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LEGAL PROCESS #1

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Bill Lockyer, Attorney General of the State of California

IN THE SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF SACRAMENTO

PEOPLE OF THE STATE OF CALIFORNIA EX
REL. BILL LOCKYER, ATTORNEY GENERAL
OF THE STATE OF CALIFORNIA,

Plaintiff,

v.

SEMPRA ENERGY TRADING CORPORATION
and DOES 1-100,

Defendants.

Case No. 05AS05115

**COMPLAINT FOR
INJUNCTION, DAMAGES,
CIVIL PENALTIES, AND
OTHER EQUITABLE AND
ANCILLARY RELIEF (Bus. &
Prof. Code, § 17200 et seq.; Corp.
Code, § 29536 et seq.)
DEMAND FOR JURY TRIAL**

The People of the State of California, by and through Bill Lockyer, Attorney General of
the State of California, allege on information and belief as follows:

NATURE OF ACTION

1. This is an action brought by the Attorney General of the State of California to
enforce the State's police and regulatory powers under California's Unfair Competition Law
(Bus. & Prof. Code, § 17200 et seq.) and the California Commodity Law of 1990 (Corp. Code,
§ 29500 et seq.) against SEMPRA ENERGY TRADING CORPORATION (SET) for engaging

1 in a number of unlawful, unfair, fraudulent, and manipulative trading schemes to the detriment of
2 the People of the State of California. A fundamental element of the trading schemes was the
3 deliberate use of false or misleading information.

4 2. In this action, the Attorney General seeks an injunction, damages, civil penalties,
5 and other equitable relief as authorized under California Business and Professions Code section
6 17206 and California Government Code section 12660.

7 **PARTIES**

8 3. Plaintiff Bill Lockyer is the Attorney General of the State of California and is the
9 chief law officer of the State. (Cal. Const., art. V, § 13.) He is authorized by California Business
10 and Professions Code section 17204 to prosecute in a court of competent jurisdiction any
11 unlawful, unfair, or fraudulent business act or practice which is prohibited by the Unfair
12 Competition Law. The Attorney General is also authorized under California Government Code
13 section 12658 to enforce the California Commodity Law of 1990.

14 4. Defendant SET is a Delaware corporation based in Connecticut. SET is a top
15 independent power marketer in North America and Europe. At all relevant times alleged in this
16 Complaint, SET was and is a marketer of wholesale energy products and services and was and is
17 engaged in energy merchant and commodity market businesses and trading activities in the
18 western United States, including California.

19 5. The true names and capacities of defendants sued in this Complaint under
20 fictitious names of DOES 1 through 100, inclusive, are unknown to plaintiff, who sues such
21 defendants by such fictitious names. Each of the fictitiously-named defendants engaged in or is
22 otherwise responsible in some manner for the acts, omissions, misrepresentations, use or misuse
23 of information or other occurrences which caused the violations alleged herein.

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

27 7. Unless otherwise alleged, whenever reference is made in this Complaint to any act
28 of any corporate or other business defendant, such allegation shall mean that such corporation or

1 other business did the acts alleged in this Complaint through its officers, directors, employees,
2 agents and/or representatives who were acting within the actual or ostensible scope of their
3 authority.

4 8. At all relevant times alleged in this Complaint, each of the defendants has acted as
5 an agent, representative, or employee of each of the other defendants and has acted within the
6 course and scope of their actual or ostensible authority.

7 JURISDICTION

8 9. This Court has jurisdiction to hear the claims alleged in this Complaint and is a
9 court of competent jurisdiction to grant the relief requested.

10 10. This Court has jurisdiction over Defendant SET because SET is a Delaware
11 corporation registered with the California Secretary of State to conduct business in California and
12 did conduct business in California by engaging in the offer, sale, and purchase of electricity in
13 the State of California and/or the control area of the California Independent System Operator
14 (“ISO”)^{1/}, and because SET otherwise has sufficient minimum contacts in California, to render
15 the exercise of jurisdiction over it by this Court consistent with traditional notions of fair play
16 and substantial justice.

17 VENUE

18 11. Venue is proper in this Court because the causes of action arise in the County of
19 Sacramento where some of the violations of law have occurred.

20 STATUTORY BACKGROUND

21 A. California Business and Professions Code Section 17200 et seq.: The Unfair 22 Competition Law

23 12. California Business and Professions Code section 17200 provides that “unfair
24 competition” shall mean and include *any* unlawful, unfair, or fraudulent business act or practice.

25 13. Section 17203 of the California Business and Professions Code provides that
26

27 1. The California Independent System Operator (“ISO”) is a not-for-profit corporation
28 established through California’s deregulation legislation. The ISO is responsible for operating the
high-voltage transmission grid serving most of California. The area encompassing this transmission
grid is known as the ISO control area.

