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FEDERAL ENERGY
REGULATORY COMMISSION

**Avista Corporation
Avista Energy, Inc.
Portland General Electric Company
Enron Power Marketing, Inc.**

Docket No. EL02-115-000

**FERC Trial Staff
Investigation Report**

Filed: January 30, 2003

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Appendix A: FERC Trial Staff Investigation Report

I. Introduction

This report sets forth FERC Trial Staff's investigation of the energy transactions and market activities of Avista Corporation (Avista Utilities) and Avista Energy, Inc. (Avista Energy) (collectively, Avista) during the 2000 and 2001 period. The Commission initiated this investigation to examine instances of possible misconduct by Avista and two affiliates of Enron Corporation: Enron Power Marketing, Inc. (EPMI) and Portland General Electric Corporation (PGE) to determine, among other things, whether any misconduct occurred.¹ This case is an outgrowth of the Commission's fact-finding investigation into potential manipulation of short-term prices in electric or natural gas markets in the Western United States in 2000 in Docket No. PA02-2-000.²

In the wake of the Enron bankruptcy filing in December 2001, allegations arose to the effect that Enron had used its market position to manipulate prices in the Western energy markets. During the Commission's investigation in Docket No. PA02-2-000, certain Enron memoranda came to light revealing trading strategies designed by Enron that appeared to circumvent the California Independent System Operator (CAISO) market rules as well as the Commission's regulations. These memoranda, in turn, sparked further

¹*Avista Corp. et al.*, 100 FERC ¶ 61,187 (2002) (August 13 Order).

²Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices, 98 FERC ¶ 61,165 (2002) (February 13 Order).

investigation into possible "energy laundering," "wash trades," "loop flows," and "sell/buyback" schemes by all Western energy market participants. In response to the Commission's industry-wide data request of May 8, 2002 for information regarding energy trading during 2000 (May 8 Data Request), PGE filed responses with the Commission identifying its participation in certain power transactions initiated by Enron that appeared to be part of the strategies outlined in the Enron memoranda. PGE also reported that Avista Utilities had been involved in certain of these transactions during the months of April, May, and June of 2000.³

Avista Utilities' response to the Commission's inquiry stated that it was not involved in any of the Enron trading strategies and the Commission subsequently issued an Order to Show Cause Why Market-Based Rate Authority Should Not Be Revoked (Show Cause Order) requiring further information from Avista Utilities.⁴ Based on the Commission's review of Avista Utilities' response to the Show Cause Order, the Commission determined that further investigation was required and set the instant case for hearing, as described in the August 13 Order.⁵

³The dates of those transactions as originally identified by PGE were: April 6, 2000, April 15, 2000, April 16, 2000, April 23, 2000, April 26, 2000, May 1, 2000, May 2, 2000, May 3, 2000, May 4, 2000, May 5, 2000, May 9, 2000, May 10, 2000, May 11, 2000, May 12, 2000, May 15, 2000, May 31, 2000, June 6, 2000, and June 15, 2000.

⁴99 FERC ¶ 61,272 (2002).

⁵*Avista Corp. et al.*, 100 FERC ¶ 61,187 (2002).

As stated in the Agreement and Resolution of this section 206 proceeding, FERC Trial Staff's investigation found: (1) no evidence that any executives or employees of Avista Utilities or Avista Energy knowingly engaged in or knowingly facilitated any improper trading strategy; (2) no evidence that Avista Utilities or Avista Energy knowingly engaged in any efforts to improperly manipulate the Western energy markets during 2000 and 2001; and (3) no evidence that Avista Utilities or Avista Energy withheld relevant information from the Commission's inquiry into the Western energy markets in Docket No. PA02-2-000.

As a part of the Agreement and Resolution reached in this proceeding, Avista Corporation agrees to pay \$75,000 within 30 days of a final and non-appealable Commission order approving this Agreement, without modification, to the U.S. Treasury to partially reimburse the costs of the Commission Trial Staff's investigation, and efforts to expedite that investigation. This payment is not a fine, penalty, or refund, and should not be construed as such. Avista Corporation shall make this payment by delivering a certified check, payable to the Federal Energy Regulatory Commission, to the following address: Federal Energy Regulatory Commission, Lockbox 93938, Chicago, Illinois 60673.

The following discussion represents FERC Trial Staff's assessment of the matters set for hearing in this case and is based entirely on the FERC rules and regulations,

policies, and procedures, and the CAISO Tariff and applicable laws that were in place during 2000 and 2001.

II. Western Power Market Manipulation Review

FERC Trial Staff investigated several avenues by which Avista Utilities and Avista Energy could have improperly manipulated markets, or participated in the improper manipulation of markets, in 2000 and 2001 to gain competitive advantages. FERC Trial Staff examined patterns of behavior related to the named Enron strategies; investigated Avista Utilities and Avista Energy forward power market transactions and futures market transactions; reviewed scheduling coordinator agreements, confirmation agreements, and master umbrella agreements; searched for Enron-type strategies by Avista Utilities and Avista Energy; compared corollary positions in the options markets; reviewed internal recordings of transactions and related accounting settlement practices; listened to hundreds of hours of taped energy trader conversations; examined corporate organizational structures, employee histories, training programs, employee performance plans, and standards of conduct training; reviewed internal management reports, minutes of the Board of Directors, and risk management reports; reviewed Avista Utilities' OASIS operation; and examined affiliate transactions. In addition, FERC Trial Staff reviewed data and information relative to the PGE proceeding in Docket No. EL02-114-000.

As described below, FERC Trial Staff did not find evidence indicating that Avista Utilities or Avista Energy attempted to improperly manipulate the Western Energy Markets in 2000 and 2001.

A. Enron Strategies

The Enron memoranda outlining Enron's energy trading strategies in the California wholesale power markets describe an effort by Enron's management and traders to enhance Enron's marketing positions using loopholes and weaknesses in the CAISO's tariff. The memoranda suggest that some of these strategies may have been based on the filing of false power transaction schedules with the CAISO. Other strategies appear designed to position power in the market ahead of demand or to create the false impression that Enron's schedules were aiding the ISO to relieve congestion in the California grid. Still other strategies required Enron to involve other counterparties in order to temporarily move energy out of California or temporarily out of Enron's control.⁶ In the discussion below we address three specific Enron strategies. The implementation of two strategies called "Deathstar" and "Big Foot," which according to Enron documents, involved Avista Utilities. The third, called "Get Shorty," involved Enron's ancillary services market activities, which did not directly involve either Avista Utilities

⁶The reasons for this are not clear to FERC Trial Staff. Due to constraints in obtaining evidence from Enron, as described below in the section titled "Enron Data Discovery Issues," FERC Trial Staff was not able to ascertain why Enron believed it was necessary to involve other counterparties in the circular schedule strategies. The result was, however, to make the audit trail murkier.

or Avista Energy. However, Avista Energy had numerous ancillary service transactions and FERC Trial Staff sought clarification regarding those transactions to see if they were similar to "Get Shorty."

1. Deathstar

Enron's "Deathstar" strategy is described as a series of transactions in which energy is sold to companies outside the state of California for immediate re-purchase and importation back into California. As defined in the Commission's May 8 Data Request and the Enron memoranda, Deathstar transactions are transactions in which a company schedules energy in the opposite direction of congestion, thus allowing the company to receive congestion payments from the CAISO, but fails to actually put energy onto the grid or take energy off of the grid. The CAISO describes these schedules as circular schedules that include a series of two or more export and import schedules that begin and end in the same control area.⁷

a. Avista's Involvement

Enron appears to have involved Avista Utilities as a middleman between EPMI and its affiliate PGE to implement the Deathstar strategy in April, May, and June of 2000 by processing certain sales from EPMI to PGE through Avista Utilities. Whether, and to what extent, Avista Utilities was a knowing partner in these transactions is central to the

⁷Response to FERC Trial Staff data request Staff-ISO 1-1: "Analysis of Trading and Scheduling Strategies Described in Enron Memos," a Report by CAISO Department of Market Analysis, October 4, 2002, included in Appendix B, Tab 1.

Commission's concerns in this case. As discussed more fully below, FERC Trial Staff found no evidence that Avista Utilities was a knowing participant in Enron's Deathstar strategy.

Although, as noted, FERC Trial Staff reviewed documents, correspondence, accounting records, internal reports, and transaction logs, nothing indicated that any executives or employees of Avista Utilities or Avista Energy knowingly engaged in or knowingly facilitated any of the Enron trading strategies. Further, FERC Trial Staff found no evidence that any executives or employees of Avista Utilities had any knowledge of the Enron trading strategies prior to the Commission's release of the Enron memoranda on May 6, 2002.⁸

Nonetheless, in pursuit of the Commission's concern, FERC Trial Staff subjected all of the transactions referenced in PGE's May 17, 2002 letter to Avista Utilities (included in Avista Utilities' response to the Commission's May 8 Data Request) to extensive scrutiny. Trial Staff submitted data requests to PGE as well as Avista Utilities to fully examine these transactions and found that PGE's accounting for these transactions is different from the Avista's accounting of the same transactions.⁹ In particular, PGE shows two buy-sell exchanges with Avista for each transaction, while Avista accounts for

⁸Response to FERC Trial Staff data request Staff-Avista-5-8, included in Appendix B, Tab 2.

