S. HRG. 107–602

ENERGY MARKET MANIPULATION

HEARING

BEFORE THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

TO EXAMINE MANIPULATION IN WESTERN MARKETS DURING 2000-2001 AS REVEALED IN RECENT DOCUMENTS MADE PUBLIC IN THE COURSE OF THE INVESTIGATION UNDER WAY AT FERC; ACTIONS THAT WERE TAKEN TO MITIGATE ANY MARKET MANIPULATION OR FAILURES; FURTHER ACTIONS THAT SHOULD BE TAKEN NOW AND IN THE FUTURE

MAY 15, 2002

Printed for the use of the
Committee on Energy and Natural Resources

U.S. GOVERNMENT PRINTING OFFICE

81–138 PDF WASHINGTON : 2002

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

COMMITTEE ON ENERGY AND NATURAL RESOURCES

JEFF BINGAMAN, New Mexico, *Chairman*

DANIEL K. AKAKA, Hawaii
BYRON L. DORGAN, North Dakota
BOB GRAHAM, Florida
RON WYDEN, Oregon
TIM JOHNSON, South Dakota
MARY L. LANDRIEU, Louisiana
EVAN BAYH, Indiana
DIANNE FEINSTEIN, California
CHARLES E. SCHUMER, New York
MARIA CANTWELL, Washington
THOMAS R. CARPER, Delaware

FRANK H. MURKOWSKI, Alaska
PETE V. DOMENICI, New Mexico
DON NICKLES, Oklahoma
LARRY E. CRAIG, Idaho
BEN NIGHTHORSE CAMPBELL, Colorado
CRAIG THOMAS, Wyoming
RICHARD C. SHELBY, Alabama
CONRAD BURNS, Montana
JON KYL, Arizona
CHUCK HAGEL, Nebraska
GORDON SMITH, Oregon

ROBERT M. SIMON, *Staff Director*
SAM E. FOWLER, *Chief Counsel*
BRIAN P. MALNAK, *Republican Staff Director*
JAMES P. BEIRNE, *Republican Chief Counsel*
LEON LOWERY, *Professional Staff Member*
HOWARD USEEM, *Senior Professional Staff Member*

CONTENTS

STATEMENTS

APPENDIX

ENERGY MARKET MANIPULATION

WEDNESDAY, MAY 15, 2002

U.S. SENATE,
COMMITTEE ON ENERGY AND NATURAL RESOURCES,
Washington, DC.

The committee met, pursuant to notice, at 2:34 p.m., in room SH–216, Hart Senate Office Building, Hon. Jeff Bingaman, chairman, presiding.

OPENING STATEMENT OF HON. JEFF BINGAMAN, U.S. SENATOR FROM NEW MEXICO

The CHAIRMAN. The hearing will come to order. Thank you all for coming. We can go ahead and get started here. We have got quite a few witnesses to hear from.

This is the seventh hearing that has been held in this Congress by this committee on the problem of California electricity markets.

At our hearing in January, Senators Feinstein and Cantwell and Wyden particularly urged the Chairman of the Federal Energy Regulatory Commission, Pat Wood, who is here with us today, to investigate whether traders in California power markets had manipulated those markets to raise prices artificially. FERC began that investigation and although the investigation is not complete, it has already uncovered strong evidence that market manipulation was occurring and that various trading practices by Enron and other companies did affect prices in California's wholesale markets. Memos describing this manipulation were provided by Enron and were released by the FERC just this last week.

Today's hearing has several purposes. I will list four of them at least here.

First would be to help us understand the nature and extent of the trading practices that Enron was engaged in.

A second purpose would be to assess the extent to which this market manipulation may have influenced prices of wholesale power.

A third purpose would be to obtain a status report from FERC on its investigation and other actions that it is taking to provide relief for past market abuses and to prevent future abuses.

A fourth would be to determine what statutory changes are required to prevent a recurrence of these problems in California and elsewhere.

There will be many more months of evidence gathering and debate about what lessons we can learn from Enron's collapse and from California's troubled efforts to deregulate its wholesale electricity market.

Alan Murray, in an article in yesterday's *Wall Street Journal* listed three lessons that he believes we should learn. No. 1, deregulation of the Nation's electrical system needs to be designed by smart people who are acting, as much as possible, in the public interest. No. 2, the deregulated system needs to have very clear rules that apply nationwide and do not vary from State to State. And No. 3, those rules need to be enforced by a well-staffed, muscular Federal regulatory agency. I will be interested in hearing from Chairman Wood and the other witnesses as to whether they agree that these are the right lessons for us to learn.

Let me defer to Senator Murkowski for his opening statement. Then we will hear from the witnesses.

STATEMENT OF HON. FRANK H. MURKOWSKI, U.S. SENATOR FROM ALASKA

Senator MURKOWSKI. Thank you very much, Senator Bingaman.

First of all, let me comment relative to the Enron issue because it has become quite fashionable to simply blame activities on Enron. They are a convenient excuse. And there is a little politics involved, but that is not rare around here. Let me remind the record and my colleagues, in 1998 the Clinton administration sent an electricity bill to Congress. This was more than generous to Enron. It proposed Federal command and control. It created a national regulatory infrastructure, best suited to large trading operations seeking to cherry pick electricity from markets across the country or across the street. It greased the skids for trading. This made it even easier for Enron to appear bigger, stronger, faster. And of course, we know better today.

Now, perhaps the Clinton bill had something to do with the fact that Ken Lay's name is in the guest book of the Lincoln Bedroom in the former Clinton White House, but it is not necessary for me to criticize who the house guests were. But I think it is fair to say that it is clear that the Clinton electricity bill was written, thanks in part to the close ties between Ken Lay and the Secretary of Energy at the time, Secretary Peña. So, make no mistake about it. It was a bill that a lot of us had concerns with. Many people recognized that it would have a broad, far-reaching effect on our economy and our energy supply. Therefore, we wanted to tread very, very lightly.

As a consequence, that bill went nowhere. Enron was not happy. They wanted their legislation to move, and as evidence, I quote an excerpt from the *Washington Post*, January 13, 2002. In a news account of one particular meeting, "Lay and Peña agreed that a go-slow approach to deregulation advocated by Senator Murkowski was unacceptable."

Now, Senate Republicans had not resisted the urging of Enron and high Clinton administration officials. The troubles of California would perhaps not be unique, nor limited to California. These same problems effected the entire Nation.

As we look at today's hearing, we are talking about Enron's trading practices and FERC's efforts to protect the consumer. I want to commend Chairman Wood, FERC's current head. I want to also recognize the contribution of Mr. Hebert who was formerly Chairman. I think FERC is to be congratulated on their aggressive pur-

suit of these problems in the West. Hopefully it will be factual information. Right now, FERC has five major western price investigations underway. One uncovered the Enron memorandums which the Chairman spoke about.

Let me also commend the administration, the Department of Justice, the SEC, and others.

So, why was the California market vulnerable to manipulation? Why were there problems in California, but apparently certainly not to the degree anywhere else such as the PJM power pool on the east coast?

Did Enron really cause California's problems or did it and other traders just take advantage of a flawed system?

I think we all know the answers to many of these questions. The State of California created a dysfunctional market. Governor Davis received some very, very poor advice. You cannot stay in the candy business very long unless you pass on your costs to the consumer.

Market participants such as Enron took advantage of the weaknesses in the California program. But California only has itself to blame for creating a flawed system in the first place. Hindsight is cheap and that is one of our jobs around here.

It should come as no surprise that if you create a flawed system riddled with loopholes, people are going to take advantage of it. Let me make reference to a May 8 *Washington Post* editorial, and I quote. "As with Enron's accounting scams, the firm's aggressive rule breaking is only half the story. The other half involves the rules themselves, which all but invited abuses. California's politicians created a flawed electric market that banned the long-term contracts that would have stabilized prices, forcing power users to depend entirely on short-term purchases. When power grew scarce because of weather and other factors, consumers were at the mercy of suppliers. By withholding power or engaging in other trading tricks, some perfectly legal, suppliers could send prices through the roof, which they did. On top of these design mistakes, California regulators refused to raise retail prices as shortages mounted in 2000. This only made the shortage more acute, increasing the opportunities for speculative profits."

California's problems resulted in price spikes and power shortages. It drove one of the three major investor-owned utilities into bankruptcy and put the other two on the verge.

When that occurred, what was California's response? More counterproductive government. The State of California signed billions of dollars of long-term power supply contracts on behalf of the investor-owned utilities. Keep in mind that the State prevented the IOU's from long-term contracts in the first place.

When the State signed contracts, when they proved to be far above the market, putting California taxpayers on the hook for billions of dollars, guess what happened? Well, we see that in the paper as Governor Davis proclaims his predicament. California, according to Governor Davis, is trying to abrogate the contracts and place the blame on industry, not just Enron.

I must note that some of the biggest winners in this mess are California's public owned utilities. Exempt from both Federal and State oversight, they were entirely free to game the system—and they did. That is where I would hope FERC would focus. Public

owned utilities charged some of the highest wholesale prices during the period that California had price spikes. Unfortunately, if FERC's investigation finds unlawful price manipulations and inappropriate windfall profits, California's municipal utilities may get off scot-free because FERC's authority is limited.

I am disturbed by reports about the activities of the California independent system operator during this period. Congressman Ose recently released a transcript of a conversation between a staff member of the California ISO and Enron power trader. In this transcript the ISO asked Enron to keep their bid high in order to artificially elevate the price of power in California. That is either accurate or it is inaccurate. I hope we will find out.

Why did the California ISO do that? After all, the California ISO was set up to promote competition and keep prices down, not to collude with energy traders to keep prices high. Perhaps the answer can be found in the *Energy Daily* publication dated April 25 which observed—and I quote—"critics have alleged that the ISO was working on behalf of the California Department of Water Resources when prices collapsed last summer and the State was left holding onto excessive power at prices that were considerably above market." This is certainly something that I think FERC and the Justice Department should look into.