1 “[a]ny person who engages, has engaged, or proposes to engage in unfair competition may be
2 enjoined in any court of competent jurisdiction.” The court may make such orders or judgments
3 as may be necessary to prevent the use or employment by any person of any practice which
4 constitutes unfair competition or as may be necessary to restore any person in interest any money
5 or property, real or personal, which may have been acquired by means of such unfair
6 competition.

7 14. Section 17206 of the California Business and Professions Code provides that any
8 person who engaged, has engaged, or proposes to engage in unfair competition shall be liable for
9 a civil penalty for each violation, which shall be assessed and recovered in a civil action brought
10 in the name of the People of the State of California by the Attorney General. Section 17205 of
11 the California Business and Professions Code further provides that the remedies or penalties
12 thereunder are cumulative to each other and to the remedies or penalties available under all other
13 laws of this State.

14 **B. California Corporations Code Section 29500 et seq.: The California Commodity**
15 **Law of 1990**

16 15. Section 12657 of the California Government Code provides the Attorney General
17 with concurrent enforcement powers to enforce the California Commodity Law of 1990 (Corp.
18 Code, § 29500 et seq.).

19 16. Section 12658 of the California Government Code provides that whenever it
20 appears to the Attorney General that any person has engaged or is about to engage in any act or
21 practice constituting a violation of the California Commodity Law, the Attorney General may, in
22 his discretion, bring an action in the name of the People of the State of California in superior
23 court to enjoin any act or practice constituting a violation of the commodities laws, and, where
24 appropriate, seek ancillary relief, including damages.

25 17. Section 12661 of the California Government Code also authorizes the Attorney
26 General to take any actions as are authorized by the federal Commodity and Exchange Act as
27 amended before or after January 1, 2004, the effective date of Section 12661.

28 18. Section 13a-2 of the Commodity Exchange Act (7 U.S.C. § 13a-2) authorizes the

1 Attorney General to bring suit for any act or practice constituting a violation of the Commodity
2 Exchange Act (7 U.S.C. § 1 et seq.) against any person (other than a contract market, derivatives
3 transaction execution facility clearinghouse, floor broker, or floor trader). Section 13a-2(7) of
4 the Commodity Exchange Act further provides that:

5 Nothing contained in this section shall prohibit an authorized State official
6 [defined by Section 13a-2(1) to include the attorney general of any State]
7 from proceeding in State court on the basis of an alleged violation of any
8 general civil or criminal antifraud statute of such State.

8 19. The Attorney General is enforcing only the general unfair competition and
9 antifraud provisions contained in California Business and Professions Code section 17200 et seq.
10 and California Corporations Code section 29500 et seq., and not provisions of the Commodity
11 Exchange Act, against SET in this action.

12 20. Section 29504 of the California Commodity Law defines a “commodity” to
13 include any fuel (whether liquid, gaseous, or otherwise), and all other goods, articles, products or
14 items of any kind. (Corp. Code, § 29504.) Section 29510 of the California Commodity Law
15 defines a “commodity option” as the right but not the obligation to purchase or sell one or more
16 commodities. (Corp. Code, § 29510.)

17 21. Section 29513 of the California Commodity Law defines an “offer” to include
18 “every offer to sell, offer to purchase, or offer to enter into a commodity contract or commodity
19 option.” (Corp. Code, § 29513.)

20 22. Section 29516 of the California Commodity Law defines “sale” or “sell” to
21 include “every sale, contract of sale, contract to sell, or disposition, for value.” (Corp. Code, §
22 29516.)

23 23. Section 29536 of the California Commodity Law provides that it is unlawful for
24 any person, directly or indirectly, in connection with the purchase or sale of, the offer to sell, the
25 offer to purchase, the offer to enter into, or the entry into, a commodity, commodity contract, or
26 commodity option to: (a) willfully employ any device, scheme or artifice to defraud; (b) willfully
27 make any false report, enter any false report, make any untrue statement of a material fact or omit
28 to state a material fact necessary in order to make the statements made, in the light of the

1 circumstances under which they were made, not misleading; (c) willfully engage in any
2 transaction, act, practice, or course of business which operates or would operate as a fraud or
3 deceit upon any persons; or (d) willfully misappropriate or convert the funds, security, or
4 property of any other person. (Corp. Code, § 29536.)

5 24. Section 12660 of the California Government Code provides that any person who
6 violates any provision of the California Commodity Law shall be liable for a civil penalty for
7 each violation, which shall be assessed and recovered in a civil action brought by the Attorney
8 General in the name of the People of the State of California.