⁹PGE's participation in these transactions is being addressed by Trial Staff in Docket No. EL02-114-000.

only one exchange for the same transaction.¹⁰ However, Trial Staff found that this discrepancy does not alter its conclusions in this proceeding with respect to Avista Utilities. This discrepancy is more fully discussed below.

In addition, FERC Trial Staff examined other transactions between Avista Utilities and Enron, and Avista Utilities and PGE; as well as transactions between Avista Energy and Enron, and Avista Energy and PGE. That scrutiny involved reviewing the daily transaction logs and the accounting records related to the transactions, interviewing traders who were involved in executing the transactions, listening to tapes of trader conversations about the transactions, and examining the transmission paths associated with the transactions. FERC Trial Staff also spoke extensively with senior management and trading personnel of both Avista Utilities and Avista Energy.

The only Enron strategy in which FERC Trial Staff found any evidence of involvement by Avista Utilities – an involvement that appears to FERC Trial Staff to be unknowing – was the “Deathstar” trading strategy.¹¹

FERC Trial Staff’s examination of potential Deathstar transactions involved the comparison of thousands of bilateral energy trade transactions between Enron and Avista Utilities with thousands of Avista Utilities and PGE transactions, where FERC Trial Staff

¹⁰Response to FERC Trial Staff data requests Staff-PGE-2-3, 2-5, 2-6, and 2-7, included in Appendix B, Tab 3.

¹¹Enron documentation identifies another trading strategy called “Forney’s Perpetual Loop,” which appears to be the same as, or similar to, the Deathstar trading strategy.

looked for pairs of transactions having the same date, time, quantity of energy, and roughly the same prices. Such pairs of transactions executed within very short time periods (minutes) would indicate a sleeving transaction and a possible link in the Deathstar circular schedule transactions. Similarly, FERC Trial Staff compared thousands of bi-lateral energy trade transactions between Enron and Avista Energy with thousands of Avista Energy and PGE transactions. Further, Trial Staff examined various accounting transactions and transmission paths to determine any unusual patterns of transactions used by Avista Utilities. Other than the transactions referenced in the days cited by PGE, FERC Trial Staff found no other pairs of transactions that would suggest a Deathstar chain of transactions involving either Avista Utilities or Avista Energy.

In the transactions on the days referenced in the Commission's Show Cause Order, according to its records, Avista Utilities' role was to purchase power from Enron at the California-Oregon border (COB), and then to resell that power to PGE at COB. Avista Utilities indicates that it did not use, purchase, or schedule any transmission for any of the transactions discussed in the Show Cause Order.¹² The transcripts of the trader conversations provided by Avista Utilities identify Avista Utilities' role in these transactions as performing a single buy/sell transaction at COB.¹³

¹²Response to FERC Trial Staff data request Staff-Avista-4-1, included in Appendix B, Tab 4.

¹³The transcripts from April 6, 2000 are not as clear as the others on this point. See Responses of Avista Corporation to the Commission's Show Cause Order

(continued...)

The telephone tapes and transcripts of the energy traders' conversations regarding these transactions evince uncertainty over the nature of the transactions, uncertainty over the transmission path, and uncertainty over the sources and sinks of the energy. However, FERC Trial Staff found that none of the tapes or transcripts indicate any knowledge on the part of Avista Utility energy traders that the transactions were part of any larger scheme to move energy in circular schedules. Moreover, Avista Utilities served as an intermediary between Enron and PGE at the request of Enron, and FERC Trial Staff found no evidence that Avista Utilities initiated any of the transactions.

Despite this exhaustive analysis of Avista Utilities' role in the Deathstar transactions, FERC Trial Staff remains uncertain as to precisely how the Deathstar strategy worked with respect to these transactions and why it was structured the way it was. Answers to these questions regarding the overall scheme and mechanism and to the extent that they would implicate Enron in an inappropriate circular schedule, lie with Enron employees, who FERC Trial Staff has been barred from contacting due to ongoing investigations by the U.S. Department of Justice. Inasmuch as Avista Utilities was an unknowing partner in these transactions, it cannot explain the overall scheme and mechanism.

¹³(...continued)
(Attachment A, at 6-14, filed June 14, 2002, in Docket No. PA02-2-000).

b. Transaction Discrepancy

Avista Utilities maintains that the nature of the transactions on each day referenced in the Show Cause Order was a single purchase from Enron and immediate sale to PGE at COB. PGE maintains that there was a second transaction with Avista Utilities at PGE's system, suggesting a string of transactions: Enron to Avista Utilities at COB; Avista Utilities to PGE at COB; PGE back to Avista Utilities at PGE's system; and Avista Utilities back to Enron, also at PGE's system. Avista Utilities provided extensive documentation supporting their position in Docket No. EL02-115-000, and PGE provided documentation supporting its position in Docket No. EL02-114-000.¹⁴

FERC Trial Staff assigned to the Avista docket examined both sets of documentation in an effort to resolve this discrepancy and accepts the validity of Avista Utilities' documentation. Avista Utilities submitted two types of documents in its response to the Show Cause Order that demonstrate a single buy/sell transaction at COB: 1) taped transcripts, which indicate the energy traders agreed to a single buy/sell (Enron to Avista Utilities to PGE) at COB, and 2) daily transaction logs (greenbar sheets), which show the real time energy traders' handwritten notes reflecting a single buy/sell (Enron to Avista Utilities to PGE) at COB.

¹⁴With respect to PGE's documentation, FERC Trial Staff in this docket examined the transcripts of PGE energy traders' real time transactions, PGE's computer generated summary of daily transaction logs, and joined in certain interviews with PGE staff at Commission headquarters. At the time of these interviews, the transaction discrepancy was not yet apparent.

However, the daily transaction logs also show the subsequent substitution of PGE for Enron in those transaction paths in handwritten notes by the account settlement personnel. FERC Trial Staff interviewed the Avista Utilities account settlement personnel on four occasions during the course of this investigation, twice at FERC headquarters in Washington, DC, twice at Avista Utilities headquarters in Spokane, Washington. The focus of these interviews was the after-the-fact adjustments to the greenbar sheets and the nature of the underlying transactions.¹⁵ As explained by the Avista Utilities personnel, a dispute arose between Enron and PGE regarding who would pay Avista Utilities for its part in the transactions. Neither Enron nor PGE would initially accept responsibility for the 25¢ to \$1.00 markup on the transactions. After months of negotiations over the payment for the markup related to each transaction, the parties agreed that Enron would be responsible for the April 6th, 15th, and 16th charges. As a result, the account settlement personnel adjusted the accounting for the transactions, showing instead a sale from PGE to Avista Utilities, and then a sale from Avista Utilities to Enron.¹⁶ After April 16th, the parties agreed that PGE would be responsible for the charges. Therefore, the account settlement personnel adjusted all the subsequent disputed payments for the markup to show sales from PGE to Avista Utilities, and then sales from Avista Utilities back to PGE, essentially deleting Enron from the transactions.

¹⁵See the sample greenbar sheet showing hand-written adjustments, included in Appendix B, Tab 14.

¹⁶*Id.*

These account transaction adjustments for payment purposes have given rise to a serious misconception regarding the nature of the originally agreed-to transaction. Where the original transaction as revealed in the transcripts, is an Enron to Avista Utilities to PGE chain, the accounting adjustments show a PGE to Avista Utilities to PGE chain. Not only were the buyers and sellers reversed, but the order in which the buy/sells occurred has been reversed. Moreover, the computerized accounting "papertrail" for both Avista Utilities and PGE, which was compiled subsequent to the actual transactions, reflects, in general, the subsequent agreed-to accounting settlement substitutions, *i.e.*, a sale by PGE (rather than Enron) to Avista Utilities and a sale from Avista Utilities to PGE. Further, the order in PGE's records is reversed to reflect Avista Utilities-to-PGE and PGE-to-Avista Utilities. Nevertheless, despite the appearance of multiple transactions, the records describe only one pair of buy/sell transactions on each date.

Although Avista Utilities' share of the dollar amount arising out of these transactions is *de minimus* (total revenues to Avista Utilities for the entire set of transactions was approximately \$2,500), it is important to address the perceptions created by these accounting reversals. If PGE's reordering of the transactions reflected the transactions that actually occurred, that would change the nature of the deals the parties executed. Thus, if the Avista Utilities-to-PGE transaction actually preceded the PGE (Enron)-to-Avista Utilities transaction, it would suggest a chain Avista Utilities-to-PGE-to-Avista Utilities, making PGE the sleeve for Avista Utilities. This would suggest that

Avista sold at one end of PGE's system and bought at the other end, placing Avista Utilities at two points in the Deathstar loop. If that were the case, it would indicate that Avista Utilities was the originator of the scheme. Otherwise, Enron would have to re-purchase the energy from Avista to make Deathstar work correctly. Thus, the order in which the deals occurred is important. However, there is nothing to suggest that more than one pair of buy/sell transactions, Enron to Avista Utilities to PGE, actually took place.