Before we rush to judgment, it is important to note that we do not know for a fact that illegal price manipulations or gaming actually occurred. That is the subject of the ongoing investigation by FERC and others. We feel we are entitled to an answer. We do not have access to the documents FERC has received in its ongoing proceedings. Moreover, we do not even know if these activities were illegal. That is the job of the Department of Justice and FERC to determine, not necessarily the Congress. We all want to prevent price manipulation and to see punished those who violated the law. But we must be careful to not presume that an entire industry is guilty on pretrial information about a single participant. This is a very capital intensive industry and investors become wary of investing in new generation and transmission. They became afraid of undue political influence and legal matters, and see a rush to judgment. Consumers in our economy will suffer in the long term. We will not have reliable electricity at reasonable prices that we have come to expect and support this Nation's standard of living.

We also need to be careful that we do not compromise ongoing Federal investigations for the sake of hearing processes. Thus, I was very disturbed by an article in *USA Today* which quotes Democratic Majority Leader Daschle as charging Enron with breaking the law. He is quoted as saying, "I don't think that there's any doubt that somebody ought to go to jail."

For those who think that Congress should do something more, we already have provisions in the Senate-passed energy bill. For example, we have given FERC new enforcement authority. We have given FERC new merger review authority. We have given FERC new authority to revoke deregulated rates. It gives FERC new authority to audit utility books. It requires FERC to establish an electronic information system. It requires enforceable reliability standards and establishes an office of consumer advocacy in the Department of Justice.

I look forward to the witnesses' testimony today, as we try to get to the bottom of some of this information. I wish the panel a good day.

The CHAIRMAN. I am sure each member of the committee here has strong views they would like to express, but I think in order to get on with our witnesses, we should proceed? Let me call on our Chairman of the Federal Energy Regulatory Commission, Pat Wood, first and then call on Mr. Winter to follow him. Please take about 8 minutes or however much of that you need to make the main points that you think we need to hear, and we will include any written statements you have in the record.

Senator WYDEN. Mr. Chairman, just a question. We have a vote on the floor. Is it your intention to hear from Mr. Wood first and then we will come back for questions? Or what is your intention?

The CHAIRMAN. Well, I had not noticed the vote. I think it is important that we all hear his testimony. Perhaps we should go ahead and vote and then return. Let's do that? We will reconvene here in about 10 minutes.

[Recess.]

The CHAIRMAN. The hearing will reconvene. Please go right ahead with your testimony, Chairman Wood, and then Mr. Winter after that.

STATEMENT OF PATRICK WOOD III, CHAIRMAN, FEDERAL ENERGY REGULATORY COMMISSION

Mr. WOOD. Thank you, Senator Bingaman, Senator Feinstein, and Senator Domenici.

One of the principal reasons that I accepted the President's request for me to come work at FERC during this term was to restore customer confidence in the Nation's energy marketplace. After the events of the Western market in mid to late 2000, that certainly has been a challenging task.

The sort of behavior indicated in the Enron memos that are the subject of today's hearing is not what I think we need to have customer confidence in the Nation's energy markets. One of the things that has fallen from that certainly is the nature of the regulatory regime at FERC, and certainly the questions, Senator Bingaman, that you asked me in the letter inviting us to the hearing draw that point.

One of the things that as a former State regulator we needed and have wanted with our Federal agencies that did the same thing, the FCC for telecom regulation and FERC for energy regulation, would be a supportive partnership as we made changes in our State's regulatory structures. Market oversight is a big part of that supportive partner relationship between the State and Federal Governments, and it is one of the principal goals that I have set for this commission because I think it has not been principally an elevated role of what we do.

Along with fostering a high quality environmentally responsible energy infrastructure and having balanced rules for the energy marketplace, we need to make sure that we protect customers through vigilant market oversight. So, one of the first things we did when I took over as chairman last September, was to formally amend our agency's strategic plan to recognize that market over-

sight is a big part of what we are about and certainly a growing part, as we move forward into the future.

Building upon the existing structures that we have, both inside and outside the Commission, we have over the past several months created a new Office of Market Oversight and Investigation, which I am pleased is now headed by a gentleman from the outside. Among many qualified people that I interviewed personally for it, Bill Hederman, who has some very good background in the energy markets, is now head of that office and will, by the end of the summer, have that office fully staffed and up and operational with, hopefully, 80 or 100 or so auditors, investigators, data folks, engineers, economists, attorneys, analysts, those type of folks, a broad multi-disciplinary group of people whose job is really to keep an eye on the day-to-day operations of the energy market in a manner that we quite frankly have not done and done well before.

I want to say—and I mentioned to the prior committee—right before I took over as Chairman, Senator Domenici called and asked, based on the testimony I gave to this committee in July of last year, was there anything we needed to basically effectuate the vision of market oversight. Certainly I thought long and hard and gave a figure for some additional funds for salaries for employees and some additional high-dollar employees. And I was pleased that at least a good chunk of that request made it through the conference and has been able to be used to support our efforts to begin that new office right away this year. So, I am appreciative of that as always to the members of the committee. I know Senator Feinstein helped as well in getting that through.

Certainly getting the right people at the Commission to have the intellectual curiosity to follow up on this stuff, who are of a new mind set, not the traditional kind that receive filings and act on them, but who are going to go out, look at markets, ask hard questions, turn over rocks, that is a different mind set than the agency has had and that agencies at the State level have. So, creating that new role for regulators is not just a resource issue, but it is kind of a cultural change as well. So, we are in the process of going through that and again appreciate the support and help of Congress in that regard.

A couple of other things we are doing besides setting up the office. Certainly the investigation I committed to all of you at your request in January to get deeper into the game here. Do not just do the refund hearing, but go deeper and find out really what happened here so we can know once and for all what kind of behaviors caused these market dislocations in the West in the past couple of years, find out if there are any particular bad players, go after them. If there are some particularly bad practices, get those fixed as well. So, that process began right away in February of this year.

While most of our investigations are not announced and are private, because of the way we initiated this one by my commitment to you all, which my colleagues ratified, and we began with the investigation, it has been more in the public light than most of our investigations have been. That has its awkwardness, but I think, quite frankly, considering the gravity of the issue, the awkwardness is worth it. Where items are available to be made public, as these memos were last week, we have done so and will continue to

do so. Our submissions from our agency will be in the public record.

And as I reported back to you all in writing following the January hearing, I expect to have to you all a report, hopefully one with some finality, but at a minimum an interim report on where we are before the summer recess so that we can start to draw some conclusions from all of the information that we have acquired in the study.

We are working with our sister agencies on this, the SEC, and the CFTC. We are also coordinating our efforts with what the DOJ has begun in its separate investigation as well.

Other things that we are doing, in addition to the investigation and the refund hearing—I should update you on the refund hearing. We have gotten, thankfully from Mr. Winter's organization and also importantly from the now bankrupt California Power Exchange, the PX, the data that we need to go forward on the refund hearing. That refund hearing, which I had hoped would have been finished by this past spring, was delayed to allow those parties to get all the accurate information for the determination of what the individual refunds were hour by hour, day by day for the period from October 2000 through June 2001, which was the refund period.

So, I expect that there will be a hearing on that. The judge has agreed to the parties' request to have that hearing in California, in San Diego this summer. The final conclusions from the judge will be out shortly thereafter, after parties have a chance to brief that. So, although I wish it had been at the first part of 2002, the refund case looks like it can come to closure at least in the latter part of this year, and I look forward to that and getting that determined and clarified.

As you all know, there have also been some filings to have the justness and reasonableness of the long-term contracts that the State of California and a number of utilities in the West have entered into that have been referred to a hearing. We sent those contracts for review at hearings before for an administrative law judge. Again, we tried to put those on a relatively short time frame, but relatively short in that means probably by year's end as well.

We have done some other things. The rulemakings that we have done to try to get things—both clarifying reports to give transparency of reporting requirements to the Nation's energy customers by all the Nation's energy sellers. That was just recently revised 2 weeks ago by the Commission.

And then we are moving forward, in a very comprehensive way, to look at rules going forward across the country, much as the editorial that Chairman Bingaman mentioned in his opening comments, we are looking for a nationwide approach, certainly with some need for regional variation, but basically a nationwide approach toward energy markets that include not only structural fixes for market power, but market monitoring and mitigation tools to be used whenever behavioral fixes are needed and system planning for the transmission grid, reliability issues, independence of the operator of the grid, and the like.

So, that comprehensive rulemaking is also a front and center issue for the Commission, and we have the assistance and help of

a lot of helpful parties across the spectrum and across the country in that very public effort.

So, that is some of the background on what we are up to. I just want to let you know, at the end of the day and the beginning of the day, our commitment is the same, to make this Nation's energy markets work for the customer. That is why regulators are here, to make sure that what are historically monopoly or potentially monopoly forces are harnessed and used for the good of the Nation's customers. It is my pledge to you all, as all along, that we will continue to do that. We have a ways to go and we are on track toward getting there.

I look forward to any questions or comments from the committee members.

[The prepared statement of Mr. Wood follows:]

PREPARED STATEMENT OF PATRICK WOOD, III, CHAIRMAN, FEDERAL ENERGY REGULATORY COMMISSION

I. INTRODUCTION AND SUMMARY

Mr. Chairman and Members of the Committee: Thank you for the opportunity to testify about potential manipulation in Western energy markets during 2000-2001 as suggested in recent documents provided in the course of the investigation under way at the Federal Energy Regulatory Commission (FERC or the Commission) and made public last week; actions that were taken to mitigate any market manipulation or failures; and further actions that should be taken now and in the future.

Two major events in the past two years have raised significant concern over how well competitive electric markets are working, whether our nation's regulatory institutions and expertise are adequate to deal with such markets, and the wisdom of continuing to move forward to promote competitive electric markets. These events are the California energy crisis and the collapse of the Enron Corporation. Since last year, FERC has moved aggressively to take steps within its authority to remedy problems in the California and Western wholesale electric markets and to investigate potential manipulation of wholesale markets. Just as importantly, the Commission is taking forward-looking measures to realign the wholesale electric industry and ensure that there are adequate market rules and appropriate market oversight in place to support fully competitive markets. While the recent California and Enron events have caused industry observers to reevaluate where we are on the road to competition, I continue to believe that competition is superior to traditional cost-based regulation for providing reliable and adequate electricity supplies at the lowest reasonable cost to the nation's electric customers. Just as competition is thriving in the natural gas industry today, so too can it thrive in the wholesale electric industry—but there is more work to be done.