9 **FACTS**

10 **A. Deregulation of California's Electric Generation Market**

11 25. Prior to restructuring of the electricity industry in California, the State's major
12 investor-owned utilities ("IOUs"), namely Pacific Gas & Electric Company ("PG&E"), Southern
13 California Edison ("SCE"), and San Diego Gas & Electric Company ("SDG&E"), provided
14 bundled services for electricity, including generation, transmission, and distribution, to the
15 majority of retail customers in the state. In September 1996, the California Legislature enacted
16 Assembly Bill 1890 ("AB 1890"), with the goal of introducing competition in the generation and
17 sale of electricity, at both the wholesale and retail levels. In order to promote competition, AB
18 1890 encouraged the IOUs to divest themselves of a significant portion of their generating
19 capacity. As a consequence, the IOUs sold almost all of their natural gas-fired generating
20 capacity to five merchant generating companies: Duke, Dynegy, AES, Mirant, and Reliant.

21 **B. The ISO and PX Markets**

22 26. AB 1890 also established two new institutions: the California ISO and the
23 California Power Exchange ("PX").

24 27. The ISO was established to operate the high-voltage transmission grid serving
25 most of the state and is responsible for all real-time operations, such as continually balancing
26 generation and load and managing congestion on the transmission system it controls.

27 28. The PX was established to operate two auction-style markets for the purchase and
28 sale of electricity for delivery during the same or next day. These were the "day-ahead" and

1 “day-of” markets. The intent of the deregulation plan was that 95 percent of the power needed to
2 serve customers in the ISO control area would be sold and purchased through the PX markets. In
3 the day-ahead and day-of markets, the PX established a single market clearing price that all
4 sellers collected and all buyers paid for power delivered in each hour across the entire ISO
5 control area, provided there were no transmission constraints. When transmission congestion
6 existed, a separate clearing price was established for each transmission constrained area or zone
7 in California.^{2/}

8 29. At all relevant times alleged in this Complaint, the ISO was responsible for
9 managing congestion on the ISO-controlled grid. The ISO solicited “adjustment bids” in order to
10 allocate the limited transmission capacity available across congested transmission paths to those
11 market participants that valued it most highly. Adjustment bids represent the amount of money
12 per megawatt hour that an entity is willing to pay to have its power transmitted over a particular
13 congested path, or to be paid to reduce the amount of power it plans to send over a congested
14 path.

15 30. At all relevant times alleged in this Complaint, in addition to operating the
16 congestion management system, the ISO administered a variety of auction markets for the
17 purpose of procuring the electricity necessary to operate the transmission system reliably,
18 including an energy market to procure the power needed to continuously match the amount of
19 power being supplied to the grid with the amount of energy being demanded by customers. This
20 market is known as the “real-time” energy market or the “imbalance” energy market.

21 31. The ISO also procured various types of capacity, known as ancillary services, that
22

23 2. A transmission path is “congested” when the total amount of electricity scheduled to be
24 transmitted between two areas across that path exceeds the path’s available transmission capacity.
25 A “schedule” is a statement submitted to the ISO that indicates both (1) an electricity demand
26 requirement (including the quantity of electricity need, the duration of the need and where the
27 delivery is needed) and (2) the proposed electricity supply that is to be used to meet the demand in
28 question (including the quantity of electricity to be delivered, the duration of delivery, the location
of the generating facility, along with other technical information regarding transmission losses and
what ancillary services will be associated with the delivery). A schedule is considered to be
“balanced” when the schedule’s demand level is matched with an equivalent level of supply.

1 could be called upon by the ISO to produce electricity in the event of a system emergency, such
2 as a major plant outage, or to correct a routine imbalance between supply and demand on the
3 grid. The ISO procured four different types of ancillary services through auction markets run one
4 day and one hour ahead of actual ("real-time") consumption of the electricity. The four different
5 services are differentiated by the amount of time it takes the producer to deliver the energy to the
6 grid when called on by the ISO.

7 32. A generator or marketer of energy wishing to participate in the PX and ISO energy
8 markets was required to do so through a scheduling coordinator. A scheduling coordinator is an
9 entity authorized to submit energy bids and schedules to the PX and ISO on behalf of electricity
10 suppliers and purchasers. A generator or marketer could serve as its own scheduling coordinator
11 or use a third party to act as its scheduling coordinator. The PX was also considered to be a
12 scheduling coordinator but with restricted capabilities. Many scheduling coordinators performed
13 several functions, including coordinating many generators and loads; negotiating generator and
14 load changes with clients; negotiating bilateral contracts with or between clients; aggregating
15 contracts between market participants; acting as energy service provider; owning, contracting for,
16 or brokering generation; bundling generation and load; acting as the sole agent to the ISO; and
17 submitting schedules and bids for electricity and ancillary services.