FERC Trial Staff examined the PGE accounting statements for these transactions and found that PGE's internal accounting records appear to be inaccurate in some places and reflect apparent uneconomic behavior in others.¹⁷ PGE's accounting records essentially depict the events each day as involving two transactions, *i.e.*, PGE buying energy from "WWPC" (Washington Water Power, *i.e.*, Avista Utilities) at one price and selling it immediately back to "WWPC" at a lower price. For example, on April 6th, 2000, PGE shows it bought 25 MW at \$28.25 and sold the same 25 MW for \$28.00, losing 25¢ on every MW bought and sold. Similar entries follow on April 23rd and 26th. Subsequent entries in PGE's Summary show prices that conflict with the prices agreed to by the real time energy traders as seen in both the transcripts and greenbar sheets. For example, the entries made by PGE from May 2nd through June 6th reflect Avista Utilities (shown as

¹⁷Response to FERC Trial Staff data request Staff-PGE-2-3, "Summary of Transactions Occuring (sic) During 17 Days Between April 6 - June 6, 2002 Study Dated May 21, 2002" (Protected Materials) included in Appendix B, Tab 3.

WWPC) selling to PGE at prices \$1.00 below what the traders agreed to (except for May 10th which reflects the trader-indicated prices).

FERC Trial Staff sought Avista Utilities' understanding of this discrepancy regarding the number of transactions. Avista Utilities representatives stated that they do not know why PGE would have entered the transactions differently on PGE's internal reports.

The conclusion of the FERC Trial Staff assigned to the Avista case accepts Avista's records as credible and reflecting what Avista itself knew at the time. Avista Utilities' daily transaction logs tell a compelling story: they show real time purchases from Enron and real time sales to PGE, and subsequent adjustments to reverse or replace the transaction simply for payment purposes. If PGE's version were correct, Avista Utilities' transaction logs would have shown two transactions on each date (Enron-Avista-PGE and PGE-Avista-Enron). Further, if PGE's version were correct, Avista Utilities' accounting records would have shown compensation from two pairs of buy/sell transactions on each date. However, Avista Utilities' transaction logs and accounting records show only one pair of buy/sell transactions for each date, and Trial Staff has neither received nor found other evidence from Avista contradicting the evidence set forth in Avista's transaction logs and accounting records. Therefore, FERC Trial Staff concludes that Avista Utilities did not take a knowing part in the Enron Deathstar circular schedule strategy.

2. Big Foot

Another Enron strategy appears to have involved purchasing energy from Avista Utilities and scheduling it into the California market as supplemental energy.¹⁸ Enron called this strategy "Big Foot." This strategy does not appear to be manipulative in nature, but simply a marketing tool aimed at a specific market niche. The strategy came to FERC Trial Staff's attention as a result of an Enron e-mail produced by PGE entitled "Annuity's and Big Foot" (sic) that references a Big Foot transaction involving "Washington Water Power" (the predecessor of Avista Utilities).¹⁹

FERC Trial Staff explored whether Avista Utilities or Avista Energy had any knowledge of transactions referred to as an "Annuity" or as "Big Foot," or had ever engaged in such transactions. Avista Utilities and Avista Energy denied having been aware of an Enron Big Foot strategy apart from their review of the same Enron materials used by FERC Trial Staff to formulate its inquiry, and stated that the term is not used by Avista Utilities to describe any electricity transaction.²⁰ FERC Trial Staff's review of all

¹⁸The CAISO tariff defines Supplemental Energy as energy from Generating Units and other resources which have uncommitted capacity following finalization of the Hour-Ahead Schedules and for which Scheduling Coordinators have submitted bids to the CAISO at least half an hour before the commencement of the Settlement Period. CAISO Tariff Sheet 350.

¹⁹Document included herein in Appendix B, Tab 5. (This document was originally included in PGE's response to its Show Cause Order.)

²⁰Response to FERC Trial Staff data request Staff-Avista-2-13, included in Appendix B, Tab 6.

of the transaction data and related documentation provided by Avista Utilities found no evidence to contradict the assertions of Avista Utilities or to otherwise demonstrate that either Avista Utilities or Avista Energy had engaged in anything identifiable as a Big Foot transaction.

To confirm these assertions, FERC Trial Staff submitted detailed inquiries regarding Avista Utilities' May 22, 2002 response to the Commission's May 8, 2002 data request. Schedule C of Avista's response to the Show Cause Order showed sales by Avista Utilities to EPMI under the generic Western Systems Power Pool (WSPP) umbrella agreements.²¹

FERC Trial Staff found that Avista Utilities was unable to sell power into the California supplemental energy markets because it lacked a scheduling coordinator agreement with the CAISO. It was able to sell into the supplemental energy market only through an entity, such as EPMI, that did have a scheduling coordinator agreement with the CAISO. In this case, Avista Utilities' sales to EPMI took place under the WSPP umbrella agreements. Avista Utilities' response to FERC Trial Staff stated that Avista Utilities did not have a separate written agreement with EPMI.

Further, FERC Trial Staff reviewed details of all transactions where EPMI served as a scheduling coordinator for Avista Utilities, and found no evidence of any improper

²¹Response to FERC Trial Staff data requests Staff-Avista 3-1 (without attachments), included in Appendix B, Tab 7; and Staff-Avista-4-4, included in Appendix B, Tab 6.

trading or pricing activity on the part of Avista Utilities in those transactions.²² No other entity was found to be a scheduling coordinator for Avista Utilities.

3. Get Shorty

Another Enron strategy outlined in the Enron memorandum, called "Get Shorty," dealt with ancillary services markets. This strategy was also described in the CAISO's October 4, 2002 "Analysis of Trading and Scheduling Strategies Described in Enron Memos," which was posted publicly by CAISO on January 7, 2003.²³ This report was first submitted (in November 2002) to Trial Staff by CAISO in response to a request for any studies the CAISO had performed regarding manipulation or potential manipulation of markets. As described in that report, the first form of Get Shorty was simply an arbitraging transaction whereby ancillary services were sold in the day ahead market to the CAISO and then bought back in the hour ahead market if prices were favorable. The second form of Get Shorty was more akin to gaming in that the resources were not actually available to provide the ancillary service. As outlined in the memo, the intent of this form was to buy back the service in the hour ahead market before they actually had to deliver and hope the prices were favorable.

²²Response to FERC Trial Staff data requests Staff-Avista 3-1 (without attachments) and 3-2, included in Appendix B, Tab 7.

²³Response to FERC Trial Staff data request Staff-ISO-1-1, included in Appendix B, Tab 1.

FERC Trial Staff's interest centered on the second form of the strategy and, in particular, whether the sellers of ancillary services actually had the resources available when they bid the resources into the market. FERC Trial Staff found that Avista Energy was active in the arbitraging of ancillary services markets. Accordingly, upon review of the CAISO report, Trial Staff further explored Avista Energy's potential utilization of the "Get Shorty" strategy.

The CAISO's discussion of the Get Shorty strategy included a table showing the sellback of ancillary services to 21 counterparties, including Avista Energy. The table indicated that CAISO sold a net \$11.6 million worth of ancillary services back to Avista Energy in 2001 and a net \$128,758 worth of ancillary services back to Avista Energy in 2000. FERC Trial Staff requested back-up information on these figures and an explanation of Avista Energy's activities regarding the buyback of ancillary services.

Avista Energy provided documentation showing that during 2000 it sold 183,328 MWh of ancillary services to the CAISO and bought back 8,098 MWh. The pricing differential between the sales and purchase prices on those buybacks amounted to \$128,758. During 2001 Avista Energy sold 151,093 MWh to the CAISO and bought back 144,280 MWh. The pricing differential on those buybacks in 2001 was \$11,668,145. Avista Energy explained that in 2000, the day ahead and hour ahead markets were more or less in synchronism, with little or no pricing differential between the two on ancillary services. However, in 2001, large pricing differentials (often in excess of \$100/MWh)

showed up between the day ahead and hour ahead markets. These differentials between the day ahead prices and the hour ahead prices for ancillary services in 2001 led to more opportunities to economically buy back the services.²⁴

The cause of these pricing differentials appears to have been the result of the CAISO's practice in late 2000 and mid 2001 of purchasing more ancillary services in day ahead markets than it needed in order to ensure that the supplies of these services would be adequate. This "overpurchasing" strategy would tend to drive up ancillary services prices in the day ahead market. These excess supplies then became available for sale by the CAISO in the hour-ahead markets, driving down the prices in the hour ahead market, thus giving rise to the opportunity for arbitrage. The CAISO tariff permitted scheduling coordinators that sold ancillary services in the day-ahead markets to buy back those services in the hour-ahead market at the hour-ahead market clearing price. Avista Energy took advantage of this provision of the tariff to buy back ancillary services that it sold to the CAISO when prices were favorable for doing so.

