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ex rel. Bill Lockyer, Attorney General

IN THE SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF SAN FRANCISCO

PEOPLE OF THE STATE OF CALIFORNIA *ex rel.*
BILL LOCKYER, ATTORNEY GENERAL

Plaintiffs,

v.

MERRILL LYNCH CAPITAL SERVICES, INC., a
Delaware Corporation, and DOES 1-100

Defendants.

Case No.: CGC02408494

**COMPLAINT FOR CIVIL
PENALTIES (BUSINESS AND
PROFESSIONS CODE § 17200)**

1 The People of the State of California, *ex rel.* Bill Lockyer, Attorney General, allege the
2 following on information and belief:

3 **I. INTRODUCTION**

4 1. In January, 2001, the Governor of the State of California declared a state of
5 emergency because of the energy crisis in the State. Skyrocketing electricity prices and supply
6 shortages resulted in widespread blackouts, utility bankruptcy, and massive economic upheaval.
7 Defendant Merrill Lynch Capital Services, Inc. (“Merrill Lynch”), through unjust, unreasonable,
8 and illegal overcharges and price gouging received unprecedented profits at the expense of
9 consumers, ratepayers, businesses, and the State of California. Merrill Lynch’s profiteering and
10 other unlawful and unfair business practices resulted in hundreds of millions of dollars of
11 overcharges and illegal profits.

12 2. This action, under section 17200 of the Business and Professions Code, based on
13 unlawful rates charged by Merrill Lynch, seeks to redress those wrongs. Each and every one of
14 the thousands of unjust and unreasonable rates charged by Merrill Lynch was an act of unfair
15 competition, subject to civil penalty. In addition, each of the thousands of rates charged by
16 Merrill Lynch, but not filed with the Federal Energy Regulatory Commission (“FERC”), was an
17 act of unfair competition subject to civil penalties.

18 **II. PARTIES**

19 3. Plaintiffs are the People of the State of California, *ex rel.* Attorney General of
20 California, Bill Lockyer. Business and Professions Code section 17204 provides that actions to
21 prohibit unfair and unlawful business practices may be brought by the Attorney General in the
22 name of the People of the State of California.

23 4. Defendant Merrill Lynch is a Delaware corporation that, at all relevant times,
24 marketed and sold electricity in the California markets.

25 5. The true names and capacities of defendants stated in this Complaint under the
26 fictitious names of Does 1 through 100, inclusive, are unknown to plaintiffs, who sue such
27 defendants by such fictitious names. Each of the fictitiously named defendants is responsible in
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1 some manner for acts, occurrences, or omissions which caused the violations of law alleged
2 herein.

3 6. Unless otherwise alleged, whenever reference is made in this Complaint to any act
4 of defendants, such allegation shall mean that each defendant acted individually and jointly with
5 the other defendants named in the Complaint.

6 7. Unless otherwise alleged, whenever reference is made in this Complaint to any act
7 of any corporate or other business defendant, such allegation shall mean that such corporation or
8 other business defendant did the acts alleged in this Complaint through its officers, directors,
9 employees, agents, and/or representatives while they were acting within the actual or ostensible
10 scope of their authority.

11 8. At all relevant times alleged in this Complaint, each of the defendants has acted as
12 an agent, representative, or employee of each of the other defendants and has acted within the
13 course and scope of said agency or representation.

14 **III. JURISDICTION AND VENUE**

15 9. This Court has jurisdiction pursuant to California Constitution Article VI, section
16 10, because this case is a cause not given by statute to other trial courts.

17 10. This Court has jurisdiction over the defendants named above because they do
18 sufficient business in California, or otherwise have sufficient minimum contacts in California to
19 render the exercise of jurisdiction over them by the California courts consistent with traditional
20 notions of fair play and substantial justice.

21 11. Venue is proper in this Court because the cause arises in the City and County of
22 San Francisco where some of the violations of law have occurred.