18 33. The IOUs were required by law to sell all of the output from the generating units
19 that they had not previously divested into markets administered by the PX and ISO, and to
20 purchase all of their energy and capacity requirements from those PX and ISO markets. As a
21 result, the PX was the largest scheduling coordinator in California, representing at times
22 approximately 90 percent of the load served by the ISO grid.

23 34. As a scheduling coordinator, the PX was required to submit a balanced schedule
24 of load and generation to the ISO for the following day. In order to maintain balance on the
25 transmission grid, the ISO would dispatch power from sellers that submitted successful bids in
26 the real-time, imbalance energy market or ancillary services markets. If there were insufficient
27 bids in the ISO real-time market to meet customer demand, the ISO, as a last resort, would
28 purchase energy "out-of-market" in order to procure the resources necessary to operate the

1 system.^{3/}

2 35. Neither the ISO nor the PX purchased or sold energy for their own accounts or
3 benefit. Rather, they served as “market-makers” or clearinghouses to facilitate the sale and
4 purchase of wholesale power by market participants such as SET. In markets administered by
5 the PX and ISO, sellers submitted bids specifying the amount of electricity and/or capacity they
6 wished to sell and the price at which they were offering to sell. The auction operator ranked all
7 bids in merit order, (i.e., from lowest to highest price) and then selected all of the bids it needed
8 in order to meet the demand in a given interval. The bid submitted by the highest priced unit
9 selected by the ISO set a single, “market-clearing price” that all buyers paid, and all sellers
10 received.

11 36. At all relevant times alleged in this Complaint, Defendant SET was a scheduling
12 coordinator authorized to submit bids in the PX and ISO markets to purchase and sell energy. In
13 its capacity as a scheduling coordinator, SET also submitted schedules to the PX and ISO
14 detailing generation and load information for bilateral energy transactions it purportedly
15 negotiated on behalf of itself with other market participants or energy entities within or outside of
16 the ISO control area. SET also communicated and interacted with the ISO regularly, including
17 during real-time and system emergencies, regarding scheduling and transmission issues or to
18 negotiate out-of-market sales with the ISO to help balance the grid.

19 **C. The Breakdown of the Market, Skyrocketing Electricity Prices, and Rolling Blackouts**

20 37. In May 2000, the price of wholesale power began to quickly rise to historically
21 unprecedented levels in California and did not begin declining until June 2001 (the period
22 referred to as “the California Energy Crisis”).

23 38. During the Energy Crisis, buyers of wholesale power incurred massive losses.
24 The two largest IOUs, SCE and PG&E, incurred enormous debts and, as a result, defaulted on
25 payments to both the PX and the ISO. PG&E filed for bankruptcy in April 2001, and SCE
26 teetered on the brink of bankruptcy. On January 29, 2001, the PX suspended trading in its
27

28 3. An out-of-market, or “OOM”, purchase refers to a purchase of energy by the ISO that was
not bid into the energy markets or was bid at a price above the price cap.

1 markets, effectively ceasing its operations, and declared bankruptcy on March 9, 2001.

2 39. On January 17, 2001, Governor Davis declared a state of emergency in order to
3 ensure that a continuous supply of energy was available in California. Governor Davis
4 authorized the State, through the California Department of Water Resources ("DWR"), to
5 purchase electricity to protect health, safety, and vital economic interests of California citizens
6 and businesses.

7 40. The crisis posed a serious threat to the safety and reliability of the high voltage
8 transmission grid serving the State, which was subjected to extended periods of ISO-declared
9 system emergencies in which operating reserves fell below system requirements. The ISO
10 declared numerous Stage 3 system emergencies (the highest level of system emergency) because
11 actual or anticipated operating reserves were less than or equal to one and a half percent (1½%)
12 of projected peak demand. For the first time ever in California history, businesses and residents
13 in the State were subjected to rolling blackouts.

14 **D. SET's Fraudulent Trading Schemes**

15 41. As a marketer of energy and a scheduling coordinator, SET sold electricity into
16 the California markets. SET operated in all of the organized spot markets, including day-ahead,
17 day-of, real-time, and ancillary services. SET made tens of thousands of electricity transactions
18 in those markets starting in approximately 1998 and continuing through to the present.