These buy-back transactions provided economic benefits to both the CAISO and Avista Energy. They relieved the CAISO of an obligation to pay for a service it did not need, and it allowed Avista Energy to lock in a profit on the price differential between the price at which it sold the services and the price at which it bought them back. In addition, with the resources resold to Avista Energy in the hour-ahead market freed from the

²⁴Avista Energy Ancillary Services 2000-2001 (Protected Materials) and CAISO Market Report - July 2, 2002 and July 3, 2002, included in Appendix B, Tab 8.

obligation tied to the ancillary services sale, Avista Energy was then able to market the resources in other directions.²⁵

A key question in the discussion of ancillary services transactions with respect to the manipulative Enron-type strategies is whether Avista Energy actually had the resources available when it initially sold the services to CAISO. While there is no way to determine whether services *not* called upon were in fact available, FERC Trial Staff did examine whether Avista Energy resources were available when they *were* called upon. The availability/non-availability of these resources can be gauged by the CAISO's July 3, 2002 market notices identifying market participants that failed to deliver ancillary services when called upon. For the period June 14, 1999 through April 30, 2002, the CAISO rescinded only \$53,466 of ancillary services payments due Avista Energy, as compared to \$129,040,522 in rescinded payments for all CAISO participants.²⁶ This indicates that a minuscule portion of the total rescinded payments was attributable to Avista Energy. The cause of the Avista Energy rescission was primarily due to a one-time, one-hour non-performance incident related to timing problems between when the services were called upon, and when the power could be delivered out of Avista Energy's contracted suppliers. Avista Energy states that it disputed the rescission because of the lateness of the call from

²⁵The CAISO "hour ahead" market closed three hours ahead of actual transmission, allowing parties that bought back ancillary services to schedule that energy into other markets' hour ahead scheduling.

²⁶Avista Energy Ancillary Services 2000-2001 (Protected Materials) and CAISO Market Report - July 2, 2002 and July 3, 2002, included in Appendix B, Tab 8.

the CAISO. The next hour, the energy was delivered when timely called for by the CAISO. Thus, it does not appear that Avista Energy attempted to manipulate the ancillary services market in the time period reviewed.

B. Other Specific Inquiries

1. Avista Core Businesses

In response to the Commission's concerns regarding any manipulation in the Western power markets, FERC Trial Staff sought to ascertain whether either Avista Utilities or Avista Energy attempted to manipulate the Western energy markets, apart from any such manipulations Enron may have been attempting. FERC Trial Staff reviewed numerous Avista Utilities and Avista Energy internal corporate reports, interviewed corporate representatives and energy traders, and examined power trading transactions to uncover patterns of behavior that would be consistent with an effort to improperly manipulate energy markets. No such behavior was found.²⁷

FERC Trial Staff's analysis of Avista Utilities' core business and energy market transactions indicates that Avista Utilities is basically a load serving utility with a net import of energy onto its system through 2000 and 2001.²⁸ During much of the period

²⁷FERC Trial Staff data requests Staff-Avista-1-9, 1-11, 1-12, 1-13, 1-14, 1-20, 1-21, 1-14, 1-25, 1-28, 1-29, 1-32, 1-33, 1-35, 1-38, 1-40, 1-42, 1-43, 1-44, 1-47, 1-49, 1-51, 1-53, 1-55, 1-58, 1-59, 1-61, 1-62, 1-63, 1-65, 1-66, 2-1, 2-2, 2-7, 2-8, 2-9, 2-10, 2-12, 2-13, 2-14, 3-1, 3-2, 3-3, 3-4, 3-5, 3-6, 4-2, 4-4, 4-5, 4-6, 4-7, 4-8, 5-4, 5-5, 5-6, 5-7, and 5-11.

²⁸Response to FERC Trial Staff data request Staff-Avista 1-2, included in
(continued...)

covered by the August 13 Order, Avista Utilities was in a net short position with respect to its supply resources, and thus was forced to purchase a substantial amount of power on the wholesale markets. As such, Avista Utilities would have had no apparent incentive to manipulate Western energy markets so as to raise prices.

Avista Energy presents a more complex situation. As a marketing entity, Avista Energy's core business is the arbitrage of pricing between those that have energy and those that need it. Being on top of market conditions and unfolding events, and taking advantage of pricing differentials, is "the name of the game." The key difference between "playing the game" and "gaming the market" is whether an entity plays by the rules or whether it breaks the rules. The CAISO Tariff's Market Monitoring and Information Protocol Section 2.1 specifies market behaviors that are subject to scrutiny and corrective action by the CAISO.²⁹ The filing of circular power transaction schedules with the ISO and other control area coordinators, as outlined in the Enron memoranda, is against the CAISO rules. However, FERC Trial Staff's analysis of Avista Energy transactions found no evidence that Avista Energy submitted misleading power transaction schedules with the

²⁸(...continued)

Appendix B, Tab 9. *See also* Avista's SEC Form 10-Q, as of June 30, 2002, at 27-28.

²⁹In particular, the CAISO tariff warns against unusual activity or circumstances related to imports or exports to other markets or exchanges (Section MMIP 2.2.2.5). The tariff also warns against "taking advantage of other conditions that may affect the availability of transmission and generation capacity, such as loop flow... or other behaviors that may otherwise render the system and the ISO Markets vulnerable to price manipulation to the detriment of their efficiency" (Section MMIP 2.1.3).

CAISO or other control area coordinators. Avista Energy's power transactions appear to be nothing other than legitimate market transactions.

2. Turlock Irrigation District Arrangement

FERC Trial Staff investigated a series of marketing arrangements between Avista Energy and the Turlock Irrigation District (Turlock) after reviewing a copy of an internal memorandum written by a Turlock employee describing a visit that he had made to Avista Energy's trading floor.³⁰ The memorandum describes Avista Energy's relationship with Turlock and several of their trading strategies in the California markets. As a result, FERC Trial Staff explored in detail the nature of the relationship between Avista Energy and Turlock and fully analyzed the proposals set forth in this memorandum. That review included the issuance of several data requests,³¹ the conducting of extensive interviews with Avista Energy personnel during FERC Trial Staff's field audit, and a detailed examination of contractual documents and transaction records in Avista Energy's possession. FERC Trial Staff's investigation found no evidence, particularly of the type

³⁰The October 1, 2000 memo from Ricardo Marquez to Ken Weisel, both Turlock employees, describing a visit by Marquez to Avista Energy and Avista Energy daily operations and sales arrangements, was forwarded to Avista Energy on May 17, 2002 in connection with the Commission's May 8, 2002 industry wide data request. Avista Energy included the letter and memo in its own May 22, 2002 response to the Commission's May 8, 2002 data request.

³¹FERC Trial Staff data requests Staff-Avista 3-2, 3-3, 3-5, 3-6, and 4-8, listed in Appendix C.

described in the Turlock memorandum, that Avista Energy engaged in any improper trading activities in its relationship with Turlock during 2000 and 2001.

The Turlock Irrigation District is a municipal entity located in California that provides irrigation water and electric power from its hydroelectric dams and projects on the Toulumne River. Turlock possesses firm transmission rights across numerous pathways in both California and the Pacific Northwest that enable Turlock to move power in the region with a firm priority. When Turlock chose not to join the CAISO as a Participating Transmission Owner, its transmission rights were grandfathered and not subject to the CAISO tariff. To sell directly into the CAISO markets, parties must sign a scheduling coordinator agreement with the CAISO. Because Turlock did not do so, it requires the use of scheduling coordinator arrangements with third parties in order to sell energy or capacity into the CAISO's markets.

The evidence examined by FERC Trial Staff indicates that Turlock and Avista Energy engaged in three types of transactions during the period at issue. The first type of transaction consisted of straightforward sales of energy either from Avista Energy to Turlock, or from Turlock to Avista Energy. FERC Trial Staff's examination of these transactions revealed nothing that would suggest any improprieties on the part of Avista Energy.

The second type of transaction was conducted pursuant to an arrangement between Turlock and Avista Energy under which Avista Energy provided its market expertise to

help Turlock optimize the use of its extensive set of transmission rights on the Western grid. Thus, Turlock entered into a contractual relationship with Avista Energy for help in effecting Turlock's transmission optimization strategy through incremental power sales using excess capacity on Turlock's transmission rights. This arrangement with Turlock involved a sharing of the net revenues garnered from the power sales transacted. Avista Energy provided FERC Trial Staff with a CD containing details of these transactions.³² FERC Trial Staff found no evidence that either Turlock's transmission optimization strategy, or Avista Energy's efforts to assist Turlock in effecting that strategy, were conducted in an improper manner.