23 **IV. STATUTORY BACKGROUND**

24 **A. The Unfair Competition Act**

25 12. California Business and Professions Code section 17200 provides that “unfair
26 competition shall mean and include any unlawful, unfair or fraudulent business practice.” Section
27 17203 of the Business and Professions Code provides that “(a)ny person who engages, has
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1 engaged, or proposes to engage in unfair competition may be enjoined in any court of competent
2 jurisdiction.”

3 13. Section 17206(a) provides that any person violating Section 17200 “shall be liable
4 for a civil penalty not to exceed two thousand five hundred dollars (\$2,500) for each violation,
5 which shall be assessed and recovered in a civil action brought in the name of the people of the
6 State of California by the Attorney General.” Under section 17205, these penalties are
7 “cumulative to each other and to the remedies or penalties available under all other laws of this
8 state.”

9 **B. The Federal Power Act**

10 14. The Federal Power Act (“FPA”), 16 U.S.C. §§ 824 et seq., governs sales of
11 wholesale electricity. Under the FPA, all rates and charges, changes to rates, and all contracts
12 must be filed with FERC. 16 U.S.C. § 824d. In addition, all rates and charges made, demanded,
13 or received for wholesale electricity must be just and reasonable, and any rate or charge that is not
14 just and reasonable is unlawful. 16 U.S.C. § 824d(a).

15 **V. FACTS**

16 **A. Deregulation of California Electricity Market**

17 15. In 1996, the State of California enacted AB 1890, codified in the Public Utilities
18 Code, to restructure the California Electricity market. AB 1890, *inter alia*, required California’s
19 investor owned utilities, Pacific Gas & Electric Co. (“PG&E”), Southern California Edison
20 (“SCE”), and San Diego Gas & Electric (“SDG&E”), to sell much of its electric generation
21 capacity in order to create competition in the generation and sale of wholesale electricity in
22 California.

23 16. AB 1890 also established two new institutions: the California Power Exchange
24 (“PX”) and the California Independent Systems Operator (“ISO”). The PX was established under
25 state law to operate a market for the purchase and sale of electricity for delivery during the same
26 or next day. The ISO was established under state law to manage the transmission network,
27 procure electricity during actual operation (“real-time”) in order to manage imbalances between
28 demand and supply as they occur, and to maintain the reliability of the transmission grid. The

1 purchases and sales of electricity in the markets administered by the PX and ISO are for
2 subsequent retail resale (to customers if the investor owned utilities, primarily). Sales of
3 wholesale electricity also occur outside of the PX and ISO markets.

4 17. The Federal Power Act grants the Federal Energy Regulatory Commission
5 (“FERC”) exclusive jurisdiction over wholesale sales of electricity. 16 U.S.C. § 824. The
6 creation and operation of the PX and ISO were approved by FERC because of the role of the PX
7 and ISO in wholesale electricity sales. Thus, the PX and ISO are governed in part by tariffs filed
8 with FERC and in part by state law. Bilateral out of market sales of wholesale electricity are also
9 regulated, in theory, by FERC and the FPA.

10 **B. Operation of the California Electricity Markets**

11 18. The investor owned utilities are responsible for providing electricity to retail
12 customers (homes, businesses, industry). Before California began purchasing wholesale
13 electricity, the investor owned utilities, to the extent their own generation was insufficient to
14 supply all of the needs of their retail customers, purchased wholesale energy from generators and
15 other sellers such as Merrill Lynch for resale, and made those purchases through both the PX and
16 ISO markets. Both the utilities and the generators are connected to the State’s electricity grid,
17 which is managed by the ISO. Because of the nature of electricity (and the fact that it cannot be
18 stored once generated), the operation of the grid and balancing of supply and demand is a highly
19 complex operation. As a result, operation of the grid requires, *inter alia*, both electricity and
20 ancillary services.

21 19. In general concept, substantial portions of the electricity requirements for any
22 given day were scheduled through the PX in conjunction with the ISO. The ISO was also able to
23 procure real-time energy as needed. These markets operate in one-hour increments (and even in
24 ten-minute increments), requiring bidding, sales, and purchases for each hour or ten-minute
25 increment. Ancillary services are separate markets operated by the ISO for the delivery of
26 electricity on demand. Generators bid into ancillary services markets and, when their bids are
27 accepted, agree to provide electricity if the ISO determines, through the operation of the grid, that
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1 the electricity is needed. There are a series of different ancillary services markets that are used by
2 the ISO to provide slightly different services.