19 42. Beginning as early as 1999 and continuing at least through 2001, SET willfully
20 engaged in an array of manipulative and fraudulent schemes designed to enable them to obtain
21 "congestion relief" payments for taking actions that did not relieve any congestion, to receive
22 payment for excess generation through the submission of false schedules, and to circumvent the
23 ISO's price cap by falsely representing the source of the energy. These gaming schemes were
24 disclosed in Spring 2002 when memoranda released by Enron Corporation described in detail
25 numerous fraudulent trading strategies which have become widely known as the "Enron trading
26 strategies" but were in fact employed by several market participants, including SET. Until the
27 disclosure of the Enron memoranda, market participants, including SET, publicly denied any
28 wrongdoing with regard to its trading activities in the PX and ISO markets. The trading

1 strategies used by SET include, but are not limited to, the following:

2 **1. Congestion Games**

3 43. SET engaged in several strategies designed to collect payment for taking actions
4 that would purportedly “relieve” congestion along constricted transmission paths. SET willfully
5 submitted false schedules to the ISO for the purpose of creating illusory congestion and
6 collecting payment for taking actions to “relieve” congestion that were bogus and did not relieve
7 any actual congestion. These sham “congestion-relief” schemes include, but are not limited to,
8 the following:

9 **a) “Death Star”**

10 44. Under the “Death Star” strategy, a market participant submits circular schedules
11 in the day-ahead and hour-ahead markets to create the appearance of relieving congestion when
12 in fact no congestion is relieved. In a “Death Star” transaction, the market participant uses two
13 back-to-back transaction schedules that schedule energy in a circular route by way of an export
14 and a re-import of that energy. In one schedule, energy is imported into the ISO control area
15 through a transmission interface. This energy is scheduled to flow in a direction opposite to
16 congestion and is then exported over another transmission interface. The counterflow created by
17 this schedule is supposed to relieve congestion, and the market participant receives a congestion
18 relief payment. However, in a second schedule, the same energy is then circled back to the ISO
19 control area along transmission lines outside of the ISO system. The energy is circled back to the
20 first transmission interface in which the energy was imported in the first schedule. As a result of
21 this circular schedule, no congestion is relieved because no energy is put onto or taken off of the
22 ISO grid.

23 45. At all relevant times alleged in this Complaint, SET engaged in numerous “Death
24 Star” transactions in which it scheduled power in the opposite direction of congestion without
25 having any intention of delivering the power. SET collected payments for “relieving” congestion
26 but put no actual power onto the grid and took no power off of the grid. Thus, no congestion was
27 relieved. Between January 2000 and June 2001, SET submitted circular schedules in at least 205
28

1 hours with a total of approximately 9,728 megawatt hours ("MWh").^{4/} Between January 2000
2 through April 2000, SET submitted circular schedules in at least 57 hours involving 2,288 MWh.
3 Between May 2000 through September 2000, SET submitted circular schedules in at least 28
4 hours involving 1,570 MWh. Between October 2000 through January 2001, the number of
5 "Deathstar" transactions by SET increased, with at least 120 hours in which it submitted circular
6 schedules involving 5,970 MWh.

7 **b) Cut Schedule Strategies: "Wheel-Out" and "Non-Firm Export"**

8 46. Under "Wheel-Out", also known as a "cut schedule" strategy, a market participant
9 submits a schedule that it knows or expects the ISO will cut due to transmission limitations or
10 outages. Often under this strategy, the scheduling coordinator will intentionally schedule energy
11 over a transmission path that it knows is out-of-service. Once the ISO cuts the schedule, the
12 scheduling coordinator receives a congestion counterflow payment.

13 47. Under "Non-Firm Export", also known as a "cut schedule" strategy, a market
14 participant will provide a counterflow of energy to relieve congestion, in whole or in part, in the
15 day-ahead or hour-ahead markets and receive a congestion relief payment from the ISO. The
16 schedule providing the counterflow, however, is "cut" after the ISO awards the congestion relief
17 payment, which cannot be rescinded by the ISO's accounting system. In the "Non-Firm Export"
18 variation of the "cut schedule" strategy, congestion is supposed to be relieved by scheduling
19 power from California to flow in the opposite direction of congestion on a constrained path
20 within the ISO control area and to an external control area. However, the market participant has
21 no intention of providing power under the schedule, because the market participant either cannot
22 or will not deliver.

23 48. At all relevant times alleged in this Complaint, SET engaged in numerous
24 "Wheel-Out" transactions in which it knew that an inter-tie line at the ISO border (connecting the
25 ISO control area with outside grids) was completely constrained (i.e., its available capacity is set
26

27 4. A megawatt is equivalent to 1 million watts or 1,000 kilowatts. One megawatt hour is a
28 unit of energy equivalent to the power of one megawatt operating for one hour. For example, ten
thousand 100-watt light bulbs burning for one hour would consume one megawatt of electric energy.

