Business Desk

Memo Shows Enron Role in Hiking Prices Electricity: 'Smoking gun' document by company lawyers reveals tactics that helped create energy shortage in California last year.

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Enron documents released Monday show the company sought to manipulate power prices in California, creating artificial shortages through the use of aggressive trading tactics during the energy crisis.

The disclosure by federal energy regulators marks the first time that a company's own documents have provided clear evidence of market manipulation, critics said, which contributed to soaring prices and blackouts.

"What we have here is a blueprint of ... manipulation," said Robert McCullough, a Portland energy consultant and economist. "It's one thing for economists to state that these things are happening.... It's another thing for there to be internal documents on the table stating these things are happening."

The documents, uncovered as part of investigation by the Federal Energy Regulatory Commission into possible manipulation of California's electricity market, are seen as strengthening the state's hand in renegotiating costly long-term contracts with electricity sellers that were reached during the worst of California's energy crisis in early 2001.

California Democratic Sens. Barbara Boxer and Dianne Feinstein both called for a Justice Department investigation, with Boxer saying the documents "confirm what I've been saying for months, that Enron manipulated the California energy market and needs to be held accountable. It is high time we see some indictments handed down in this case."

Although Feinstein said the trading practices may violate federal fraud statutes, energy experts saw the strategies as infractions of market rules that are punishable by fines or suspensions rather than criminal prosecution.

The state's grid operator has sought a variety of remedies from FERC for such practices and received some relief in June in the form of price caps throughout the West and other mitigation measures.

Enron lawyer Robert Bennett said company executives, under new leadership after Enron's Dec. 2 bankruptcy filing, gave the documents to the government and waived attorney-client privilege because "they thought it was the right thing to do. The truth of the matter is, we don't know what the truth of the underlying facts are" in the memos.

Power shortages sent prices skyrocketing in May 2000, which pushed California's two largest privately held electricity utilities to the edge of ruin, caused six days of statewide blackouts and forced the state to buy power for more than 10million utility customers.

Enron and other power sellers have denied that they manipulated prices or power supplies, contending that the energy crisis was caused by a shortage of power plants and hydroelectricity.

"These documents make it clear that Enron was trying to squeeze every dime it could out of the market. It's not surprising that they violated [California Independent System Operator] rules because the ISO don't provide much punishment for violators," said Severin Borenstein, a UC Berkeley professor and director of the UC Energy Institute.

One memo, dated Dec. 6, 2000, and prepared by an Enron staff attorney and an outside lawyer in anticipation of investigations and lawsuits, explained how Enron traders exploited loopholes or market limitations to boost prices or to wring special payments out of the agencies that operated California's electricity markets.

Enron traders used such price-hiking techniques as sham congestion on electricity lines or selling electricity to out-of-state affiliates only to re-import it at higher prices, the memo said.

One strategy, code-named Death Star, "earns money by scheduling transmission in the opposite direction of congestion," the Dec. 6 memo said. "No energy, however, is actually put onto the grid or taken off."

A second undated memo, written by a different law firm, sought to cast a more favorable light on the strategies discussed in the first memo.

The second memo defended the Death Star strategy, saying it actually reduced congestion on electricity lines at times and increased supply along underused electricity lines.

The Dec. 6 memo also claimed that other traders had begun copying Enron's techniques, many of which have been identified by California officials, although without documented evidence.

"These are the smoking guns we always alleged," said Public Utilities Commission President Loretta M. Lynch. "These documents show their business plan was to game the California market so they could suck every dollar out of California."

Department of Water Resources spokesman Oscar Hidalgo said the department hopes the release of the Enron documents will spur more companies to renegotiate dozens of long-term contracts that DWR signed after it became the power buyer for customers of financially troubled utilities.

The California Independent System Operator, which runs California's last remaining official energy market, has asked FERC to grant the state $9 billion in refunds because prices charged in 2000 and 2001 were unreasonable, although the regulators now are considering a lower payment.

The quirks of the California energy market presented Enron and other market participants with myriad opportunities to take profitable advantage.

California had two markets: a "day-ahead" auction market through the California Power Exchange--"the PX," in trader lingo--and the "real-time" market run by Cal-ISO.

Traders quickly found ways to play the two markets off each other.

The day-ahead market was supposed to handle the bulk of the electricity requirements, and the real-time market was meant only to correct occasional imbalances.

When the crisis hit, the real-time market grew in importance and was the locus of wild price swings.

Buyers and sellers who wanted to participate in the real-time market were required to submit to Cal-ISO daily schedules of their production and their "load," or the amount of power they intended to use. The two were supposed to be in balance.

But sometimes when power supply was tight, Cal-ISO paid participants a premium when they happened to provide more power than Cal-ISO required.

One of Enron's basic strategies, according to the memo, involved deliberately overstating its load. It would deliver as much power as promised but then use less than scheduled and get a premium for the difference.

Another Enron stratagem was to take advantage of congestion in the real-time market that Enron had helped create in the day-ahead market, the memo said.

During the energy crisis, the amount of power scheduled for delivery into the California market sometimes exceeded the capacity of the system's transmission lines.

At such times, Cal-ISO would make "congestion payments" to market participants that either schedule transmission in the opposite direction or reduce their generation/load schedule.

"Because the congestion charges have been as high as $750/MW [per megawatt], it can often be profitable to sell power at a loss simply to collect the congestion payment," the memo said.

Enron traders, acknowledged as among the industry's most creative, worked a number of variations on these two themes. In addition to Death Star, other colorful nicknames for trading methods included Get Shorty, Ricochet and Fat Boy to identify them in discussions with traders from other firms.

California imposed price caps to cope with the emergency, but even these offered an opportunity for clever traders who realized that prices weren't capped in neighboring areas that were affected by the crisis.

On Dec. 5, 2000, for example, prices soared to $1,200 per megawatt-hour in the Pacific Northwest, while a $250 cap was in place in California.

Enron traders saw that they could lock in an instant $950 profit for each megawatt-hour of electricity by buying power on the California PX and selling it up north, according to the memo.

"This strategy appears not to present any problems, other than a public relations risk from the fact that such exports may have contributed to California's declaration of a Stage 2 emergency yesterday," the memo said.

Cal-ISO spokeswoman Stephanie McCorkle said some of the behaviors probably caused prices to rise, but the grid operator does not believe they contributed to the six days of blackouts in early 2001. The reason, she said, is that the blackouts were caused by a severe shortage of power, not by phantom congestion.

Cal-ISO has asked FERC to extend market protections that are due to expire Sept. 30, including a price cap on electricity in the West.

Times staff writer Richard Simon in Washington contributed to this report.