avista.\(^{51}\)

(10) 2003-2004 - the Commission approved settlements which resolved issues in the gaming investigations against 19 sellers. These settlements resulted in the total payment of over $22 million.\(^{52}\)


\(^{51}\) Portland General Electric Co., 100 FERC ¶ 61,186 (2002); and Avista Corp., 100 FERC ¶ 61,187 (2002).

2. Global Settlements: California Refund Proceeding and Market Manipulation Issues

The Commission has approved nine global settlements resulting in approximately $4.5 billion in refunds or other benefits to California and others, which constitute approximately more than half of the estimated refund liability owed by jurisdictional entities. Despite the magnitude and encompassing nature of these settlements (several address pre-October 2000 issues), not all parties have chosen to join the settlements. Settlements include:

(1) November 2003 - the Commission approved a settlement with El Paso Natural Gas Company,\textsuperscript{53} that benefited California ratepayers by approximately $1.45 billion.\textsuperscript{54}

(2) July 2004 - the Commission approved a settlement with Williams Companies, Inc. and Williams Power Company, Inc. (Williams) that benefited California ratepayers by approximately $140 million.\textsuperscript{55}

(3) October 2004 - the Commission approved a settlement with Dynegy, Inc. (Dynegy) that benefited ratepayers by approximately $281 million.\textsuperscript{56}

(4) December 2004 - the Commission approved a settlement with the Duke

\textsuperscript{53} This settlement was a joint settlement with El Paso Merchant Energy-Gas, L.P. and El Paso Merchant Energy Company.


Companies\textsuperscript{57} that benefited ratepayers by approximately $207.5\textsuperscript{58} million.\textsuperscript{58}

(5) April 2005 - the Commission approved a multi-party settlement involving Mirant Companies\textsuperscript{59} (Mirant) and others resolving all issues involving Mirant arising from the energy crisis. If approved by the bankruptcy court, the settlement will transfer approximately $495 million to the State of California and others.\textsuperscript{60}

(6) November 2005 - the Commission approved the Enron settlement agreement with the California Public Utilities Commission, California Attorney General, California investor-owned utilities, the California Department of Water Resources, and the California Electricity Oversight Board and the Attorneys General of Oregon and Washington.\textsuperscript{61} The major terms of the settlement with Enron are: (1) Enron’s payment of $47 million in cash or its equivalent; (2) an allowed unsecured claim in bankruptcy of $875 million; and (3) a $600 million civil penalty in favor of the Attorneys General of California, Oregon, and Washington.


\textsuperscript{61} Enron Power Marketing, Inc., 113 FERC ¶ 63,002 (2005).
(7) November 2005 - the Commission approved the Enron settlement agreement with New West Energy Corporation and the Salt River Agricultural Improvement and Power District. The terms of the settlement with Enron include a cash payment totaling $884,000 and non-monetary considerations.

(8) December 2005 - the Commission approved the settlement of the Public Service Company of Colorado (Colorado PSC) with the California Parties and Commission Market Oversight Staff. The Settlement resolves all issues in the California Refund Proceeding and market manipulation Proceedings, including the investigation of gaming and physical withholding. The terms of the settlement with Colorado PSC include payment of monetary considerations totaling over $7 million.

(9) December 2005 - the Commission approved the settlement among Reliant, the California Parties, and Commission Market Oversight Staff. Under the terms of this settlement, Reliant is to make cash payment in the amount of $460 million.

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63 The California Parties, for purposes of the settlement with the Colorado PSC, are: Pacific Gas & Electric Company (PG&E), Southern California Edison Company (SCE), San Diego Gas & Electric Company (SDG&E), the People of the State of California, ex rel. Bill Lockyer, Attorney General, and the California Department of Water Resources.


65 The California Parties, for purposes of the Reliant Settlement, are: PG&E, SCE, SDG&E, the People of the State of California, ex rel. Bill Lockyer, Attorney General, the California Electricity Oversight Board (CEOB), and the CPUC.

ESTIMATED TIMELINE FOR COMpletion OF DISTRIBUTION OF REFUNDS

As mentioned, there are four stages to the California Refund Proceeding. These consist generally of: (1) settling past accounts in order to have an accurate baseline from which to calculate refunds, which has been completed; (2) establishing just and reasonable market clearing prices through use of a formula, which has been completed; (3) adjusting the refund obligations to account for emissions, fuel and general cost recovery offsets; and (4) final accounting and payment. In an effort to ensure due process but yet efficiently close the proceeding, the Commission is allowing as short a time frame as possible for filings, comments and responses in its administrative procedures. Further, the Commission is adjudicating the disputes through an administrative process as opposed to lengthy protracted litigation procedures. However, it is very important that the Commission-adopted procedures for addressing refund issues strictly adhere to the due process principles. The Commission is committed to treating parties with fairness in all stages of the California Refund Proceeding and ensuring that its determinations withstand judicial scrutiny on due process grounds; otherwise, refunds could be delayed for years.