1 at zero) or out-of-service. SET scheduled power over the inter-tie line for the sole purpose of
2 creating the appearance of congestion on the affected path. SET submitted these bogus schedules
3 knowing that the schedule ultimately would be “cut” by the ISO and that it would receive a
4 congestion relief payment from the ISO without having to send any power over the line in the
5 first place, and without having to “relieve” any congestion.

6 49. At all relevant times alleged in this Complaint, SET engaged in numerous “Non-
7 Firm Export” transactions under the “cut schedule” strategy. Pursuant to this strategy, SET
8 scheduled non-firm energy from a point in California to a control area outside of California in the
9 opposite direction of congestion without having any intention of making the delivery. As soon as
10 SET collected payment for purportedly “relieving” congestion on constrained transmission line,
11 it cut the export schedule. As a result, no power was transmitted and no congestion was relieved,
12 even though a congestion relief payment was collected.

13 50. Between
14 January 2000 and June 2001, SET engaged in “cut schedule” transactions in at least 160 hours
15 involving 3,811 MWh for which it earned congestion revenues. Between January 2000 through
16 April 2000, SET engaged in “cut schedule” transactions in at least 11 hours involving 698 MWh.
17 Between May 2000 through September 2000, SET’s use of this strategy increased, with “cut
18 schedule” transactions during at least 22 hours involving 1,944 MWh. Between October 2000
19 and January 2001, SET engaged in “cut schedule” transactions in at least 34 hours involving
20 1,076 MWh. Between January 2001 and June 2001, SET engaged in “cut schedule” transactions
21 in at least 3 hours involving 93 MWh.

22 **c) “Load Shift”**

23 51. Market participants within the ISO-control area are required to submit balanced
24 schedules to the ISO in which anticipated generation is scheduled against an equal amount of
25 load that the market participant expects to serve. The schedules also must identify the zone
26 within the ISO control area in which the load resides. Identification of the location of the load is
27 an important factor in the ISO’s efforts to manage congestion on transmission lines. At all
28 relevant times alleged in this Complaint, under the “Load Shift” strategy, SET intentionally
submitted false schedules which overscheduled load in one zone in order to create congestion on

1 the transmission line leading into that zone. After creating the congestion, SET adjusted, or
2 “shifted”, it loads on both ends of the transmission line to appear to relieve the falsely created
3 congestion and receive a congestion payment. Between January 2000 and June 2001, SET
4 engaged in “load shift” transactions during at least 1,300 hours involving over 150,000 MW of
5 false flows across transmission lines.

6 **2. Ancillary Services-Related Games / “Get Shorty”**

7 52. Market participants providing ancillary services to the ISO are paid by the
8 megawatt for keeping their capacity in reserve in the event it is needed by the ISO to generate
9 power. In the event the ISO orders a market participant to produce electricity from this reserve
10 capacity, the ISO also pays the seller by the megawatt hour for the power provided.

11 53. At all relevant times alleged in this Complaint, SET engaged in a manipulative
12 scheme, known both as “Get Shorty” or paper trading of ancillary services, under which it
13 collected payment for ancillary services it did not provide, and never intended to provide. SET
14 carried out this scheme by willfully submitting bids to provide ancillary services in the day-ahead
15 market without having any physical resources (i.e., actual generating reserves) backing up the
16 sale. SET then “covered” all or part of its commitment by buying ancillary services in the hour-
17 ahead market so that it could profit from selling high in the day-ahead market and buying back at
18 a lower price in the hour ahead or real-time markets. In submitting its bids to provide ancillary
19 services to the ISO, SET willfully and falsely represented that the capacity it was obligated to
20 keep in reserve was actually available for dispatch, when in fact it did not exist.

21 54. Between May 1, 2000, and October 1, 2000, SET repurchased day-ahead ancillary
22 service sales during 204 hours. During those hours with buybacks, SET’s day-ahead sales were
23 2.5 times as much as its ancillary services sales during hours without buybacks. When buybacks
24 occurred, SET was buying back more than 75% of its day-ahead sales. Between October 1, 2000,
25 and December 31, 2000, SET had 155 transaction hours in which it repurchased its day-ahead
26 ancillary services sales. When these buybacks occurred, SET bought back more than 83% of its
27 day-ahead sales. Between January and June 2001, SET repurchased 98% of its day-ahead
28 ancillary services sales during 565 hours. When repurchasing ancillary services, its day-ahead

1 sales were more than 3.7 times higher than its ancillary services sales during transaction hours
2 without buyback. SET sold ancillary services without buybacks during only 141 hours.