The third type of contractual arrangement between Avista Energy and Turlock was a scheduling coordinator arrangement for sales of energy and capacity by Turlock into the CAISO's markets. Avista Energy performed this scheduling coordinator function for Turlock on numerous occasions during 2000 and 2001. The details of these transactions were provided by Avista Energy in the same CD referenced above. Generally, Avista Energy bid energy into the CAISO's markets on Turlock's behalf as a price-taker.³³ Turlock would receive the CAISO market-clearing price, which Avista Energy would pass

³²Response to FERC Trial Staff data request Staff-Avista 4-7 (without certain transaction data attached to the response), included in Appendix B, Tab 10.

³³A "price taker" bids power into the market at a zero price to ensure its position in the stack of scheduled power. As the CAISO adds power generation to the stack to meet actual load increases, higher cost generation is called on, which raises the market clearing price. The zero price and other lower cost bidders receive the market clearing price.

on to Turlock, less a \$0.13/MWh charge for performing the scheduling coordinator service. FERC Trial Staff's examination of these scheduling coordinator transactions found no evidence of any improper trading behavior on the part of Avista Energy.

C. Congestion Management

The description of the Deathstar strategy in the Enron Memoranda indicates that a primary element of the strategy was to schedule power in such a way as to take advantage of congestion caused by the inadequacy of the transmission grid and the congestion management provisions of the CAISO's tariff. FERC Trial Staff sought to ascertain whether Avista Utilities or Avista Energy earned congestion relief payments in conjunction with the misuse of Enron's scheduled power transactions or through the misuse of their own scheduled power transactions. FERC Trial Staff found no evidence that Avista Utilities or Avista Energy manipulated the California congestion management mechanism in 2000 and 2001.

Participants in the California power markets in 2000 and 2001 were required to submit Preferred Energy Schedules, Adjustment Bids, and Ancillary Services Bids to the CAISO in the day ahead transmission scheduling protocols. The Preferred Energy Schedule reflected the participant's desired transaction. The Adjustment Bid reflected the participant's marginal costs of maintaining its bid despite congestion or rescinding its bid due to congestion. The Ancillary Services Bid assured the CAISO that the scheduling coordinator had sufficient ancillary services contracted to ensure grid integrity.

As noted in the CAISO Tariff, congestion occurs when there is insufficient capacity to simultaneously implement all the preferred schedules submitted to the CAISO.³⁴ The CAISO attempted to alleviate congestion in both the day ahead and hour ahead markets by scheduling inter-zonal interfaces based on the highest value Preferred Schedule Bids and the congestion Adjustment Bids submitted by scheduling coordinators. The CAISO Tariff provided that all power scheduled along a congested path would be charged a congestion surcharge as an economic incentive for marketers and utilities to find other alternative sources or transmission routes. The CAISO Tariff also provided that parties that scheduled power in the opposite direction of the congested path would receive congestion relief payments for assisting the CAISO in managing congestion. At times of peak congestion, the congestion relief payments could greatly exceed the value of the power itself. Consequently, market participants that submitted Adjustment Bids that alleviated congestion, or appeared to do so, stood to earn substantial rewards at peak times.

FERC Trial Staff notes that scheduling power transactions to take advantage of market conditions and tariff provisions is not a violation of any Commission regulation and, in general, constitutes sound business practice and improves the liquidity of the market. However, a key element of the Deathstar strategy, as outlined in Enron's memoranda, appears to be the filing of circular transmission schedules that did not reflect intended or actual power flows, and which were intended to game the system with

³⁴CAISO Tariff, Section 7.2.1.1.

intentionally misleading schedules. The filing of such circular schedules could be a violation of the CAISO's anti-gaming provisions.

FERC Trial Staff examined the correlation between the CAISO congestion peaks in 2000 and 2001 and the days of transactions specified by the Show Cause Order. FERC Trial Staff found no correlation between the congestion payments by the CAISO and the transactions in question. The information reviewed by FERC Trial Staff showed that Avista Utilities never sold directly into the CAISO or Cal PX markets and received no congestion payments from the CAISO during 2000 or 2001.³⁵ Staff also reviewed the Master Purchase and Sale Agreements for Avista Utilities and Avista Energy for the years 1999-2001 and copies of all relevant contract information.³⁶ Consequently, FERC Trial Staff found no evidence that Avista Utilities manipulated the California congestion management mechanism in 2000 and 2001.

Avista Energy, however, did transact directly in the California markets and was affected by congestion conditions and the CAISO's congestion management system. Avista Energy submitted congestion Adjustment Bids for one of two reasons: first, to mitigate the risk of congestion impacting Avista Energy imports into California markets (i.e., Avista Energy was willing to pay higher rates to stay on its preferred schedule); and,

³⁵Response to FERC Trial Staff data requests Staff-ISO-1-1, 1-2, 1-3 (Protected Materials), and 1-4, included in Appendix B, Tab 11; and Response to FERC Trial Staff data requests Staff-Avista 1-30 (without attachments) and 3-6, included in Appendix B, Tab 12.

³⁶FERC Trial Staff data requests Staff-Avista-1-39 and 1-40, listed in Appendix C.

second, to alleviate the congestion caused by other parties or conditions on the transmission grid (i.e., Avista Energy was willing to be paid to withdraw its preferred schedule).

As a scheduling coordinator with the CAISO, Avista Energy, like most other marketing entities in the West, had thousands of transactions with other parties in the California markets. In response to FERC Trial Staff data requests, Avista Energy indicated that it received a net \$315,000 in congestion relief payments in 2000, and paid a net \$1,458,000 in congestion payments in 2001.³⁷ FERC Trial Staff has examined confidential records supplied by the CAISO. These records do not suggest that Avista Energy was attempting to game the CAISO congestion management mechanisms. Moreover, FERC Trial Staff found no other evidence to indicate that Avista Energy manipulated the California congestion management mechanism in 2000 and 2001.

D. Options Markets Review

FERC Trial Staff's understanding is that even small variations in market pricing can have exaggerated effects on derivatives markets. The California and Western Energy markets of 2000 exhibited increasing volatility in both the direct transactions markets and the derivatives markets. FERC Trial Staff sought to determine whether Avista Utilities or Avista Energy had attempted to take advantage of opportunities presented by Enron

³⁷Response to FERC Trial Staff data request Staff-Avista 1-30 and confirmed by Staff-ISO-1-1 (Protected Materials), included in Appendix B, Tabs 12 and 11, respectively.

strategies to garner earnings in the derivatives markets. FERC Trial Staff examined the put and call positions reported by the Avista entities for the relevant time period and found no evidence of attempts to manipulate the Western energy markets during the relevant time period.³⁸

For example, if Avista Utilities intended to profit in the options markets on information relating to the Enron strategies, it would have undertaken positions that profit from an increase in energy prices. Such positions would include the buying of calls and selling of puts. However, as the response to Staff-Avista-2-1 shows, Avista Utilities' engaged in considerable selling of calls and buying of puts. Consequently, a substantial percentage of Avista Utilities' options portfolio was positioned to lose money with rising energy prices during the period in question. This evidence contradicts the notion that Avista Utilities used possible information concerning Enron's schemes and their consequent impact on energy prices in the western power markets to profit in the options markets.

Likewise, Staff found no evidence that Avista Energy used information relating to the Enron strategies to profit in the derivatives markets. For instance, with advanced knowledge of a future increase in energy prices, Avista Energy could have made windfall profits by purchasing forwards contracts that specified a low purchase price that did not

³⁸FERC Trial Staff data requests Staff-Avista 1-10, 1-11, 1-12, 1-13, 1-14, 1-20, 1-21, 1-22, 1-23, 1-24, 1-27, 1-28, 1-29, 1-35, 1-36, 1-38, 1-40, 1-42, 1-44, 1-54, 1-55, 1-58, 1-59, 1-60, 2-1, 2-2, and 2-3, listed in Appendix C.

consider the impact on energy prices of the Enron schemes. However, a review of the information provided in response to data request Staff-Avista-2-1B indicates that Avista Energy had sold a significant number of forwards contracts during the period in question. Consequently, there is no evidence to suggest that Avista Energy used knowledge of Enron's schemes to profit in the derivatives markets.

E. Internal Operations Issues

1. Daily Transaction Logs

FERC Trial Staff found that during 2000, real time energy transactions of Avista Utilities were recorded only on a daily log chart, called a "greenbar sheet." These greenbar sheets contain all the forward contracts that come due each day. These forward contracts are the result of thousands of transactions executed during over the prior months. The greenbar sheets are daily records that show the portfolio of contracts and physical resources (including Avista-owned generation) necessary to meet Avista Utilities' daily load requirements.³⁹ Adjustments and additions to the contracts to meet real time changes in supply or demand are hand-written on the greenbar sheets by the real time energy traders to reflect the trades that they execute. These transactions are simultaneously entered into a "regional transaction settlements system" called CASSO, which synthesizes the numerous transactions among all parties, and nets out all purchases and sales so that the parties in the Pacific Northwest pay only one monthly net bill to their counterparties.