Let's confront the key issues head-on. Did California experience severe electric market problems? Clearly, yes. Were these problems the result of market manipulation? We are currently investigating that issue. Many observers agree that these problems stemmed in part from the poor design of the California electricity market and the lack of adequate reserves and demand response relative to growing electricity demand. Those conditions made it possible for Enron (apparently)—and possibly other market participants—to exploit, profit from, and possibly exacerbate the magnitude of California's problems. Did FERC respond properly to help California deal with these problems? Yes. It is clear that FERC took action to address problems in California and western markets, which became apparent in May 2000, by instituting a fact-finding investigation into the nation's electric bulk power markets on July 26, 2000, and has been dealing with those issues extensively ever since. Since I joined the Commission in June 2001, we have addressed California and western states issues in almost every single open meeting and have dealt with each issue using the best information and evidence available to us under the guidance and limits of the law.

In the eleven months since I joined FERC, the nation has continued to reap the continuing benefits of wholesale electric and natural gas competition. The billions of dollars invested in efficient, economical, independent generation and gas pipelines and production over the past decade have caused wholesale electric prices across the nation to drop by 59 percent, while weighted average prices in California have dropped from almost $140 to about $25 per megawatt-hour. Approximately 41,000

new megawatts of electric generation capacity have been built across the country—but only 2,922 megawatts have come on-line in California. Since I arrived in Washington, FERC has issued over 60 orders on issues relating to California and the western states electric market and instituted numerous proceedings relating to the California and western electric market. And to ensure adequate market oversight for all wholesale electric markets in the future, FERC has formed and is now staffing a new Office of Market Oversight and Investigation.

My purpose today is not only to look backward, but to look to the future as well. I will begin this testimony by speaking about the Commission's ongoing investigation into potential market manipulation by Enron or other entities in the West, and then describe what steps the Commission has taken on California issues. But it is important to look forward, and address the broader issue of how we can assure that competitive electric markets work effectively across the nation, so all Americans can enjoy the benefits of vibrant wholesale electric competition. The Commission is working on numerous initiatives to build a sound foundation for competitive markets. These efforts—to improve and expand our nation's energy infrastructure, standardize and improve wholesale market design and rules, establish independent regional transmission organizations (RTOs) to manage our nation's electric grids and markets, ease and expedite new generation interconnection, enable the full participation of customer demand response, improve market transparency, and police market participants' behavior—should greatly improve the effectiveness of competitive wholesale markets, and assure that market power abuse does not compromise long-term market success.

II. THE COMMISSION'S WESTERN MARKETS INVESTIGATION

It has been alleged that Enron, through its affiliates, used its market position to distort electric and natural gas markets in the West. In response to these allegations, on February 13, 2002, the Commission issued an order directing its staff to launch a non-public, fact-finding investigation. This on-going staff investigation is gathering information to determine whether any entity, including Enron Corporation, through any of its affiliates or subsidiaries, manipulated short-term prices for electric energy or natural gas markets in the West, or otherwise exercised undue influence over wholesale prices in the West since January 1, 2000.

FERC staff members are collaborating with experts at the Commodities Futures Trading Commission (CFTC), pooling the agencies' expertise on the physical and derivative transactions involved. We have established information-sharing agreements with the CFTC and the Securities and Exchange Commission (SEC). In addition, FERC has contracted with leading experts in business and academia to assist in the investigation, and hired specialists in large-scale electronic data retrieval and analysis to perform needed data processing and analysis.

On March 5, 2002, Commission staff issued an information request directing all jurisdictional and non-jurisdictional sellers with wholesale sales in the U.S. portion of the Western Systems Coordinating Council (WSCC) to report by April 2, 2002: (1) on a daily basis, their short-term and firm and non-firm wholesale sales transactions for years 2000 and 2001; (2) on a monthly basis, monthly firm and non-firm capacity and energy wholesale transactions for years 2000 and 2001; and (3) long-term capacity and energy sales transactions executed for delivery on or after January 1, 2000. Enron filed a deficient filing on April 15, 2002, and was directed to remedy its filing immediately. In a letter to Enron's counsel, on April 18, 2001, the Commission's staff noted that the deficiencies of Enron's response signaled a breakdown in supervision and quality control and seriously impeded the Commission's investigation. In light of these concerns, the Commission has sent two computer specialists to Enron's Houston office to help access the Enron databases that contain the information the Commission's staff seeks. At this time, Enron has yet to fully comply with the March 5, 2002, information request, particularly with respect to providing affiliate sales data.

On May 6, 2002, counsel for Enron turned over to Commission staff three internal Enron memoranda that were partially responsive to previous data requests issued by Commission staff. Two of the memoranda are dated from December 2000 and the other memorandum is undated. Enron's counsel informed Commission staff that Enron's Board of Directors had voted, on May 5, 2002, to disclose these documents and waived all claims of attorney-client privilege. Enron's counsel also informed the SEC, the Department of Justice, and the Attorney General of California about these documents. FERC promptly released these memoranda to the public on the Commission's website, along with a letter asking follow-up questions about the documents. Because the investigation is non-public, the Commission has not made available to

the public questions issued under subpoena or companies' responses containing confidential information.

The two dated Enron memoranda provide a detailed description of certain trading strategies engaged in during the year 2000 by Enron traders, and, allegedly, traders of other companies active in wholesale electricity and ancillary services markets in the West and, particularly, in California. The last section of the dated memoranda discusses the California Independent System Operator's (CAISO) tariff's definition of, and prohibition of, "gaming" and other "anomalous market behavior." The memoranda then list and discuss actions that the CAISO could take if the CAISO were to discover that Enron was engaging in such activities.

According to the memoranda, the trading strategies generally fall into two categories. The first category is described as "inc-ing load"—slang for increasing load—into the CAISO real-time market, whereby a company artificially increases load on a schedule it submits to the CAISO with a corresponding amount of generation. The company then dispatches the generation it scheduled, which is in excess of its actual load, and the CAISO pays the company for the excess generation. Scheduling coordinators that serve load in California were apparently able to use this trading strategy to include generation of other sellers. The second category is described as "relieving congestion" and involves a company first creating congestion in the California Power Exchange (PX) market (which terminated January 31, 2001), and then "relieving" such congestion in the CAISO real-time market to receive the associated congestion payments. This trading strategy is accomplished through such actions as reducing schedules or scheduling energy in the opposite direction of a constraint (counterflows), for which the CAISO pays the company. The two dated Enron memoranda also outline ten "representative trading strategies" that were used to "inc load" and "relieve congestion" for profit.

On the same day Enron counsel divulged these documents, the Commission's staff sent a follow-up data request to Enron to elicit more information about the trading strategies described in the memoranda. The follow-up data request ordered Enron to give the Commission, by May 10, 2002, the names of the traders who were interviewed and whose trading strategies are the subject of the memoranda. The Commission's staff also requested the production of any comparable memoranda that discuss trading strategies and asked Enron to provide all correspondence related to the subject matter of the memoranda. At this time, Enron has partially complied with the Commission's follow-up data request.

The Enron memoranda allege that traders from other companies also employed several of these trading strategies. Therefore, the Commission's staff issued a notice, on May 7, 2002, to all sellers of wholesale electricity and/or ancillary services in the West, alerting them that the Commission would seek information about their use of the trading strategies discussed in the Enron memoranda in a data request, and directing them to preserve all documents related to such trading strategies. Also on May 7, 2002, the Commission's staff issued a data request to the CAISO, seeking information for the two-year period 2000-2001; FERC staff is currently analyzing this material.

On May 8, 2002, the Commission's staff issued a data request to over 130 sellers of wholesale electricity and/or ancillary services in the West during the years 2000-2001, with a due date of May 22, 2002. This data request asks every company with wholesale sales during this period to admit or deny whether it has engaged in the types of trading activities specified in the Enron memoranda, as well as any other trading strategies. The data request asks for all internal documents relating to trading strategies that the company may have used during the relevant time period, including correspondence between companies, reports, and opinion letters, and information concerning megawatt laundering transactions that any of these sellers might have engaged in with Enron. The data request specifies that the company's response should be an affidavit signed under oath by a senior corporate officer, after a diligent investigation into the trading activities of the company's employees and agents.

This investigation is non-public and confidential, as are all of the Commission's enforcement activities. From the start, we have made many of our activities public (such as the questions asked of industry participants) and have released the Enron documents for which privilege was waived, because of the high level of public interest and the right of the public to be confident in our conduct of the investigation. But at the same time, we must protect the integrity of the on-going investigatory process and the rights of those being investigated. We need a complete record and extensive analysis on which to base any findings, and we have not yet compiled such a record. Although the Enron memos clearly are very serious, we cannot and should not indict either a single company or an entire industry based on three memos. Once the facts are clear, FERC will take appropriate actions within our statutory authority. But first we must gather all the facts.

The Commission staff's discovery process has elicited, and continues to elicit, important information about trading strategies that several sellers in the West may have used. The Commission's staff is currently assessing how best to respond in terms of further discovery, analysis and theories of the case. As soon as the fact-finding investigation is complete, a thorough and timely report will be submitted to Congress and the public.