3 **3. Submission of False Load Schedules / “Fat Boy”**

4 55. Market participants within the ISO-control area are required to submit balanced
5 schedules to the ISO, in which anticipated generation must be scheduled against an equal amount
6 of load that the market participant expects to serve. At all relevant times alleged in this
7 Complaint, SET willfully submitted false schedules that overstated the load it intended to supply,
8 knowing that the “excess” generation would be accounted for by ISO as an “uninstructed
9 deviation” and paid the market clearing price for imbalance energy.

10 56. At all relevant times alleged in this Complaint, SET submitted numerous false
11 load schedules in which it scheduled more load than was actually served. Between January 2000
12 and May 2000, SET submitted false load schedules for at least 1,052 hours. During many of
13 these hours, the average scheduled load exceeded the average metered (or actual) load by more
14 than 100 MW. From May 2000 to October 2000, SET submitted false load schedules for at least
15 1,473 hours. During many of these hours, the average scheduled load exceeded the average
16 metered load by more than 184 MW. From October 2000 to June 2001, SET submitted false
17 load schedules for at least 746 hours. During these hours, the average scheduled load exceeded
18 the average metered load by approximately 262 MW.

19 **4. “Ricochet” or “Megawatt Laundering”**

20 57. At all relevant times alleged in this Complaint, SET engaged in a manipulative
21 trading scheme known as “ricochet” or “megawatt laundering” designed to evade the price cap in
22 the ISO’s real-time, imbalance energy market. The ISO had a practice of paying prices above its
23 cap for power imported from sources located outside the State when supplies bid into the real-
24 time market were insufficient to meet demand. Such sales, known as “out-of-market” or “OOM”
25 sales, were completed outside the centralized, imbalance energy market.

26 58. In a ricochet transaction, SET purchased energy in the PX day-ahead or day-of
27 market, exported it to another control area where it briefly stayed, and then imported it back into
28 the ISO control area through an OOM sale to the ISO at a greatly inflated price. Through this

1 strategy, SET willfully and falsely represented to the ISO that the energy it sold as OOM had
2 been imported into California in order to avoid the price caps, despite the fact that, as a practical
3 matter, no energy ever left or re-entered the State.

4 59. At all times alleged in this Complaint, SET engaged in numerous ricochet
5 transactions. Between January 2000 and May 2000, SET exported and re-imported in the same
6 hour at least 13 MWh during at least one hour. Between May 2000 and October 2000, SET's
7 ricochet transactions increased. During this period, SET exported and re-imported in the same
8 hour at least 58,316 MWh during at least 224 hours. Between October 2000 and January 2001,
9 SET exported and re-imported in the same hour at least 8,801 MWh during at least 84 hours.
10 Between January 2001 and June 2001, SET's ricochet activities again increased, exporting and
11 re-importing in the same hour at least 12,157 MWh during at least 294 hours.

12 FIRST CAUSE OF ACTION

13 UNFAIR BUSINESS COMPETITION 14 (Business & Professions Code § 17200 et seq.)

15 60. Plaintiff realleges and incorporates by reference paragraphs 1 through 59 inclusive
16 as if fully set forth herein.

17 61. Section 17200 of the California Business and Professions Code prohibits unfair
18 competition, which includes any unlawful, unfair, or fraudulent business act or practice.

19 62. Beginning in 1999 and continuing through at least 2001, SET willfully engaged in
20 unfair competition that includes, but is not limited to:

21 (a) offering to sell ancillary services to the ISO without having any physical
22 resources backing up the sale, and collecting payment for ancillary services it did not provide and
23 had no intention of providing;

24 (b) misrepresenting "out-of-market" sales of power to the ISO as "imports," and
25 collecting payment for "out-of-market" sales at prices above the price cap, when in fact the
26 power originated in California;

27 (c) overstating the amount of load it expected to serve, and thereby collecting
28 payment for the "excess" generation at the market clearing price;

1 (d) scheduling non-firm energy in the opposite direction of congestion to a point
2 outside the ISO control area without having any intention of delivering the power, collecting
3 payment for purportedly relieving congestion, and then cutting the schedule before putting any
4 energy on the grid;

5 (e) scheduling power across an inter-tie with the knowledge that it was out-of-
6 service or already completely constrained, and without having any intention of delivering the
7 power, and collecting payment for purportedly relieving congestion on the line without relieving
8 any congestion.

9 (f) scheduling power in the opposite direction of congestion without having any
10 intention of delivering the power, and collecting payment for purportedly relieving congestion,
11 when in fact no congestion was relieved; and

12 (g) submitting false schedules to over-schedule load in one zone in order to
13 create congestion on transmission lines, and collect payment for relieving the falsely created
14 congestion.