The Commission and parties have been working on the calculation of the baseline amounts, the mitigated market price and the three offset amounts. Significant progress has occurred on all stages. However, refunds solely through the California Refund Proceeding (as compared to settlements in which refunds are more quickly returned to California) cannot be completed as long as there remain open and disputed issues. To date, as mentioned above, approximately $4 billion have been returned as a result of global settlements; thus, the total obligation in the California Refund Proceeding would be reduced to reflect the portion of the $4 billion settlement amount associated with refunds.  

Stage 1. Settling Baseline Amounts: The lengthy process of establishing a baseline from which to compute refunds has been completed. The Commission issued orders on the baseline calculations; and there are no outstanding issues pending rehearing. Importantly, the California ISO has been working with parties to resolve any outstanding issues; and according to the California ISO, it has resolved most if not all of the disputes arising from the baseline calculations, which at one time numbered in the thousands. In order to facilitate closure of this proceeding, the Commission directed

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67 Note that many sellers were not paid for the energy sold into the California ISO and PX markets.

parties to inform the Commission of any outstanding disputes by December 1, 2005.\textsuperscript{69} On December 1, seven parties made the Commission aware of such disputes.\textsuperscript{70} The Commission will determine whether these disputes are best handled as billing disputes under the California ISO tariff or whether the Commission should intervene to resolve any disputes.

**Stage 2. Mitigated Market Clearing Prices:** Since July 2004, market participants have had access to the 37,728 ten-minute interval price increments that form the mitigated market clearing prices for the entire refund period October 2, 2000 through June 20, 2001. The mitigated market clearing prices have been calculated by the California ISO and posted for market participant review since July 2004; and parties were provided an opportunity to comment on and dispute the California ISO’s determinations. To the Commission’s knowledge there are no remaining disputes concerning the California ISO’s calculation of the mitigated market clearing prices. The California ISO used the services of independent auditor, PricewaterhouseCoopers LLP, to evaluate its calculation of the mitigated market clearing prices; and, on October 18, 2004 the auditor submitted its report to the California ISO Board of Governors stating that the California ISO calculated the mitigated market clearing prices in accordance with guidance provided in Commission orders.

**Stage 3. Offsets:** As described in more detail below, the determination of the offset amounts is nearing completion. Before the California ISO can proceed with the financial adjustment stage, in which it will make adjustment to its refund settlement data to account for offsets, the offset amounts must be determined and made available to the California ISO. As mentioned above, the cost offsets were limited to a fuel cost allowance, an emissions adder, and a cost-and-revenue study for marketers and load-serving entities.

(1) **Fuel Cost Allowance:** Despite the Commission’s directive that only a generator’s actual gas costs that exceeded the baseline price of natural gas production plus transportation were eligible for offset from the refund liability, the fuel cost allowance developed into a highly contested issue.

\textsuperscript{69} Had the Commission not directed this, there is the possibility under the California ISO’s tariff that disputes could remain outstanding and unknown.

\textsuperscript{70} The following parties filed disputes concerning the refund calculations performed by the California ISO: PG&E; the City of Santa Clara; the California Parties (comprising the People of the State of California, \textit{ex rel.} Bill Lockyer, Attorney General, CEOB, CPUC, SCE, and PG&E); Merrill Lynch Capital Services., Commerce Energy, Inc., and Morgan Stanley Capital Group Inc.; the Northern California Power Agency; Powerex Corp.; and Puget Sound Energy, Inc.
The fuel cost proceeding started in March 2003 and initially involved 22 claims exceeding $0.5 billion. In September 2004, the Commission appointed an independent auditor to verify that the source data used in fuel cost calculations were accurate and conformed to the Commission-established methodology. After a series of conferences, comments and numerous Commission orders setting forth both the format and methodology, sellers eventually filed their fuel cost claims with the California ISO. These claims were submitted in October 2005. Any outstanding disputes involving these claims had to be submitted to the Commission by December 1, 2005. To the extent global settlements do not include all parties, then sellers may still have a claim for a fuel allowance, which has the effect of reducing refunds due.