³⁹Response to FERC Trial Staff data request Staff-Avista-2-11, and 1-47, included in Appendix B, Tab 13.

FERC Trial Staff first examined the greenbar sheets for the transactions in question on the dates referenced by the Commission's Show Cause Order, and then went on to examine Avista Utilities' greenbar sheets for scores of additional transactions. FERC Trial Staff also listened to the tapes of trader conversations from the dates referenced by the Show Cause Order, and compared the information from the tapes with the information on the greenbar sheets. FERC Trial Staff found that the real time handwritten notations accurately reflected the energy trades agreed to by the energy traders, as recorded by the taping system and transcribed in the Response to the Show Cause Order. FERC Trial Staff found that the greenbar sheets constitute a "paper trail" connecting the taped discussions of energy traders to the accounting settlement records in the CASSO billing reports. The greenbar sheets also show adjustments made by the account settlement personnel to settle billing disputes.⁴⁰

2. Telephone Taping System

Avista Utilities provided transcripts of the transactions that occurred on the 17 days in question in its response to the Commission's June 4th Show Cause Order. FERC Trial Staff subsequently requested and received copies of all of the available tape recordings of all Avista Utilities transactions for the entire years of 2000 and 2001.⁴¹ These tapes

⁴⁰See the sample greenbar sheet showing hand-written adjustments, included in Appendix B, Tab 14.

⁴¹FERC Trial Staff data request Staff-Avista 1-51, listed in Appendix C.

encompass thousands of hours of conversations and energy transactions over eight channels and involve numerous Avista Utilities personnel and counterparty personnel.

FERC Trial Staff's examination of the tape recordings discovered instances in which the electronic copy of the tape was not audible, and had incorrect time references. FERC Trial Staff also found that conversations on the tapes often jump from one channel to another, making them difficult to follow. FERC Trial Staff notes the impracticality of conducting an all-encompassing review of the thousands of hours of tapes in the possession of Avista Utilities, particularly under short time deadlines. The Avista Utilities' taping systems do not permit the use of word searches.

FERC Trial Staff's review targeted, but was not limited to, the April - June 2000 time period referenced in the Show Cause Order. For each of the referenced days, FERC Trial Staff listened to all calls, both real time and pre-schedule, within each 24 hour time period. This review entailed listening to many thousands of conversations.⁴² Additionally, FERC Trial Staff thoroughly reviewed numerous other dates from Avista Utilities' pre-scheduler trading tapes, channels three through nine, for April and May 2000. Further, FERC Trial Staff reviewed trading tapes from random days in March, April, November, and December 2000 and January 2001. Finally, FERC Trial Staff reviewed phone

⁴²As an example of the magnitude of reviewed calls, Channel One contained approximately 870 call segments for the single day April 26, 2000. The twelve hour period 12:00 AM to 12:00 PM, April 26, 2000, included approximately 940 call segments covering channels one through nine.

transcripts for Avista Energy during December 18-22, 2000 and various phone transcripts for Avista Utilities for the January 2000 - October 2001 time period.

FERC Trial Staff's investigation found that the inadequacies noted above suggested a need for a better recording system capable of easier review. FERC Trial Staff notes that Avista Utilities replaced its old system with a new Stencil DVD recording system in December 2000 comparable to the system used at Avista Energy.

3. Account Settlement Processes

FERC Trial Staff examined the accounting for energy trades in general and the accounting for disputed energy trades in particular.⁴³ FERC Trial Staff's investigation found several instances in which the accounting true-up for energy trades undertaken by real time energy traders did not match the transaction path discussed and agreed to by energy traders on the recorded transaction tapes. The differences between the accounting records and the tapes were a result of after-the-fact accounting settlements between Avista Utilities and its counterparties in which it was agreed that payment would be made in a manner different from that agreed to by the traders.⁴⁴

⁴³FERC Trial Staff data requests Staff-Avista-1-7, 1-8, 1-9, 1-13, 1-14, 1-20, 1-21, 1-22, 1-23, 1-32, 1-33, 1-34, 1-36, 1-37, 1-38, 1-39, 1-40, 1-41, 1-42, 1-44, 1-51, 1-52, 1-53, 1-57, 1-68, 1-69, 2-4, 2-5, 2-6, 2-7, 2-8, 2-9, 2-10, 2-11, 2-12, 3-1, 3-2, 3-3, 4-2, 4-3, 4-7, and 4-10, listed in Appendix C.

⁴⁴Response to FERC Trial Staff data request Staff-Avista-4-2, listed in Appendix B, Tab 15.

FERC Trial Staff found that the process for reconstructing details of disputed energy transactions relied in large part on the hand-written notes on the greenbar sheets, hand-written notes taken by the accounting personnel, and on the personal recollections of the traders involved. In several instances, after-the-fact notations were made on the greenbar sheets to reflect the accounting settlement of a transaction, rather than the actual energy transaction agreed to by the energy traders.⁴⁵ The reliance on hand-written notations and personal recollections can raise questions as to the reliability of the transaction recording and the accounting process. However, Avista Utilities asserted that all Commission-required quarterly transaction reports were filed reflecting the transactions that the traders recorded.⁴⁶ Thus, these quarterly transaction reports do not reflect the impact of the subsequent adjustments.

4. Phone Transcripts

Transcripts of the taped conversations between energy traders, provided by Avista Utilities in its Response to the Show Cause Order, reveal that the nature of the transactions proposed by Enron was not familiar to the traders from Avista Utilities. In the initial days on which the transactions took place, Avista Utilities traders consistently expressed confusion about how the mechanics of the transactions were to work.

⁴⁵See the sample greenbar sheet showing hand-written adjustments, included in Appendix B, Tab 14.

⁴⁶WSPP Quarterly Transaction Report for Second Quarter 2000, filed July 31, 2000, Docket No. ER91-195-043; Avista Corporation Quarterly Transaction Report for Second Quarter 2000, filed July 25, 2000, Docket No. ER97-7-000.

When Enron's traders placed calls to Avista Utilities to initiate the transactions, the Avista Utilities traders exhibited uncertainty about whether they needed transmission capacity to effect the transactions, where they would have to deliver the power to PGE, and how the transactions would be reflected in the Avista Utilities accounting system. On a few occasions, part of the transaction routing was made clear to Avista Utilities' real-time traders. However, FERC Trial Staff found no evidence that the term "Deathstar" was used in Avista Utilities' descriptions of these transactions at the time they occurred.

In the weeks after the initial buy/sell transaction with Enron and PGE, the Avista Utilities energy traders grew accustomed to the transactions, and accommodated Enron's requests when they were submitted to Avista Utilities. Despite their uncertainties about the mechanics of and the accounting for the transactions, the Avista Utilities traders proceeded with the transactions, and did not raise their concerns with management.

5. Revenues

FERC Trial Staff's investigation found that Avista Utilities received approximately \$2,500 in total revenue as a result of its participation in transactions where it bought power from Enron at COB and immediately resold it to PGE at COB.⁴⁷ As demonstrated in the telephone transcripts and accounting sheets, the per megawatt hour charge for these transactions ranged between \$0.25/MWh and \$1/MWh. The transactions themselves involved relatively small amounts of power each hour, totaling less than 2,500 MWh for

⁴⁷Response to FERC Trial Staff data request Staff-Avista-4-2, included in Appendix B, Tab 15.

all of the transactions combined, and they occurred at prices ranging from \$2/MWh to \$87/MWh, with an average price of \$34/MWh.

FERC Trial Staff also explored other potential sources of revenues to determine if \$2,500 was, in fact, the only form of compensation received by Avista Utilities for these transactions. In this regard, Trial Staff examined data for transactions between Avista Utilities and Enron for the years 2000 and 2001 in which there was no price recorded for energy. FERC Trial Staff found that these transactions involved index prices or scheduling coordinator services, which explained the lack of a real-time price (since price was recorded after the fact). FERC Trial Staff also found that these transactions were not related to the transactions in question.⁴⁸ In sum, FERC Trial Staff found no evidence of any other compensation to Avista Utilities for its role in the Deathstar transactions.⁴⁹ FERC Trial Staff also explored whether Avista Energy received any form of compensation related to the Deathstar transactions and found none.⁵⁰

As noted earlier, the evidence also demonstrated that Avista Utilities was a significant net purchaser of electricity during the period covered by the August 13 Order, and therefore Avista Utilities had no apparent incentive to seek to inflate prices in Western

⁴⁸Response to FERC Trial Staff data request Staff-Avista-4-6, included in Appendix B, Tab 16.

⁴⁹Response to FERC Trial Staff data requests Staff-Avista 3-4, and 3-5, included in Appendix B, Tab 17.

⁵⁰Response to FERC Trial Staff data request Staff-Avista-3-6, included in Appendix B, Tab 18.

wholesale markets. Thus, it appears that Avista Utilities was simply an unknowing transferor of power along the loop.