15 63. Each of the acts and practices of SET, including, but not limited to, those alleged
16 in Paragraph 62 to this Complaint are “unfair” within the meaning of California Business and
17 Professions Code section 17200.

18 64. Each of the acts and practices of SET, including, but not limited to, those alleged
19 in Paragraph 62 to this Complaint are “fraudulent” within the meaning of California Business
20 and Professions Code section 17200.

21 65. Each of the acts and practices of SET, including, but not limited to, those alleged
22 in Paragraph 62 to this Complaint are “unlawful” within the meaning of California Business and
23 Professions Code section 17200 because they violate California law, including but not limited to
24 California Corporations Code section 29536.

25 66. As a direct consequence of SET’s unlawful, unfair, and fraudulent business
26 practices, the operations of the ISO and PX markets were adversely affected, overall system-wide
27 grid reliability was degraded, and the health, safety, and economic well-being of California
28 businesses and residents were put in danger.

67. As a direct consequence of SET's unlawful, unfair, and fraudulent business practices, California businesses and residents were subjected to the risks and dangers of power supply interruptions, rolling blackouts and other adverse consequences.

SECOND CAUSE OF ACTION

UNLAWFUL COMMODITY TRANSACTIONS (California Corporations Code § 29500 et seq.)

68. Plaintiff realleges and incorporates by reference paragraphs 1 through 67 inclusive as if fully set forth herein.

69. Under California Government Code sections 12658 and 12660, the Attorney General has authority to enforce the California Commodity Law (Cal. Corp. Code § 29500 et seq.) and to seek injunctive relief, civil penalties, and ancillary relief, including damages, for violations thereof.

70. Electricity is a “commodity” as defined under section 29504 of the California Commodity Law.

71. Ancillary services are “commodity options” within the meaning of section 29510 of the California Commodity Law.

72. SET engaged in transactions in which it offered to sell, sold, offered to purchase, and purchased commodities and commodity options in the PX and ISO markets.

73. Section 29536 of the California Commodity Law provides in relevant part:

It is unlawful for any person, directly or indirectly, in connection with the purchase or sale of, the offer to sell, the offer to purchase, the offer to enter into, or the entry into, a commodity, commodity contract, or commodity option, to do any of the following:

- (a) To willfully employ any device, scheme, or artifice to defraud.
- (b) To willfully make any false report, enter any false record, make any untrue statement of a material fact, or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.
- (c) To willfully engage in any transaction, act, practice, or course of business which operates or would operate as a fraud or deceit upon any persons.

1 (d) To willfully misappropriate or convert the funds,
2 security, or property of any other person.

3 74. Beginning in 1999 and continuing through at least 2001, in connection with its
4 offers to sell, sales, offers to purchase, and purchases, of commodities and commodity options in
5 the PX and ISO markets, SET violated section 29536(a)-(d) of the California Commodity Law by
6 engaging in conduct including, but not limited to, the following:

7 (a) willfully and fraudulently offering to sell ancillary services to the ISO
8 without having any physical resources backing up the sale, and collecting payment for ancillary
9 services it did not provide and had no intention of providing;

10 (b) willfully and fraudulently misrepresenting "out-of-market" sales of power to
11 ISO as "imports," and collecting payment for "out-of-market" sales at prices above the price cap,
12 when in fact the power never left or re-entered California;

13 (c) willfully and fraudulently overstating the amount of load it expected to serve,
14 and thereby collecting payment for the "excess" generation at the market clearing price;

15 (d) willfully and fraudulently scheduling non-firm energy in the opposite
16 direction of congestion to a point outside the ISO control area without having any intention of
17 delivering the power, collecting payment for purportedly relieving congestion, and then cutting
18 the schedule before putting any energy on the grid;

19 (e) willfully and fraudulently scheduling power across an inter-tie with the
20 knowledge that it was out-of-service or already completely constrained for the purpose of
21 creating the appearance of congestion, and then collecting payment for relieving congestion on
22 the line without relieving any congestion, and without having any intention of doing so.

23 (f) willfully and fraudulently scheduling power in the opposite direction of
24 congestion without having any intention of delivering the power, and collecting payment for
25 purportedly relieving congestion, when in fact no congestion was relieved; and

26 (g) submitting false schedules to over-schedule load in one zone in order to
27 create congestion on transmission lines, and collect payment for relieving the falsely created
28 congestion.

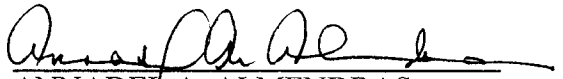
1 DATED: November 14, 2005

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