(2) Emissions Costs: Seven sellers submitted emissions costs claims, which were examined by an ALJ in an evidentiary hearing and subsequently addressed in three Commission orders. The most recent compliance filing

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74 San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator and the California
in this proceeding was filed on June 21, 2005. Currently, the allowed emissions costs claims exceed $50 million. However, these claimed amounts include claims by non-public utilities, which were found by the Ninth Circuit to not be subject to refund liability. There is a pending request for rehearing, which involves an emissions costs claim submitted by a non-public utility. To the extent issues arise now, they will concern particular disputes over particular cost amounts claimed.

(3) Cost-and-Revenue Study: Early on in the refund proceeding, the Commission stated that it would provide an opportunity at the end of the California Refund Proceeding for sellers to submit evidence demonstrating that the refund methodology creates an overall revenue shortfall for their transactions made during the refund period October 2, 2000 through June 20, 2001. As of December 2004, no parties had filed a claim so the Commission in a December 10, 2004 order solicited comments and reply comments on a limited number of specific issues pertaining to the format of future cost filings. In response, the Commission received 23 comments and 12 reply comments. After reviewing the parties’ comments, the Commission issued an order establishing the framework for the evidence sellers must submit to demonstrate that the refund methodology results in an overall revenue shortfall for their transactions in the relevant markets from October 2, 2000 through June 20, 2001, and established the timeline for such submissions.

On September 14, 2005, 23 sellers filed a demonstration of their actual cost data from the refund period, claiming $4.2 billion in cost recovery. These cost submissions provide an opportunity for sellers to demonstrate that the mitigated market clearing price and other allowances do not provide an opportunity for recovery of costs associated with mitigated sales. The

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75 Bonneville Power Administration v. FERC, 422 F.3d 908 (9th Cir. 2005).


information contained in these submissions is substantial. The Commission will act on these submissions as expeditiously as possible.

The Commission, in the August 2005 Order, revised the procedural schedule for the California Refund Proceeding to accelerate the issuance of refunds. Specifically, the August 2005 Order condensed several previously-established deadlines, altered the compliance phase, and strongly encouraged parties to settle by early November 2005. The Commission also directed that parties inform the Commission of any outstanding disputes no later than December 1, 2005. In response, the California Parties made a filing addressing disputes in regard to offsets claimed by sellers in fuel cost allowance, emissions costs, and cost filing submissions and other stages of the California Refund Proceeding. In general, the California Parties do not question the need to allow offsets but rather challenge the process the Commission has employed to determine offsets, largely claiming that insufficient opportunity for discovery was provided. If the Commission finds that there is merit in the California Parties’ challenge, the completion of the California Refund Proceeding would be further delayed.

Stage 4. Final Accounting and Payment: Throughout the refund proceeding, the California ISO has assumed the role of the administrator of market data and calculator of refunds and refund liabilities based on direction from the Commission. Thus, it is the California ISO that will be performing the calculation, and allocation of refunds. As soon as all the disputes are resolved on the baseline calculations, the mitigated market clearing prices and the three offsets, the California ISO will proceed with the financial adjustment stage, in which the California ISO will make adjustments to its settlement data to account for the settlements and offsets. At this stage, the California ISO is also required to determine interest on all amounts due from either sellers or buyers. The California ISO then must submit a refund report to the Commission showing “who owes what to whom.”

As mentioned in the “Structure of California Markets” section of this Report, the PX acted as an interface with the California ISO on behalf of market participants. Thus, the PX will receive amounts owed and owing from the California ISO that it must then pass back to its participants. Once the Commission approves the California ISO’s refund report, the PX will have fourteen days to submit its refund report to the Commission. Similarly, upon Commission approval of the PX’s refund report, Automated Power Exchange (that served as a Scheduling Coordinator in the California ISO markets) will have sixty days from the time of the PX report to submit a refund report for its thirty-seven market participants. Upon Commission approval of these filings, the California ISO will be in a position to settle all accounts.

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See California Parties’ Disputes Relating to Cost Offsets and Refund Re-Runs, Docket No. EL00-95-000, at 3, December 1, 2005.
Completing the entirety of this proceeding depends on the continued efforts of many parties. The Commission has provided direction and guidance on all pending matters. Quick resolution of the remaining issues depends in part on whether the parties comply timely with the Commission’s directives. The Commission’s objective is to bring this proceeding to closure, including the distribution of amounts owed and owing, as soon as possible. Regardless of the Commission’s actions to bring this proceeding to closure, the entirety of it is not within the Commission’s control. Certain critical issues in the refund proceeding remain pending on appeal to the courts. As the courts decide these issues, the Commission may be required to revisit its prior determinations.