III. OTHER FERC INVESTIGATIONS RELATING TO CALIFORNIA AND THE WEST

The current Enron investigation should be placed in context with the Commission's other activities and investigations pertaining to California and the western states. The Commission has been working diligently on the evolving California issues, and will be acting on key pieces in the coming months. Some of these activities include:

- Requests for refunds for spot market sales through the CAISO and the California Power Exchange are now in hearings initiated by the Commission's order of July 25, 2001 (and supplemented on December 19, 2001). This proceeding should determine the appropriate mitigated market clearing price in each hour of the refund period consistent with the rate pricing methodology prescribed by the Commission; the amount of refunds owed by each supplier according to the Commission's pricing methodology; and the amount currently owed to each supplier, with separate quantities due from each entity, by the CAISO, the investor-owned utilities, and the State of California. Consistent with refund authority under Section 206 of the Federal Power Act, the effective refund period extends from October 2, 2000, to June, 2001.
- The Commission's order of July 25, 2001, initiated hearings on whether there may have been unjust and unreasonable charges for spot market bilateral sales in the Pacific Northwest for the period beginning December 25, 2000, through June 20, 2001. The proceeding addresses the extent to which dysfunctions in the California markets may have affected spot market prices in the Pacific Northwest. The administrative law judge issued an initial decision on September 24, 2001, recommending against the ordering of refunds.
- On October 9, 2001, the Commission released a request for proposal for an independent audit of the CAISO, which included an evaluation of the CAISO's ability to manage the California market, and appropriate recommendations. The audit, submitted to the Commission on January 25, 2002, by Vantage Consulting, Inc., confirmed FERC's prior findings that the CAISO board is not fully independent, and offered recommendations to improve the CAISO's management and processes. This matter is a pending, contested proceeding before the Commission.
- On April 11, 2002, the Commission ordered a hearing for the complaints filed by Nevada Power Company and Sierra Pacific Power Company, Southern California Water Company and Public Utility District No. 1 Snohomish County, Washington. These utilities allege that dysfunctions in the California electricity spot markets caused long-term contracts negotiated in the bilateral markets in California, Washington and Nevada to be unjust and unreasonable; they ask that FERC remedy the problem by modifying the contracts. The Commission directed the parties to first participate in contractually mandated mediation.
- On April 25, 2002, the Commission issued an order setting for evidentiary hearing complaints by the Public Utilities Commission of the State of California and the California Electricity Oversight Board against a group of sellers under long-term contracts with the California Department of Water Resources. The state agencies allege that the prices, terms and conditions of such contracts are unjust and unreasonable and seek contract modification. Here too, the Commission strongly encouraged the parties to pursue settlement.

IV. THE COMMISSION'S ACTIONS TO MITIGATE MARKET MANIPULATION OR FAILURES IN CALIFORNIA AND THE WEST

To understand FERC's actions and their impacts in California and the western power markets, it is useful to first understand how Enron's trading strategies were designed to exploit the California market:

- Strategies that involved "inc-ing load"—artificially increasing load on schedules, dispatching generation in excess of actual load, and getting paid for the excess generation at the market clearing price;
- Strategies that exploited the congestion management system by relieving real or artificial congestion;

- Strategies that exploited the California v. Western price differential (e.g., megawatt laundering); and,
- Strategies that involve misrepresentation (paper trading of ancillary services when the company doesn't actually have the services to sell, submitting false information about the identity of the plants providing the services, and selling non-firm energy as firm to the PX).

With the exception of those strategies which involved deceit, these strategies were specifically designed to exploit flaws in California's market design. Since November 2000, FERC has been taking action to address these flaws and alleviate their consequences, even though the specific trading behaviors outlined in the Enron memos were not the target of the Commission's efforts. These Commission actions are described below.

Energy price levels—An extensive series of Commission orders served to moderate California and Western states' electricity prices, both through direct action on prices and through indirect action to stabilize California's spot and long-term markets.

- On December 8, 2000, at the CAISO's request, the Commission responded to the supply emergency and snowballing price conditions in California by modifying the $250 price cap, so that bids above that level would be accepted but would not set the clearing price paid to all sellers. That order also limited generators' ability to withhold generation (using scarcity to drive up prices) by authorizing the ISO to penalize participating generators that refuse to operate in response to emergency dispatch instructions.
- FERC's December 15, 2000, order reduced the impact and vulnerability of the spot market by ending the requirement that California's three investor-owned utilities (IOUs) sell all of their resources into and buy all of their requirements through the California PX. By terminating the requirement, FERC released a total of 40,000 MW of load from the spot market and placed 25,000 MW of the IOUs' resources directly under the jurisdiction of the California Public Utilities Commission.
- To reduce possible withholding of generation and increase available supplies, FERC's April 26, 2001, order allows the CAISO to order increased production from any on-line, uncommitted in-state generation capacity in the real-time market if the energy is needed. The June 19, 2001, order expanded this must-offer requirement to include all utilities in the Western Systems Coordinating Council (WSCC).
- FERC's April 26, 2001 order also established a prospective mitigation and monitoring plan for wholesale sales through the CAISO spot market, and established an inquiry into whether a price mitigation plan should be implemented throughout the Western Systems Coordinating Council (WSCC). This plan included price mitigation for all sellers (excluding out-of-state generators) bidding into the CAISO real-time market during a reserve deficiency (i.e., when reserves fall below seven percent), with a formula to calculate the market clearing price when mitigation applies.
- FERC's June 19, 2001 order established price mitigation for spot markets throughout the West, equalizing region-wide price limits across all western states through September 30, 2002; this reduced the incentive to megawatt launder. Key elements of the mitigation plan, to be in effect from June 21, 2001, through September 30, 2002, included: retaining the use of a single market clearing price for sales in the CAISO's spot markets in hours when reserve margins fell below 7 percent; applying that market clearing price for sales outside the CAISO's single price auctions (i.e., bilateral sales in California and the rest of the WSCC); and establishing a different price mitigation level formula for those hours when California does not face a reserve shortage.

Congestion management—The fundamental flaw in California's congestion management system is that it does not fully recognize the existence of major transmission constraints outside the real-time market. Therefore, the CAISO schedules buyers' and sellers' transactions without regard to the system's actual physical transfer capabilities, so that day-ahead pre-schedules are often not feasible. In such a case, the infeasible day-ahead schedule causes the CAISO to anticipate a congested system, so it pays entities in real-time to relieve the congestion. This can be prevented—as it has been in all other active ISO organized markets—by designing the day-ahead market to recognize all transmission system constraints and reliability limits, and limiting the number of transactions and transmission accordingly to avoid artificial congestion and reduce real congestion. Other ISOs also use some version of congestion pricing that charges the cost of congestion to the entities that cause it. These approaches limit the ability of market participants to manipulate congestion and to profit from such manipulation.

The Commission told the CAISO in January, 2000, that California's congestion management system was flawed and needed to be fixed. Although the CAISO has proposed significant changes to the system, those reforms are not scheduled to be in place until 2003-2004. Similarly, the addition of much needed generation and transmission capability, which will also help relieve congestion, will not occur in the near future, but rather will take years to accomplish.

- In an order issued on January 7, 2000, FERC found the CAISO's congestion management structure to be fundamentally flawed and directed the CAISO to develop and submit a comprehensive congestion management and market redesign.
- In the face of limited response from the CAISO, FERC issued its December 15, 2000 order, requiring the CAISO to file a comprehensive redesign of its congestion management program by January 31, 2001. The CAISO, under a new state-appointed Board, did not make the filing.
- To the degree that exploitation of the interplay between trading on the Cal PX and the ISO's day-ahead market enhanced the ability of traders to manufacture congestion for profit, the Commission's termination of the California PX rate schedule reduced the effectiveness of these strategies. Trading on the California PX was halted in January, 2001.
- In an order issued May 25, 2001, the Commission clarified that price mitigation applies to both energy and congestion management, thus limiting congestion payments and disincenting this behavior.
- One year after directing changes to the CAISO's congestion management system, FERC's December 19, 2001 order again directed the CAISO to file a revised congestion management plan, due May 1, 2002.
- The CAISO filed a market redesign proposal on May 1, 2002, which anticipates implementing some congestion management reforms by fall 2003 and winter 2004. The aspects of the ISO's proposal that are proposed to become effective by September 30, 2002, will not change the congestion market substantially.

The price mitigation measures put in place in the April 26, 2001, and June 19, 2001, orders have limited the effect of anti-competitive behaviors on market prices, and they will continue to do so until September 30, 2002, when price mitigation is scheduled to terminate. Before that date, the Commission will ascertain the appropriate mitigation tools needed for the California and western market going forward. The CAISO has filed its plan for post-September mitigation, and I expect the Commission to address this matter soon.

Megawatt laundering—These strategies exploited the fact that there were price caps in effect for generation within California, but no caps affecting out-of-state imports into the California market. FERC addressed this through a number of actions, including its actions to increase the availability of in-state generation and to stabilize prices across all of the western states.

- In early August, 2000, the CAISO prohibited non-firm exports.
- FERC's April 26, 2001, order forced marketers outside of California bidding into the CAISO to be price-takers, so they could not bid a higher price for imports and set the price for the entire market; rather, as price-takers, importers accept whatever price is set by in-state, non-imported generation.
- The June 19, 2001, order treated sales within and outside California uniformly and imposed uniform price mitigation throughout the West. These measures eliminated incentives for megawatt laundering.

Attachment A* is a detailed list of the significant FERC orders and actions pertaining to California and western states electric markets since November, 2000.

Deliberate misrepresentation of information—This is clearly wrong. For instance, selling or reselling what is actually non-firm energy but claiming that it is "firm" energy is prohibited by the rules of the North American Electric Reliability Council. But it should be recognized that many of the trading strategies contained in the Enron memos were not necessarily prohibited under the CAISO tariff, except for the general prohibitions against gaming.

Although we have not completed our fact-finding investigation with respect to sellers in California and the western electric markets, as a general matter it is clear that regulators must have two essential tools to prevent or mitigate significant misbehavior. First, the market regulator must have adequate monitoring and oversight capabilities, and a good understanding of market activities and patterns, to identify when and whether misrepresentation and manipulation is occurring. Second, regulators must have meaningful penalty authority, to ensure that market participants

*The attachments have been retained in committee files.

do not jeopardize reliability or manipulate market outcomes. FERC is working to develop and improve its understanding of markets and market manipulation through the new Office of Market Oversight and Investigation and its on-going cooperation with the CAISOs' Market Monitoring Units and other federal agencies. But it is clear that the Commission's penalty and enforcement authorities are limited and need to be expanded if they are to serve as effective deterrents to market misbehavior. I will discuss this issue further below.