3 20. Before declaring bankruptcy and ceasing operations as a result of the energy crisis,
4 the PX operated two electricity markets: the day-ahead market for delivery the next day, and the
5 day-of market for delivery the same day. While it was operating, the PX scheduled the majority
6 of electricity in the State (through the ISO as the operator of the grid).

7 21. While demand for electricity may be reasonably forecast for any given day, the
8 forecast is never exact. As a result, every day, the ISO must supplement the day-ahead and day-
9 of electricity with real time and ancillary services electricity.

10 22. The ISO does not buy and sell electricity for its own account. As part of its market
11 functions, it assigns costs and payments to market participants based on sales and purchases in the
12 various real-time and ancillary services markets that the ISO administers.

13 23. Entities also buy and sell wholesale electricity in bilateral out of market deals.
14 These deals can and do impact market prices and supplies.

15 24. In theory, through the interaction of these various markets and out of market sales,
16 electricity supply and demand remain in check, and the ISO can operate the grid with reliability.
17 The theory did not come to fruition in California.

18 **C. Breakdown of Market and Skyrocketing Prices**

19 25. For a number of reasons, including limited supply of natural gas and possible
20 manipulation of supply by generators of electricity, the wholesale price of electricity increased
21 dramatically in California in the summer of 2000. The massive price increases and the drop in
22 supply resulted in blackouts and massive economic upheaval in the State.

23 26. On January 17, 2001, Governor Davis declared a state of emergency because of
24 the energy crisis. The State suffered repeated rolling blackouts, was subject to two months of
25 stage 3 electricity emergencies requiring reduced usage, and ratepayers were hit with massive
26 increases in retail electricity charges.

27 27. The two primary investor owned utilities, which each had upstreamed billions of
28 dollars to their parent companies, were subject to retail price caps and were limited in the amount

1 of revenues they could raise from ratepayers. As a result, both SCE and PG&E incurred
2 enormous debt and defaulted on payments to both the PX and the ISO. PG&E declared
3 bankruptcy. The State, as the only available creditworthy buyer, spent billions of dollars
4 purchasing electricity to keep the lights on in California.

5 28. On December 14, 2000, the Department of Energy ordered out-of-state suppliers to
6 deliver power to California. FERC also ordered both soft and hard price caps in an attempt to
7 control prices charged by generators for electricity in the State.

8 29. Prices for wholesale electricity soared. In 1999, California paid approximately \$7
9 billion for energy. In 2000 and 2001, Californians paid approximately \$27 billion for
10 approximately the same quantity of energy.

11 30. Meanwhile, generators and other sellers of electricity, including Merrill Lynch,
12 enjoyed massive, historic profits.

13 **D. FERC's Determination of Unjust, Unreasonable, Unlawful Prices**

14 31. In a November 1, 2000 order (and repeated and reaffirmed in orders dated April
15 19, 2001, July 25, 2001, and December 15, 2001), FERC found that the "electric market structure
16 and market rules for wholesale sales of electric energy in California were seriously flawed and
17 that these structures and rules, in conjunction with an imbalance of supply and demand in
18 California, have caused, and continue to have the potential to cause, unjust and unreasonable rates
19 for short-term energy. . . ." *San Diego Gas & Electric Co., et al.*, 93 FERC ¶ 61,294 (2000).

20 32. The FPA, at 16 U.S.C. § 824d(a), declares unlawful any unjust and unreasonable
21 rate or charge for wholesale electricity.

22 33. In its July 25, 2001 and December 19, 2001 orders (and in a refund proceeding
23 currently before FERC), FERC determined a formula for the maximum just and reasonable price,
24 based on the heat rate of any particular generating unit times the gas price plus six dollars times
25 1.1. All charges above the formula are unjust and unreasonable.