6. Enron Affiliate Transaction Questions

On several occasions, Enron's traders stated or implied to Avista Utilities' traders that routing the transaction through Avista Utilities was necessary to avoid affiliate transaction restrictions (discussed below), despite the fact that Enron and PGE had the authority to transact directly with one another.⁵¹ As noted, in light of these representations, Staff is concerned about the acquiescence of and the lack of inquiry by the Avista Utilities traders, particularly with respect to affiliate issues. While it is clear that the Avista Utilities energy traders were confused about the nature of and the accounting for the transactions, and by the affiliate questions raised by the Enron and PGE traders themselves, it is also clear that these traders did not seek guidance from management on whether to agree to these transactions or how to handle them.

At bottom, while no FERC rule or policy governs circumstances in which a non-affiliated party engages in a simultaneous buy/sell transaction between two affiliates when the affiliates are not barred from transacting with each other, the traders could have done more to confirm the legitimacy of their participation in these unusual and recurring transactions.

⁵¹See Avista Corporation's response to the Commission's Show Cause Order, Attachment A, at 1, 35-36, 46, 49-51, 56-57, and 72.

F. Enron Data Discovery Issues

FERC Trial Staff has examined volumes of materials received from EPMI, including transaction data, e-mail correspondence, and internal memoranda and nothing in those documents is inconsistent with the conclusions reached herein. These conclusions are based solely on the EPMI documents that were made available to, and reviewed by, FERC Trial Staff. However, in addition to the materials that were made available, some of EPMI's responses referenced volumes of data that was not available for scrutiny, either because of the lack of EPMI's manpower available to sort through and locate relevant materials, or the inability of electronic search techniques to sort through the data. Furthermore, EPMI was not able to provide certain documents requested by FERC Trial Staff because they were seized by the Federal Bureau of Investigation. FERC Trial Staff also provided a list of questions for EPMI employee Timothy Belden to the United States Department of Justice for the purpose of obtaining a better understanding of the transactions discussed above. However, because of the continuing investigation by the Department of Justice and other federal agencies, these questions were not answered and the FERC Trial Staff has been unable to conduct discussions or depositions with appropriate EPMI or Enron representatives.

Other documents were unavailable due to a protective order issued by the Superior Court of the State of California, while still others were unavailable because of data base management problems with Enron's data system. Thus, Enron cannot certify that it has

provided all relevant documents requested by FERC Trial Staff. In this regard, the Chief Administrative Law Judge directed Enron's counsel to provide the information on a best-efforts basis, and allowed Enron to describe the search methodology it used and certify that it engaged in that search methodology.⁵² Nevertheless, the Enron documents reviewed by FERC Trial Staff so far are not inconsistent with the findings in this report.

III. Affiliate Issues

A. Sleeving Transactions

“Sleeving” is a term used by energy traders to refer generally to transactions wherein one party purchases and immediately resells an energy package. Sleeving is often employed when one of a seller's counterparties has run up against internally imposed credit limits established by that seller for that particular counterparty. For example, Company A’s risk management officers may have determined that transactions with Company B should not exceed a credit position of more than one million dollars. When that limit is reached, and Company A and Company B still desire to transact trades, one of the parties may ask Company C to step in to “sleeve” the transaction. Company C will then purchase the energy package from Company A, assume all risks of default or nonperformance, and immediately sell the package to Company B.⁵³ Sleeving transactions are common transactions in the industry and provide substantial benefits by increasing liquidity and

⁵²See Tr. 104-106.

⁵³This is just one simplified example of the different variations of sleeving transactions.

permitting appropriate transactions that might not otherwise occur due to credit issues and other commercial restrictions. Sleeving transactions are a normal industry practice in and of themselves which do not constitute any violation of FERC rules or regulations.

Sleeving transactions must be distinguished from other buy/sell transactions that are also a normal part of the energy business. The energy business is focused to a large degree on the purchase and sale of forward contracts, i.e., bundles of energy to be delivered at specific times and places in the future. Energy trading desks resell and repurchase these bundles to manage their portfolios as the prices of these bundles, and/or the load requirements of their customers, fluctuate over time. Any given bundle of energy may be bought and resold several times before its actual delivery date. A sleeving transaction is distinguished by: 1) the fact that it involves a purchase and an immediate resale of an energy product, and 2) the fact that the sleeving party is brought in specifically to act as a sleeve and has no other interest in the energy package being traded.

Sleeving transactions raised questions for FERC Trial Staff because of the concern that such transactions may make it more difficult to verify compliance with Commission rules. Where market-based rate authority may place limits and restrictions on a company's ability to trade with affiliates, sleeving transactions have the potential to hide or obscure certain transactions and thus evade Commission imposed restrictions. Consequently, FERC Trial Staff adopted a broad view of its investigative responsibilities with respect to sleeves and affiliate transactions. First, FERC Trial Staff examined whether Avista

Utilities or Avista Energy had assisted other companies in circumventing the Commission's affiliate rules. Further, FERC Trial Staff investigated whether Avista Utilities and Avista Energy had improperly transacted with each other; whether Avista Utilities' Transmission Function was adequately separated from its Merchant Function; and whether Avista Utilities' Transmission Function was adequately separated from Avista Energy's traders.⁵⁴

Avista Utilities and Avista Energy provided FERC Trial Staff with extensive information on every transaction in which either Avista Utilities or Avista Energy had engaged in simultaneous buy/sell transactions with two affiliates, as well as extensive information on the necessary separation of functions within Avista Utilities, and between Avista Utilities and Avista Energy. FERC Trial Staff's review of all of the transactions in which Avista Utilities served as an intermediary between two affiliates indicates that the only affiliated entities for which Avista Utilities served as an intermediary during 2000 and 2001 are Enron and PGE.⁵⁵ Other than broker-arranged transactions, discussed below, there is no evidence that Avista Utilities served as an intermediary or sleeve between any

⁵⁴FERC Staff data requests Staff-Avista 1-8, 1-9, 1-11, 1-12, 1-13, 1-14, 1-15, 1-16, 1-17, 1-18, 1-19, 1-20, 1-21, 1-22, 1-23, 1-25, 1-26, 1-27, 1-28, 1-34, 1-35, 1-36, 1-37, 1-38, 1-39, 1-40, 1-41, 1-43, 1-44, 1-45, 1-47, 1-48, 1-49, 1-50, 1-51, 1-52, 1-53, 1-54, 1-55, 1-56, 1-57, 1-60, 1-61, 1-62, 1-63, 1-65, 1-66, 1-68, 1-69, 1-70, 1-71, 1-72, 1-73, 1-74, 2-4, 2-5, 2-6, 2-7, 2-8, 2-9, 2-10, 2-11, 2-12, 2-13, 3-1, 3-2, 3-3, 5-6, and 5-10, listed in Appendix C.

⁵⁵Response to FERC Trial Staff data request Staff-Avista 1-57 (without attachments), included in Appendix B, Tab 19.

affiliated companies other than Enron and PGE during 2000 and 2001.⁵⁶ Similarly, with respect to Avista Energy, all but one of the more than 200 transactions in which Avista Energy served as a sleeve between (non-Enron) affiliated companies during 2000 and 2001 were arranged by brokers without the knowledge or direct involvement of the affiliated parties.

Enron and PGE had tariffs and codes of conduct that allowed them to directly engage in market-based rate transactions during 2000 and 2001.⁵⁷ In fact, Enron and PGE directly engaged in over 2,000 market-based rate transactions during 2000 and 2001. Thus, based on FERC Trial Staff's investigation, Avista Utilities' role in the buy/sell transactions involving Enron and PGE did not constitute or aid in the violation of any Commission rule or Code of Conduct with respect to affiliate transactions.⁵⁸ Furthermore, the buy/sell transactions between Avista Utilities and Enron and PGE that occurred on days other than the 17 days specified in the Commission's Show Cause Order were, with two exceptions, deals struck by brokers without the prior knowledge of Avista Utilities' energy traders.

⁵⁶FERC Trial Staff data requests Staff-Avista 1-32, 1-33, 1-34, 1-39, 1-40, 1-41, 1-44, 1-51, 1-57, 1-61, 2-12, 3-1, and 4-9, listed in Appendix C.

⁵⁷December 28, 1998 letter order accepting Enron's market-based rate schedule and Code of Conduct enabling Enron to sell power to PGE in Docket No. ER99-364-000 and Director's Order dated September 22, 1998 authorizing PGE market-based rate sales to Enron in Docket Nos. ER98-3671-000 and ER98-1643-001.

⁵⁸This conclusion only applies to Avista Utilities, and not to Enron or PGE. Issues regarding PGE and Enron are being addressed in Docket No. EL02-114-000.