As the California situation evolved between 1996 and mid-2001, I was a state regulator, and I appreciated from afar FERC's deference to California's legislators and regulators as they worked to design competitive wholesale and retail markets for electricity. In 1996, California's restructuring legislation, AB 1890, was unanimously passed by the state's Legislature. In retrospect, the Commission may have been too deferential to California's market design, allowing it to go forward because California had gone through a great deal of stakeholder consensus and compromise—and because many crucial measures of the market design were dictated by state legislation. But as the magnitude of the problems in California and the West deepened, it has been difficult to find a constructive way out of the binds that our joint history has created.

Chairman Bingaman asked a number of questions in his letter of invitation which I would like to address here.

First, are current disclosure rules sufficient to discover the kinds of behavior referred to in the Enron memos? That is not entirely clear. Based on a proposal issued in July, 2001, FERC recently adopted a rule requiring detailed, standardized, electronic reporting on electricity market transactions. We believe that these data will help to detect inappropriate behavior in energy markets, but it will take some time to assess whether the new information permits us to monitor markets effectively. We are also undertaking a comprehensive analysis of our information collection requirements to determine what information is needed to effectively monitor a competitive marketplace, and may seek to change reporting further in the future.

Are there behavior patterns that should be considered presumptively manipulative? I don't know yet. Clearly anything that involves deceit, fraud or misrepresentation is manipulative, but it is not always easy to detect and prove such behavior. I hope we will be able to answer this question more definitively after the Commission completes its on-going western states investigation.

Are FERC's market rules sufficient to ensure that markets are not being manipulated? I believe that the rules now in effect across the organized markets in the eastern markets prevent major market manipulation of the type outlined in the Enron memos. And the Standard Market Design rules which we are now developing, through a public process, seek to prevent such market manipulation in the future. But the rules which have been in place in California have allowed some types of manipulation to be practiced. Until organized electric markets exist across the entire nation and transmission grid, it is still possible for market participants in vast areas of the country to engage in behaviors that can adversely affect both the long- and short-term markets. The Commission's goal is to rely on clear rules of the road under standard market design, and non-discriminatory transmission access, that would apply to all transmission owners and operators and all generators and load-serving entities. For this reason, we have placed the Standard Market Design effort at the top of our regulatory agenda.

V. INTERACTION BETWEEN THE COMMISSION AND THE CAISO

There are two critical issues affecting the future of the CAISO and its ability to remedy the problems that have occurred in California's electricity markets. One is the degree to which the Commission works with the CAISO to monitor activities and developments in the California market. The other is the independence of the CAISO itself.

In the past year, FERC staff has maintained frequent contact with members of the CAISO's staff, including its market monitoring staff. The Commission has also held a series of technical conferences, most recently on April 4 and 5, 2002, and May 9 and 10, 2002, to facilitate continued discussions between the CAISO, market participants, state agencies and other interested participants, on a revised market design for the CAISO. In addition, the CAISO's market monitoring staff routinely contacts FERC staff to discuss events and issues in the California markets. In an April 26, 2001, order, the Commission established a process to better track the developments in the California market. The CAISO now submits weekly reports to the Commission of schedule, outage and bid data to review current market performance, and includes any concerns such as possibly inappropriate bidding behavior.

When the Commission's new Office of Market Oversight and Investigation (OMOI) is fully staffed, it will take over the task of working with ISO and RTO market monitoring units (MMUs). The OMOI will coordinate closely with MMUs with respect to local and regional market patterns and problems, but will also look for patterns and problems across multiple regions and markets. OMOI will conduct monitoring and oversight and issue regular reports on the status of the nation's energy markets. It will also have the responsibility of investigating possible market problems and participant misbehavior and recommending improvements and solutions to the problems it finds.

The issue of the CAISO's independence remains pending before the Commission as a compliance issue. In its December 15, 2000, order, the Commission directed that the CAISO board should be replaced with a non-stakeholder board that is independent of the market participants. The CAISO declined to respond to this directive. FERC hired consultants to conduct an independent audit of the CAISO, and has recently received public comments on that audit report. To avoid pre-judging the issue, I cannot state any conclusions now on this contested matter, but at a minimum we should note that the issue of ISO independence and credibility is critical not only for California but for every ISO and RTO. Participants in a competitive, effective market need to be confident that the entity which manages the grid and the market is independent and unbiased and will not act in a way that favors or disadvantages any market participant. I expect the Commission to take up this matter soon.

VI. CAISO'S COMPREHENSIVE MARKET REDESIGN PLAN

On May 1, 2002, the CAISO submitted for filing a comprehensive market design proposal, as directed in the Commission's order on clarification and rehearing, issued on December 19, 2001. The CAISO states that its proposal largely reflects the market structure in the Commission's standard market design rulemaking, i.e., an integrated day-ahead and real-time congestion management, energy and ancillary services market based on locational marginal pricing.

The market redesign issue is pending before the Commission, so I cannot offer any substantive comments on its merits. I can say that California is part of, and dependent upon, the broader western states grid, and there will be many issues to resolve with neighboring markets before we can realize seamless, efficient, full competition that benefits California and all of its western neighbors.

VII. WILL MARKET DESIGN ALONE SAVE CALIFORNIA?

Even with the CAISO's proposed market redesign, California's electricity problems will not be over. As California and others have recognized, a combination of factors combined to cause the state's problems in the year 2000:

(1) tight supply conditions in California and throughout the West;
(2) lack of significant demand response to hourly prices;
(3) high natural gas prices;
(4) inadequate infrastructure (including inadequate transmission capacity);
(5) lack of long-term supply arrangements and underscheduling in the forward markets;
(6) inadequate tools to mitigate market power; and
(7) poor market design. (Charles F. Robinson and Kenneth G. Jaffe, CAISO's May 1, 2002 filing before the FERC of its Comprehensive Market Design Proposal, pp. 7-8, footnotes omitted)

Since 2000, natural gas prices have dropped and a majority of California's demand is now served under long-term bilateral contracts rather than through the spot market. There are currently market mitigation measures in place for the load remaining in the spot market, and the CAISO has filed a proposal for a new and better market design and congestion management system. But little else has changed:

- California has built little new generation—only 3,055 megawatts of new generation have come on line since 2000, so there is now a total of 50,345 MW in-state to serve a peak demand of 54,255 MW projected for 2002. Power plant developers have announced the cancellation of 17 plants previously proposed to be built in California, for 1,296 MW, over the past year alone; Attachment B, a map of new and cancelled power plants across the western states since the year 2000, shows that many proposed plants have been cancelled. Although the CAISO itself has stated that "the capacity reserve margin . . . should be 14% to 19% of the annual peak load to promote a workably competitive market outcome" ("Preliminary Study of Reserve Margin Requirements Necessary to Pro-

mote Workable Competition", Anjali Sheffrin, Market Analysis, CAISO, November 19, 2001), California remains dependent on out-of-state imports for a significant share of its load, and on unpredictable hydroelectric generation for 15% of its supply. In the year 2000, California's reserve margin was only 2%; for the summer of 2002, the CAISO predicts a reserve margin of 8.4% at expected peak.

- California has built no new bulk transmission, either to link the north and south portions of the state grid or to improve its import capabilities from out-of-state generators. Recently, the Western Area Power Administration, PG&E and TransElect filed a proposal to upgrade California's Path 15 line.
- The ability of individual customers to receive price signals and adjust their energy demands accordingly remains limited. California has done much to reduce peak customer loads, but more demand response is needed across the western states, as a crucial check on the ability of suppliers to exercise market power by raising prices.

Most of the above problems can only be resolved by California itself; but FERC stands ready to assist the state within the limits of the law and our respective jurisdictions. For instance, over the past year this Commission has acted expeditiously to approve several natural gas pipeline applications to assure that additional gas supplies can be delivered to the California border to serve the state's growing load.

VIII. MAKING MARKETS WORK FOR THE LONG TERM

The Commission believes firmly that sound, competitive wholesale electric markets serve America's energy users better than the cost-of-service, vertically integrated utility alternative. FERC has been working hard to implement Congress' vision of this since the passage of the 1992 Energy Policy Act. Since that time, we have seen clear evidence in other countries and states that wholesale competition improves reliability, drives down delivered energy prices, sparks technological innovation, and enhances local economies with new capital investment. It is time to recommit ourselves to the challenge of completing the transition to fully competitive wholesale markets.

The Commission's strategy to complete the task of making wholesale markets work has several key elements. Many of them are informed by what we have learned from observing markets in California and the western states over the past three years, and comparing them to other energy markets. Here are some of the lessons we have learned, which underlie the Commission's initiatives concerning competitive wholesale electric markets.

Standard Market Design

Energy markets are geographically large and regionally inter-dependent, so it is critical to promote clear, fair market rules to govern wholesale competition that benefits all participants, and assure non-discriminatory transmission access. Market rules must also specify what constitutes inappropriate behavior and the consequences for such behavior. Through its ongoing Standard Market Design (SMD) rulemaking initiative, the Commission intends to reform public utilities' open access tariffs to reflect a standardized wholesale market design. SMD will help enhance competition in wholesale electric markets and broaden the benefits and cost savings to all customers. The goals of the SMD initiative include providing more choices and improved services to all wholesale market participants; reducing delivered wholesale electricity prices through lower transaction costs and wider trade opportunities; improving reliability through better grid operations and expedited infrastructure improvements; and, increasing certainty about market rules and cost recovery for greater investor confidence to facilitate much-needed investments in this crucial economic sector. A sound market design, similar to the designs developed and tested in the East, will reduce the incentives and opportunities to manipulate the market.