26 34. Based on FERC formula and the calculation done by ISO, Merrill Lynch has
27 exceeded the just and reasonable price on thousands of separate occasions.
28

1 **E. Merrill Lynch's Actions and Profits**

2 35. Through its scheduling coordinators, Merrill Lynch sold wholesale electricity into
3 the California markets. It operated in all of the markets, including day-ahead, hour-ahead, real-
4 time, and ancillary services. It made thousands of electricity transactions in those markets
5 beginning in or before 1998 and continuing through 2001. Merrill Lynch also contracted directly
6 with the California Department of Water Resources for the sale of electricity.

7 36. Under the FPA, all rates and charges, all changes to rates and charges, and all
8 contracts must be filed with the FERC. 16 U.S.C. § 824d; 18 C.F.R. § 35.1.

9 37. Since 1998, Merrill Lynch has entered into thousands of separate transactions for
10 the sale of wholesale electricity.

11 38. Merrill Lynch has never filed its rates, charges, changes to rates and charges, or its
12 contracts with FERC. Instead, it filed a statement with FERC that it will charge rates as agreed
13 upon by Merrill Lynch and the purchaser. In addition, Merrill Lynch files quarterly summaries of
14 sales (with limited information) after the fact. Merrill Lynch's failure to file rates as required by
15 the FPA deprived the public, power purchasers, ratepayers, and FERC of notice and information
16 necessary to make informed decisions about rates.

17 39. Regardless of whether Merrill Lynch withheld supply of electricity, exercised
18 market power, or manipulated the price of electricity or the electricity markets in any other way,
19 Merrill Lynch charged rates in the California electricity markets that were unjust, unreasonable,
20 and therefore illegal, and did so on thousands of occasions starting in early 2000 and continuing
21 through 2001. And on thousands of occasions, it failed to file the rates it charged.

22 **FIRST CAUSE OF ACTION**
23 **UNFAIR BUSINESS COMPETITION**
 (Business and Professions Code § 17200 et seq.)

24 40. Paragraphs 1 through 39 are realleged and incorporated as if fully set forth herein.

25 41. Beginning on an exact date unknown to plaintiffs, but within four years preceding
26 the filing of this complaint, defendants have engaged in acts of unfair competition as defined in
27 Business and Professions Code section 17200, as follows: Each and every sale or purchase of
28 wholesale electricity by defendants for which defendants failed to file the charge, rate, price or

1 contract reflecting the terms of the sale or purchase, as required by the Federal Power Act, FPA
2 regulations, and FERC orders setting forth filing requirements. The number of such sales or
3 purchases is in the thousands.

4 42. Said violations render each defendant liable to plaintiffs for civil penalties
5 according to proof up to \$2,500 per day for each violation, and other equitable relief as
6 appropriate.

7 **SECOND CAUSE OF ACTION**
8 **UNFAIR BUSINESS COMPETITION**
(Business and Professions Code § 17200 et seq.)

9 43. Paragraphs 1 through 42 are realleged and incorporated as if fully set forth herein.

10 44. Beginning on an exact date unknown to plaintiffs, but within four years preceding
11 the filing of this complaint, defendants have engaged in acts of unfair competition as defined in
12 Business and Professions Code section 17200, as follows: Each and every rate, charge, or price
13 charged by defendants in violation of the Federal Power Act, 16 U.S.C. § 824d(a), was unfair,
14 unreasonable, and therefore unlawful.

15 45. Said violations render defendants liable to plaintiffs for civil penalties of up to
16 \$2,500 per day for each violation, and other equitable relief as appropriate.

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1 **PRAYER FOR RELIEF**

2 WHEREFORE, plaintiffs pray that the Court:

- 3 1. Award civil penalties according to proof;
4 2. Award plaintiffs their costs of suit;
5 3. Grant such other and further relief as the Court deems just and proper.
6

7 Respectfully submitted,

8 Dated: May 30, 2002

9 KRONICK, MOSKOVITZ, TIEDEMANN & GIRARD
10 A Professional Corporation

11 By **BRUCE A. SCHEIDT**

12 Attorneys for the People of the State of California,
13 *ex rel.* Bill Lockyer, Attorney General
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