The courts of appeals currently are considering more than 100 petitions for review of FERC orders, arising out of the Western energy crisis of 2000-2001, reforming California market institutions and mitigating prices for electricity purchased in California through centralized spot markets. Most are pending in the U.S. Court of Appeals for the Ninth Circuit. Some are pending in the U.S. Court of Appeals for the District of Columbia Circuit.

Most of the pending appeals concern the dozens of orders issued by the Commission in the California Refund Proceeding, FERC Docket No. EL00-95, et al. After several years of procedural dispositions, the Ninth Circuit, on November 24, 2004, grouped the appeals into three broad categories. The first, captioned Public Utilities Commission of the State of California, et al. v. FERC, 9th Cir. No. 01-71051, et al., typically is referred to as the Phase One “Scope/Transactions Cases.” They concern the date (October 2, 2000 or earlier) that refunds for rates that are adjudged not to be just and reasonable commence, as well as the categories of transactions that are subject to refund. The second group, captioned Bonneville Power Administration, et al. v. FERC, 9th Cir. No. 02-70262, et al., typically is referred to as the Phase One “Jurisdictional Cases,” and concerns whether governmental entities that are not public utilities are subject to the Commission’s refund plan. The third group, Public Utilities Commission of the State of California, et al. v. FERC, 9th Cir. No. 01-71934, et al., consists of Phase Two appeals on specific refund calculation issues.

Briefing in the Phase One appeals has been completed. Oral argument on Phase One issues was conducted in San Diego, California, on April 12 and 13, 2005. The Ninth Circuit issued its decision in the Phase One Jurisdictional Cases (finding that the Commission did not have refund authority over governmental entities) on September 6, 2005. A decision in the Phase One Scope/Transactions Cases is due any day now. All Phase Two appeals are being held in abeyance (briefing has not yet commenced) pending the disposition of all the Phase One appeals.

The Ninth Circuit also is considering appeals of the Commission’s orders issued in the Pacific Northwest Refund Proceeding (concerning rates charged during 2000-2001 in Western states outside California). Those consolidated appeals, captioned Port of Seattle,
et al. v. FERC, 9th Cir. No. 03-74139, et al., have been fully briefed and are awaiting an oral argument date.

A third group of appeals seek review of FERC orders initiating and resolving docket-specific investigations of individual energy sellers, to determine whether any of them had violated, at any time, the terms and conditions of filed tariffs and, if so, how to enforce the tariffs. Some of these appeals have been fully briefed and argued and await decision. See Pacific Gas & Elec. Co., et al. v. FERC, 9th Cir. No. 03-72874, et al. (appeals of FERC orders approving settlements with Reliant and Duke). Most of these appeals are being held in abeyance (i.e., briefing has not yet commenced) pending the outcome of the California Refund Proceeding appeals. See Pacific Gas & Elec. Co., et al. v. FERC, 9th Cir. No. 05-71008, et al. (appeals of gaming/collusion show cause orders); Nevada Power Co., et al. v. FERC, D.C. Cir. No. 04-1039, et al. (appeals of orders revoking Enron’s market-based rate sales authority); Pacific Gas & Elec. Co., et al. v. FERC, 9th Cir. No. 05-71436, et al. (appeals of orders terminating anomalous bidding investigations); People of the State of Cal., et al. v. FERC, 9th Cir. No. 05-75487, et al. (appeals of orders initiating and conducting investigation of Enron activities).

Finally, other appeals seek review of FERC orders addressing complaints seeking relief from electricity prices charged in the West during the 2000-2001 period. See California ex rel. Lockyer v. FERC, 383 F.3d 1006 (9th Cir. 2004) (upholding FERC authorization of market-based pricing, but remanding to consider refunds for violations of its after-the-fact reporting requirements) (rehearing pending before 9th Circuit; Commission cannot act on remand until court acts on rehearing and issues mandate returning record to the agency); Public Utility District No. 1 of Snohomish County, Washington, et al. v. FERC, 9th Cir. No. 03-72511, et al. (denial of complaints seeking reformation of long-term contracts) (briefing completed; oral argument presented Dec. 8, 2004); Public Utilities Commission of the State of California, et al. v. FERC, 9th Cir. No. 03-74207, et al. (same).

CONCLUSION

The Commission is in the process of reviewing all pending refund-related filings arising from the California Refund Proceeding and will take every action within its authority to complete the refund process in the near future. The Commission will continue to work with parties to resolve any unresolved disputes that were filed with the Commission by the December 1, 2005 deadline. The Commission is committed to concluding the California Refund Proceeding as expeditiously as possible.