Regional Transmission Organizations (RTOs)

As long as they are properly structured and truly independent, RTOs will provide significant benefits to electric utility customers across the nation by eliminating obstacles to competition and making markets more efficient. RTOs facilitate wholesale competition and, where states choose to pursue it, retail competition. Even in the absence of retail competition, electricity customers benefit from increased competition in wholesale markets because it reduces bulk power prices and improves reliability. First, RTOs should eliminate "pancaking" of transmission rates, that raises the cost of moving power across multiple utility systems. Second, RTOs that have the proper tools can better manage transmission congestion, reduce the instances when power flows on transmission lines must be decreased to prevent overloads, and effectively solve short-term reliability problems. I believe that RTOs (and independent transmission companies operating under an RTO umbrella) will attract the

capital and expertise needed to expand the grid and serve the generation capacity necessary for growing, competitive electricity markets. Third, RTOs should ensure that vertically-integrated transmission-owning utilities do not discriminate in favor of their own generation over another seller's generation. Fourth, RTOs can facilitate transmission planning across a multi-state region and, by operating the grid as efficiently as possible, should provide assurance to state siting authorities that new transmission facilities are proposed only when truly needed.

Infrastructure

The Commission continues to work with others to promote adequate infrastructure by anticipating the need for new generation and transmission facilities, determining the rules for cost recovery of new energy infrastructure, encouraging the construction of new infrastructure, and licensing or certificating hydroelectric facilities and natural gas pipelines. Without adequate infrastructure, prices will rise due to scarcity and there will be greater opportunity for market manipulation. To speed the interconnection of new generation facilities, FERC has proposed a rule to standardize interconnection agreements and procedures, for use between all transmission owners and generators. The Commission is also assessing the available energy infrastructure across the nation, working by region-by-region with state officials and industry members to determine whether any problems or gaps exist and how joint effort and attention can help to remedy the deficiencies.

Market Monitoring and Mitigation

The Commission has instituted measures to ensure market mitigation in the future in all RTO markets. The Commission's Office of Market Oversight and Investigation will interface with the RTOs' market monitoring units and will monitor markets to ensure that market rules are working. Furthermore, under the Commission's ongoing standard market design initiative, monitoring for physical and economic withholding will be an important focus of the market monitoring units within each RTO region. Each market monitor will report directly to the Commission and to the independent governing board of the RTO. The Commission will exercise oversight over market monitoring and the impact of RTO operations on the efficiency and effectiveness of the market.

IX. LEGISLATIVE ACTIONS THAT COULD HELP FERC DEAL WITH MARKET POWER

A. Earlier Refund Effective Date

The Commission must rely on Federal Power Act section 206(b) for refund protections if it finds that market-based rates are no longer just and reasonable. Section 206(b) provides that whenever the Commission institutes a section 206 investigation of a rate or charge that may be unjust or unreasonable, the Commission must establish a refund effective date. If the investigation is based on a complaint, the refund effective date must be no earlier than 60 days after the complaint is filed. Congress can help the Commission protect customers against the exercise of market power by amending Section 206(b) to allow the Commission to establish a refund effective date that is as early as the date a complaint is filed.

Permitting the Commission to set a refund effective date as of the date a complaint is filed will have two principal effects. First, it will increase the deterrent effect of refunds by increasing the period over which the Commission can require refunds for market manipulation or other improper conduct. Second, it will give customers a stronger incentive to notify the Commission immediately when they perceive manipulation even very short-term manipulation—of the electricity markets, because customers will have greater access to refunds.

B. Increased Civil and/or Criminal Penalty Authority

The White House has requested that Congress, as part of the energy bill, increase criminal penalties under the Federal Power Act. Specifically, the White House proposes that the penalty for a willful and knowing violation of the FPA be increased from the current $5,000 level to $1 million and that the potential prison term be increased from two years to five years. For a violation of the Commission's regulations under the FPA, the White House proposes to increase the penalty from $500 per day to $25,000 per day. These changes will provide stronger deterrents to anti-competitive behavior, market manipulation, and other violations of the FPA and Commission regulations.

Congress could create additional deterrents to anti-competitive and bad-faith behavior in the marketplace by broadening and strengthening the Commission's civil penalty authority. Currently, FPA section 316A provides for a civil penalty authority of up to $10,000 per day for violations of Section 211, 212, 213 or 214. These penalties could be broadened to all sections of the FPA and increased significantly.

C. Encouraging Construction of Needed Energy Infrastructure

Congress could encourage construction of needed infrastructure—particularly bulk transmission, to reduce costly (and manipulable) congestion—by adopting measures that include support for Regional Transmission Organizations and their regional planning function. Another crucial measure is to adopt needed tax code revisions to assure that municipally owned transmission owners can commit their assets to common grid use without losing the tax-exempt financing of those assets, and that investor-owned transmission owners can transfer or consolidate their assets without incurring a taxable event that raises the costs of the transaction. In May 2002, the Department of Energy released an excellent report, "The National Transmission Grid Study," which explains the crucial need for and value of a sound national transmission grid. The Commission strongly supports the report's recommendations.

X. CONCLUSION

The Commission is moving aggressively to investigate potential market manipulation in California and the West, whether by Enron or other market participants. We also are moving forward on initiatives that will put in place clear wholesale market rules and effective market monitoring to protect customers in every region of the country. We will continue to work with other federal agencies, with the states, and with Congress to protect the nation's electric customers and achieve the full benefits of wholesale electric competition.

I look forward to sharing the results of our western markets investigation with you this summer and welcome your input and questions.

The CHAIRMAN. Thank you very much.

Mr. Winter, please go ahead.

STATEMENT OF TERRY WINTER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORP., FOLSOM, CA

Mr. WINTER. All right. Mr. Chairman, members of the committee, thank you for allowing me to be here. I did not hear how much time I had. You said 8 minutes.

The CHAIRMAN. About 8 minutes. If you need another minute or 2, you are entitled to that, whatever you would like.

Mr. WINTER. I have submitted as direct testimony quite a number of documents that I may refer to, but rather than go into them in detail, I will wait for that to happen during the questioning period.

But I would like to emphasize three points today, and then I will respond to any questions you may have.

First, as disturbing as these strategies may be, I think that we have to look a little deeper, as we go forward, into the real cause of the dilemmas that we have faced in California. So, we have identified that market power is a big issue and that is not always identified as gaming or the things you have seen. So, you have to look at both of those together.

From the start-up, the ISO has been filing documents. I did not bring them all. We had about a 2-foot stack of the different documents that we have filed concerning market power, but I have provided a chronological listing in the attachment of each of those documents.

As you will see in that, there is a strong and consistent emphasis on detecting, constraining, and combating market power. Through the turmoil of late 2000 and early 2001, our Department of Market Analysis and an independent market surveillance committee repeatedly documented both the presence and the impact of the market power in the California markets, and we have proposed many

different ways of dealing with those, some of which we have enacted, some of which were not.

From the very beginning, there has been a potential for market power in the design that California implemented. We recognized that and we tried to combat it as we saw it come about. I stress these points because market power has been the means from which the greatest profits have been extracted from the California market and in many ways it is the enabler that allows these different gaming activities to take place.

Second, with regard to the gaming of the type described in the Enron memos, the ISO consistently has monitored for such activities and, when appropriate, we have taken action. To cite but a few examples, we have rescinded payments to suppliers who have gamed our ancillary service markets. We have levied penalties on suppliers who withheld energy and had invalid dispatch instructions, and we have issued directives requiring suppliers to cease gaming strategies, and you will see the effect of those. We have also chosen to change the market rules when we identified this, and we have had our own internal practices of trying to counter the gaming, and in some cases, where a lot of these operated beyond our authority, we have referred those matters to FERC.

Third, it is imperative that we learn from the experience we have had so that we may move forward to secure the consumer benefits and trust and efficiency of the system, but we cannot forget reliability. The ISO's goal is to maintain reliability and assure that we have sufficient power to meet the needs of our customers.

On May 1, 2002, we filed with FERC a detailed proposal for a comprehensive redesign, and it adopts the best practices we could find not only in the West-wide area, but also in the Mid-Atlantic and any foreign markets that we saw. One of the problems that we saw is that you cannot implement a market design piecemeal, so if you pick pieces apart and you only implement part of it, you leave an opportunity for people to go in and game the system. So, as you look at these designs, you have to be very careful that you pick up all the pieces, and that was very clear to us, especially in California, where in operating the system, there were many entities that, one, I could not see outside the State, and two, internally with the municipalities having their different systems, we found that we could not see a lot of the activities that were going on.

Our proposal includes an integrated set of market monitoring and mitigation proposals. I think it is imperative that we probably overreact and protect customers from price spikes and high volatility in the market.

Let me anticipate the question that rightfully you should expect me to answer, and that is, would this market design change that we propose address and close all opportunities for market manipulation? We have tried to do that, but as we have found in the past, every time we try to come up with a counter, somebody figures out a way around that counter. So, I cannot sit here and say that it would absolutely without doubt close off all gaming opportunities. On the other hand, a well-designed market with sufficient capacity certainly would discourage many of these and, in fact, with the right penalties and sanctions, I think we could react quickly to those.

In closing, let me just say that we are here to help. We have developed a tremendous amount of experience in the last 4 years. We see tremendous amounts of data. We have a close relationship between our market monitoring and our operating people so as we see things that occur, then we can address it.

Now, as I move on, let me answer one of the questions that was brought up earlier, and that was the incident of an ISO employee who recently made certainly the newspaper and every place else. Again, it is not easy to explain what happened, but in one of these markets, if you in fact make the differential between the price that is paid and the price that is actually bid, you end up reducing the overall cost to the marketplace because we have to pay the differential.

So, this employee tried to raise, through an improper contact, that price so that the differential would be smaller and there would be less money paid out. In his mind, he thought that he was helping the people of California by reducing that cost to them. In fact, that violated our code of conduct, and so he was terminated for that activity.

We then launched into a rather extensive investigation of the incident by an outside group. I put absolutely no limits on what they were to look at, and they interviewed people both vertically and horizontally, some 24 to 40-some people in the organization. And at this point, the preliminary results appear that this was an isolated example. But that investigation is not complete because the firm wants to look at some of the other areas. So, we will have to report on that later.