The use of brokers to connect parties with mutual interests is a common industry practice that provides liquidity to the marketplace. Brokers act as a clearinghouse for buyers and sellers, saving the parties the substantial transactional costs of contacting all potential counterparties one by one. Any restrictions placed by a buyer or a seller upon specific counterparties are relayed to the broker through frequently updated confidential trading instructions. The brokers are thus aware of who can and cannot trade with whom. Armed with this information, brokers seek to find parties willing to sleeve a transaction between two counterparties who otherwise would not enter into a deal with each other, and often find potential deals that cannot otherwise be transacted. Brokers treat each part of the deal in a confidential manner so as to maintain an arms-length transaction which does not violate the restrictions placed by either the buyer or the seller. Again, the sleeving party purchases the energy package, assumes all risk of default or non-performance, and resells it to the otherwise restricted counterparty. The counterparties may not know who the other party is until well after the deal has been struck and the transaction executed.

In summary, FERC Trial Staff's investigation produced no evidence that Avista Utilities' role in the buy/sell transactions involving Enron and PGE constituted or aided in the violation of any Commission rule or Code of Conduct with respect to affiliate transactions. In addition, this investigation produced no evidence that any transactions in which Avista Energy served as a sleeve between (non-Enron) affiliated companies during 2000 and 2001 were conducted to circumvent any prohibitions on affiliate transactions.

B. Corporate Separation of Functions

FERC Trial Staff examined the corporate structure and separation of functions practices of Avista Utilities and Avista Energy.⁵⁹ FERC Trial Staff found that the division of corporate functions between Avista Utilities and Avista Energy was clear and enforced. FERC Trial Staff further found that the separation of functions between the Avista Utilities transmission and marketing functions was clear and enforced. These separations satisfy the Commission's Code of Conduct and Standards of Conduct rules.

In the course of its efforts to respond to this investigation, Avista Utilities discovered and notified FERC Trial Staff about an instance on April 25, 2000 where traders from Avista Utilities and Avista Energy spoke to each other directly during an emergency situation in which Avista Energy found itself short of power needed to serve load due to a major unit outage and needed to cover a customer's next-hour load. Neither Avista Utilities nor Avista Energy notified the Commission of this communication at the time. As a result of that emergency, PGE subsequently agreed to sleeve energy from Avista Utilities to Avista Energy for one hour on April 25, 2000 to address that emergency. It appears that this conversation was an isolated event and that the circumstances surrounding the conversation clearly constituted an emergency.⁶⁰ Both

⁵⁹FERC Staff data requests Staff-Avista 1-7, 1-8, 1-10, 1-13, 1-14, 1-15, 1-16, 1-17, 1-18, 1-19, 1-20, 1-21, 1-22, 1-23, 1-32, 1-36, 1-38, 1-40, 1-44, 1-45, 1-48, 1-51, 1-52, 1-53, 1-56, 1-57, 1-68, 1-69, 1-70, 1-71, 1-73, and 2-12, listed in Appendix C.

⁶⁰Response to FERC Trial Staff data requests Staff-Avista-1-65 and 1-66, included in Appendix B, Tab 20.

Avista Utilities and Avista Energy have committed to establish a procedure that would provide for notification to the Commission within 72 hours if similar direct contact occurs in the future.

IV. Cooperation with Commission Inquiry

The Commission also set for hearing in this proceeding the issue of whether Avista has in fact provided all relevant information in the fact finding investigation initiated in the February 13 Order (in Docket No. PA02-2-000) and what the appropriate remedies for any failure should be, including whether Avista's market-based rate authority should be revoked.⁶¹

Avista Utilities asserts that its response to the Commission's May 8 Data Request was based on an internal inquiry in which: (1) all personnel engaged in energy trading were required to read the data requests and were then interviewed by those responding to the data requests, (2) transaction data was subjected to both electronic searches and manual review, and (3) other documents, most notably e-mails and other correspondence, were subjected to electronic and manual searches. The internal inquiry and the response focused on the market manipulation schemes defined in the Enron memoranda. After Avista Utilities received the letter from PGE on May 17, 2002 notifying Avista Utilities of the documents that PGE intended to provide FERC, Avista Utilities indicates that it focused its investigation on the particular days specified in the PGE letter, and provided its

⁶¹See 100 FERC ¶ 61,187 (2002).

response to FERC. That response denied that Avista Utilities had engaged in any of the Enron trading strategies, and attached the letter from PGE.

After reviewing Avista Utilities' response and the materials submitted by PGE, the Commission determined that Avista Utilities had not sufficiently explained the transactions specified in the PGE letter. Thus, on June 4, 2002, the Commission issued its Show Cause Order.

After the Commission issued its Show Cause Order, Avista Utilities conducted a second internal inquiry in which representatives of Avista Utilities first contacted PGE to obtain copies of the materials that had been submitted by PGE to the Commission. Those materials, mostly transcripts, allowed Avista Utilities to focus its own internal inquiry onto the transactions that had been the subject of the Show Cause Order, and thus to discover the relevant transactions which had not been found prior to the filing of its data response on May 22, 2002. Using its greenbar sheets and transcripts of tapes in its possession, and supplementing its review of those materials with interviews with traders and management, Avista Utilities was able to discover that the transactions on the relevant days were, as described above, buy/sell transactions in which Avista Utilities served as an intermediary between Enron and PGE. Using additional descriptions of the Enron trading strategies that were released just after the Commission issued its Show Cause Order, Avista Utilities concluded that its role in the buy/sell transactions was as an unknowing participant in a portion of the Enron Deathstar strategy.

Thus, in its June 14, 2002 response to the Commission's Show Cause Order, Avista Utilities provided transcribed phone logs of the energy trades in question, the greenbar sheets showing the scheduling and accounting entries for the trades, handwritten account settlement notes regarding the disputed transactions, and a lengthy narrative explaining the nature of the transactions, the confusion of the traders and accounting personnel, and the final accounting for the transactions. The June 14, 2002 response was the starting point for FERC Trial Staff's investigation ordered by the Commission.

As discussed at length above, FERC Trial Staff followed up on its review of the June 14th submission with several telephone conferences, five sets of data requests, conferences at FERC headquarters with Avista Utilities and Avista Energy representatives and counsel, and an on-site "field audit" to the separate corporate offices of Avista Utilities and Avista Energy in Spokane, Washington. FERC Trial Staff also had discussions with PGE representatives, reviewed information relative to Bonneville Power Administration, and sent data requests to the California Attorney General, the CAISO, PGE, and Enron.

The responses of Avista Utilities and Avista Energy to the FERC Trial Staff investigation indicated an overall cooperative attitude and response. FERC Trial Staff found some responses to the data requests slow in coming or incomplete, but these deficiencies were corrected in due time and on a timely basis. FERC Trial Staff did not find evidence that Avista Utilities or Avista Energy personnel were uncooperative, had

filed false information, or were hiding damaging evidence. FERC Trial Staff did not find that Avista Utilities or Avista Energy knowingly withheld relevant information from the Commission's inquiry into the Western Energy Markets for 2000 and 2001 in Docket No. PA02-2-000. Finally, FERC Trial Staff did not find any evidence that Avista Utilities or Avista Energy failed to make a good faith effort to provide all relevant information in the investigation in Docket No. PA02-2-000, and did not find any evidence that any of the responses filed by Avista Utilities or Avista Energy in Docket No. PA02-2-000 were incorrect.

A. Correspondence Records

As noted earlier, the energy trading business is focused to a large extent on the purchase and sale of forward power contracts. These transactions generally do not require separate contracts but rather are conducted, by and large, under umbrella agreements and transacted by phone.⁶² While Avista maintained confirmation agreements, these agreements only indicated the pro-forma information, and no other detail was available for review. Consequently there is relatively little in the way of hard copy or electronic correspondence between counterparties. Avista Utilities does, however, maintain the minimal records that the Commission requires it to keep.

FERC Trial Staff examined correspondence between Avista Utilities and Enron, and between Avista Utilities and PGE, to determine whether Avista Utilities had

⁶²FERC Trial Staff data requests Staff-Avista 1-28, 1-33, 1-40, and 1-51, listed in Appendix C.

transactional discussions with Enron other than the real time energy trader discussions.

Because most transactions between Avista Utilities and Enron and between Avista Utilities and PGE were conducted by telephone, there was a relatively small amount of formal correspondence between the two companies. Hard copy searches and the results of electronic searches of Avista Utilities' records and e-mail systems conducted by Avista Utilities produced no evidence that Avista Utilities engaged in any of the Enron trading strategies, or otherwise conspired with Enron to manipulate Western markets.⁶³

B. Avista Affidavits

As additional support for the findings above that Avista Utilities and Avista Energy have fully addressed FERC Trial Staff's concerns, the individual affidavits of certain Avista Utilities and Avista Energy personnel are included in Appendix D.

V. Conclusion

The following Staff technical witnesses participated in this investigation and state that the facts and conclusions contained herein are true and accurate to the best of their knowledge: Patrick Crowley (Case Team Leader), Economist; Bonnie Pride, Energy Industry Analyst; Erin Wasik-Gutierrez, Economist; Douglas Green, Senior Financial Analyst; Andrew Bieltz, Energy Industry Analyst; and Donna Zugris, Electrical Engineer.

⁶³FERC Trial Staff data request Staff-Avista 1-32, listed in Appendix C.