Last and very quickly, what are some things I think the legislation should do? Senator Murkowski mentioned the Senate bill. I also am a great believer in visibility to the market or transparency. It is the best way to catch what these gaming things are. If we have a visible market and it is open for people to see what is going on, that is the way we determine and make these things visible. So that transparency is important.

Second, on the refunds, it is my belief that if examples of market power are found, we should give refunds back to any ill-gotten gains. And if FERC feels that they are limited for some reason on going back, then I would suggest legislation that would let them address that.

Then from an operating standpoint, we need to have clear rules that we can implement immediately, and by that, I mean it is very, very important that we take action quickly. Sometimes the process just does not let us do that. We have to go back to FERC, ask for the authority. And the tariff should clearly define those before we get there.

Another issue that I am always concerned about—and I am not an attorney. But one of the actions we tried to take was take one of the generating entities to court, and we were successful at the district court to enforce a restraining order to get them to take action. But that was overturned in the appellate court because it said only FERC had the authority to enact that tariff, and they had to defend their own tariff. I think sometimes that takes more time.

So, from legislation, I would like to see FERC have the authority either to have those injunctive powers or, in fact, pass them down

to somebody so we could go to court and attack some of these behaviors.

Beyond that, I think my time is up. I am here to answer any questions that you may have and certainly look forward to working with you in the future. Thank you.

[The prepared statement of Mr. Winter follows:]

PREPARED STATEMENT OF TERRY WINTER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORP., FOLSOM, CA

Mr. Chairman, Members of the Committee: Thank you for inviting me to join you in an inquiry that is most important to electric consumers in California and throughout the western United States.

I would like to emphasize three points today, and then I would be happy to respond to your questions.

First, as disturbing as some of the strategies described in the Enron memos are, the greatest potential harm to electricity consumers in California and elsewhere comes not from "games" that some clever traders may play, but from the persistent exercise of market power by suppliers and traders. By "market power," I mean the ability of a single seller or group of sellers—to command excessive prices on a sustained basis. It is the exercise of market power by suppliers that has cost California consumers billions of dollars since the summer of 2000.

From start-up four years ago, the ISO has placed particular emphasis on documenting and mitigating market power. I am providing the Committee with a chronology of activities the ISO has pursued in the past four years, directed to market power, gaming, and providing relief to consumers that have been victimized by market power.* You will see there a strong and consistent emphasis on detecting, constraining and combating market power. Through the turmoil of late 2000 and early 2001, both our Department of Market Analysis and the independent Market Surveillance Committee repeatedly documented both the presence of and impact of market power in the California electricity markets. And we have proposed measures effectively to control that power. There have been times, indeed, when we have been accused of reacting too vigorously to the potential for market power to be exercised or market rules flouted as, for example, when we unilaterally imposed price caps on the ISO's markets and only afterward sought the authority to do so. I stress these points because market power has been the means by which the greatest profits have been extracted from the California markets, and because it has been the enabler for many of the gaming strategies identified in these markets.

Second, with regard to gaming of the type described in the Enron memos, the ISO consistently has monitored for such activity, and when appropriate, we have taken action. To cite but a few examples, we have rescinded payments to suppliers who have gamed our ancillary services markets, we have levied penalties (following FERC approval) on suppliers who have withheld energy in the face of valid dispatch instructions, and we have issued directives requiring suppliers to cease gaming strategies in our congestion management market. In many instances, we have chosen to change market rules or our own internal practices to counter a gaming opportunity. In other cases, operating within the authority given to us, we have referred matters to FERC for review and further action.

Third, it is imperative that we learn from the experiences we have had so that we may move forward to secure for consumers the benefits of efficiency and reliability that best can be provided by a robust regional grid and electricity market. Our focus must be to understand what went wrong and to put in place the protections necessary to ensure that consumers are unlikely ever again to be subject to the prejudice of market power abuse and gaming strategies.

The most effective means of detecting and deterring the exercise of market power and unfair gaming of market rules is to establish market rules that encourage appropriate behavior—by which I mean offering all available electricity supplies at prices that reflect the suppliers' costs—coupled with enforcement programs that rest on clearly defined rules and consequences for non-compliance.

On May 1, 2002, we filed with the FERC a detailed proposal for a comprehensive market redesign, that adapts the best features of the market design employed in the Mid-Atlantic region to the unique circumstances we face in California. The proposed design centers around a day ahead integrated market for procurement of energy and reserves and the management of congestion on the grid; and day ahead

*The exhibits submitted by Mr. Winter have been retained in committee files.

residual unit commitment, which will permit the ISO to require suppliers to make preparations to generate to meet tomorrow's demand. It also includes an obligation on utilities and others serving customers to arrange for a surplus of supply in advance to meet their customers demands, so that the short-term market never again becomes the primary vehicle for serving customers' needs.

Our proposal also includes an integrated set of market monitoring and mitigation proposals to deter both the exercise of market power and the types of gaming strategies exemplified in the Enron memos. As it will take time to complete the development of the software and hardware, the filing includes a request that FERC extend and enhance the effectiveness of the current bid cap mechanism. We look forward to a positive and prompt response from the FERC so that we may go forward quickly to implement the new market design.

Let me anticipate the question that you rightfully should expect me to answer: Would the market design changes we propose address and close the opportunities for market manipulation that it has been suggested Enron has engaged in? We think so, for the most part.

Can I assure you that if we succeed with our redesign, all opportunities for market power abuse and market manipulation will be eliminated? Of course not. Many of the problems that contributed to the market failure in 2000-2001—deficiencies in supply, failure to engage in long-term contracting for resources, limitations on demand responsiveness, and inadequate transmission infrastructure—can only be addressed through close cooperation, not only between the ISO and FERC but also among state officials and market participants, in California and in our neighboring states. Moreover, I cannot tell you how often in the past we acted with the conviction that we closed a door to abuse only to find market participants creating new opportunities. What I can tell you is that our design will draw from the teachings across the country and do all that we now know to be feasible to assure a fair, efficient and competitive market.

Mr. Chairman, members of the Committee, let me close with a pledge to each of you and to electric consumers in California and throughout the west: We at the ISO will learn from experience, and we will utilize every ounce of our considerable expertise so as best to assure that consumers never again suffer a repetition of past market power abuses, but instead, reap the benefits of a robust competitive market which I continue to believe can be substantial.

The CHAIRMAN. Thank you very much. Let me just start and I will just take 6 minutes, since I had an opening statement, and then we will do 8 minutes in this first round so that people have a couple of more minutes.

Senator DOMENICI. Mr. Chairman?

The CHAIRMAN. Yes.

Senator DOMENICI. Since I have to leave, can I just submit questions for answering by the witnesses.

The CHAIRMAN. All right.

Senator DOMENICI. Let me start and ask a question for either or both of you. To what extent do we believe that these various strategies, which were employed and which have gotten such attention and which are described in these memos—the strategies for manipulating the market, or gaming the market—actually contribute to and account for the dramatic price spikes that we saw in the California market at the end of 2000 and the first half of 2001? Do either of you have an opinion on that? Maybe that is still a subject of your analyses going forward.

I thought I understood you to say, Mr. Winter, that your belief is that the majority of the problem is with market power and not with these individual strategies. Is that what you said?

Mr. WINTER. Yes, that is what I said. If I were to look at the costs of the California market, I think in the 1999 time frame energy to California was approximately $7 billion.

The CHAIRMAN. That is the cost of all the energy, of all of the electricity purchased, of all the wholesale power?

Mr. WINTER. Wholesale energy power to the State of California. That dramatically then—I cannot remember whether it was the next year or the year after that, but jumped to around $28 billion and then it went down to $26 billion. Those kind of increases to me, there is absolutely no way that a common market design ought to have that kind of result.

So, if I look at the price of gas and I look at the natural things, let us assume that the $7 million was an extremely good deal and that the people were actually operating at a loss. To then jump that high, to me, is not supportable. If I go back and look at what I would expect competitive markets to produce, then I am more in the $10 million to $14 million. So, I look at a combination of market power and gaming, and to me we are in the neighborhood of anywhere from $10 billion to $15 billion more that California paid than it should have had to pay.

Now, if you ask me to break those out, what was market power and what was gaming, here I have a lot of trouble because all I am able to see are the things inside California.

So, one of the comments in the memos was that people were counter-scheduling congestion, and the figure of $30 million was in there that Enron made from congestion. Well, I am here to tell you they actually made $33 million on congestion for that path, which was called path 26.

However, we then looked at their bidding activities because we could see how they bid across that line, and if you take out just the normal congestion that occurred from others bidding on both sides of that path, we came down to maybe the total impact was somewhere between $180,000 and $500,000, which says that is not a big amount of money when you are looking for $10 billion to $15 billion.

Now, those that happened outside the control area or outside California could have had a much greater impact, and therefore, that is why I cannot really answer that. I also am not privy to the bilateral contracts and how they were arranged for or how much they cost.

The CHAIRMAN. Let me ask about how the interaction between FERC and the ISO's will work in the future. Let me ask Chairman Wood about that. As I understand it, you are about to issue a rule on standard market design for the entire country. How do you envision this working here?

It seemed like there were problems with the way the ISO in California was monitoring what was going on. They had things they were not able to stay on top of or deal with. How do you see FERC being able to correct any of that, or what do you see happening?

Mr. WOOD. One of the aspects of the market design rule and a key one is what are the monitoring and market mitigation responsibilities of an RTO, of a regional transmission organization. Actually just last week, we had the different folks like the ones that work for Terry and the ones that work elsewhere in the country come up to the Commission and talk about that critical aspect of the rulemaking. Again, that is a part that is still under a lot of discussion, certainly with these issues in mind.

I expect, Senator, that there will be at each RTO the ability to mitigate anti-competitive or defined behavior and not have to have

FERC come in and do it with the process. And I think Terry just laid that out pretty well. That would exist at the RTO. It would be clear. There would be basically what we have called tools in the tool box for the different RTO's in the country to use to address potential market power problems immediately and have those really be present at the RTO rather than, as we have had, here with California, kind of dished out with tariff filings and the like.

The CHAIRMAN. You referred, Mr. Winter, to having the right penalties and sanctions with which to enforce these various provisions. Do you have anything you could tell us about whether the penalties and sanctions that are provided for in Federal law and particularly in this legislation that we are working on, the energy legislation, whether those are adequate or whether we should strengthen those, whether those are what they should be? I would ask Chairman Wood the same question, whether he sees something we should strengthen in the penalties and sanctions that can be imposed for this kind of gaming that obviously has taken place.

Mr. WINTER. I assume you want me to answer first and then he can correct me.

[Laughter.]

Mr. WINTER. I think the whole idea of sanctions gets to be very difficult because when you start talking about the magnitudes of dollars, you really have to encourage people to follow the rules. I think it is very important that we look just beyond one State because you have got to look at the whole market or you leave pieces out of it. So, I am a large supporter of the RTO monitoring process. But I think it is a shared responsibility with a lot of entities.

FERC has to have the authority to have injunctive power or we go to court and then they bounce it back to FERC, and 6 months later we are out several billion dollars and we are trying to figure out what is going on. So, as far as the level, I would have to look at each individual sanction, but as long as FERC has that authority, I am okay.

I think the RTO's have to have a clear set of rules so that when they see it broken, they can act immediately. Sanctions work in really two ways. No. 1, they identify that people are aware of this activity and you should not do it, and No. 2, it gets your name on a bad list and that has a lot of impact on what they can do. So, I think the local area has to do that.

I think there is a local State function that needs to look at what is going on in markets, and that together, you get that information because it is impossible for FERC to sit in Washington, D.C. and have the information I have from an operator who is sitting on the floor and knows exactly what is going on and how the trades are being made. So, I support the RTO concept and that that market monitoring works itself down to the local level.

The CHAIRMAN. Mr. Wood.

Mr. WOOD. With regard to the changes in the law to increase the tool box for the FERC, I mentioned in my testimony—and I think these are things, as I have followed them, that are in the bill that came out of the Senate a couple weeks ago. One is getting rid of the 60-day wait for a complaint. Under the electric law, it ought to be the day the complaint is filed. I believe that that has been eliminated in the bill.

Secondly is the increased ability of the commission to assess civil penalties, administrative penalties for violations of the rule or the law. Certainly there are criminal penalties. I understand the administration has asked to maybe rethink those as well, make those higher on the criminal side. Criminal, of course, is handled by the Justice Department. And those could well be merited. But I think the broadening of the civil authority at the commission was in the bill that came out of here as well.

So, as to the sanctions, I guess if what came out of the Senate goes all the way through and is enacted, I think that will certainly strengthen the commission's hand.

I think the process issue that Terry just mentioned sounds like a good one. We have not really discussed that before, but the ability to actually to do some injunctive relief through probably an ALJ or through a commission order may well be a streamlining effort that would be worth looking at.

The CHAIRMAN. I will go back and forth between the two sides here, and then go in the order that people arrived. Senator Smith, I believe is next.

Senator SMITH. Thank you, Mr. Chairman. I wonder if I can include in the record an opening statement and one for Senator Craig?

The CHAIRMAN. You sure can.

[The prepared statements of Senator Smith and Senator Craig follow:]

PREPARED STATEMENT OF HON. GORDON SMITH, U.S. SENATOR FROM OREGON

Mr. Chairman, there have been several hearings in this and other Senate Committees into the demise of Enron, its effect on consumers and employees, and Enron's manipulation of the West Coast energy market in 2000 and 2001.

I must say, however, that the documents that are the focus of today's hearing are very disconcerting to me. They are, in essence, the smoking gun concerning Enron's trading practices in the West Coast energy market. These practices, with nicknames like "Fat Boy," "Death Star," and "Get Shorty," all had a common thread: they all used deceptive practices to circumvent California's price caps and to increase Enron's profits.

I want to commend Christian Yoder and Stephen Hall for being willing to put their names on such a blunt memo. I can imagine that Christian faced angering his employer, and Stephen risked losing a client. We need to ensure that our investigative focus remains on those who engaged in deceptive practices, not those who reported on them.

The information in these memos is not really surprising to me. I became convinced in early 2001 that the West Coast energy market at that time was not a free market, it was a broken market. That is why I cosponsored legislation with Senator Feinstein to impose price caps on the entire western market. In the face of our legislation, the Federal Energy Regulatory Commission finally stepped in and instituted certain price caps that have stabilized the market. Unfortunately, for my constituents, this stabilized market is still high by historic Northwest standards.

While much of the press at the time focused on California, the entire West Coast energy market was driven by the prices in California. Prices in the Northwest for spot power in April 2001 were 10 to 12 times their historic levels. This was devastating to those living on fixed incomes, small businesses, school districts, and small towns. In 2001, job losses averaged 3,100 a month in Oregon.

The repercussions of these high prices are still being felt in the Northwest. The Bonneville Power Administration had to raise its rates by 46 percent last October. This has huge implications for BPA's customers, most of which are publicly owned utilities serving rural communities continuing to struggle with high unemployment. Statewide, Oregon's unemployment remains at 7.5 percent, making it the highest in the nation.

As we examine what went so wrong in the West Coast electricity market, we must not forget that the flawed way in which California implemented electricity restruc-

turing also contributed to the broken market. They forced the investor-owned utilities to sell much of their generation assets, forced them to buy power only in the day-ahead market, and artificially lowered consumers' power rates. This meant that there were no long-term contracts to minimize risk of price volatility, and when shortages began there were no price incentives for consumers to conserve.

It is going to take years for the courts to sort much of this out.In the meantime, we must examine the extent to which market manipulation occurred, and what the appropriate legislative response is in order to protect consumers who rely on this basic commodity. I look forward to hearing from the witnesses today.

PREPARED STATEMENT OF HON. LARRY E. CRAIG, U.S. SENATOR FROM IDAHO

The words I am about to speak are not the first, and will certainly not be the last, on the electricity crisis last year that so devastated California and many other western states, including my own. But I hope my words will move us closer to solutions, and not further away. And I am confident they will, for my premise for speaking is that we must pay closer attention to facts, and move away from myth and distorting rhetoric.

There has been much too much distortion and rhetoric in this debate. In part, this is understandable. Like other serious and complicated problems that face us, the western electricity crisis was laced with emotion and partisanship. But we must try to put both aside, for the sake of our constituents and our country. We must try to be calm, and truthful and wise.

So let us try to focus on the facts.

Allow me to begin with an observation.

I believe that reasonable people may, in good faith, reach differing conclusions on the question of whether the prices charged for wholesale electricity in California was "just and reasonable" under the law. It is worth noting that a dramatic rise in rates does not, by itself, make those rates "unjust and unreasonable."

To a certain extent, justness and reasonableness is a judgment call. We in Congress have empowered FERC with the authority and responsibility to make that judgment call. Saying that FERC went AWOL because it didn't order refunds automatically is unfair.

When FERC makes its findings on whether rates are unjust and unreasonable, it gives the companies involved a chance to rebut the Commission's conclusions. In America, we allow the accused the means and the opportunity to defend themselves. Under the Federal Power Act, when the accused fail to justify their conduct, FERC orders refunds.

We do not want knee jerk, shot-gun justice from any tribunal, let alone FERC when it needs to be very careful not to scare off suppliers with false refund orders, while not permitting overcharging to consumers.

So let's allow the debate to rage on as to whether that agency has exercised its judgment on just and reasonable rates wisely and fairly.

This is a legitimate topic for debate. So be it.

But there is another debate that I believe has not proven to be legitimate in all respects.Indeed, it is a debate that has been marred by a notable lack of reason and good faith.

The debate of which I speak concerns the causes of the high prices that have been charged for wholesale electricity in California. In this debate many have, for their own political purposes, engaged in distortions and outright lies.

Some people said last year during the crisis and continue to suggest today that there was no lack of electricity supply in the West. They say there were and are plenty of power plants and transmission lines to meet all of the demand for electricity. They say that a small group of companies, based mainly in Texas, have conspired to withhold electricity from the market in order to drive prices up to unreasonable, indeed, unconscionable, levels.

Let's talk about the facts—not just the ones we like, but the ones we may not like to acknowledge.

Since 1990 there has been a 26% increase in the demand for electricity in the State of California. During that time, not one major power plant was constructed—to repeat, not one. Even the Governor of California, Gray Davis, who has led the misdirected and politically inspired assault on the independent generators in the state, has repeatedly alluded to the fact that California has been derelict in not adding new generation.

Even Gray Davis, in a prime time speech delivered last spring, said that the major problem facing the state in this crisis was the lack of available generating capacity.

Despite a chronic shortfall in electric capacity to meet peak demands, Californians have, until last year, been able to get by without blackouts and price spikes. They have covered their shortfall by importing electricity—lots of it—from neighboring states, especially hydropower from the Pacific Northwest.

But last year, the Pacific Northwest suffered from its worst drought in decades. Reservoir levels were at their lowest since the 1930's.

In addition, the economic growth in the Pacific Northwest, Arizona and Nevada caused power plants in these areas to dedicate more of their output to their own localities and less to California. To be specific, peak summer demand in the west has increased at an annual average rate of 8% in the Arizona/New Mexico/Nevada region, 3.2% for California, 2.8% for the Rockies, and 2.4% for the Pacific Northwest. Yet, from 1991 to 1998, the growth rate of new generation capacity additions was less than 1%.

All of these factors have resulted in a stark exposure of the electricity supply deficiency within California. California had to subsist off of the kindness of its neighbors, and those neighbors were not in a position to be so kind.

Another important part of the reality in California has been the high price of natural gas and of securing necessary emission credits. The costs of both have soared through the roof. This has created enormous upward pressure on the price of electricity generated by these old gas-fired power plants.

A shortage of electric generating capacity, a region-wide drought causing a reduction in imported power, high natural gas and emission credits costs—these are the fundamental causes of the California electricity crisis. Any one of these factors would have caused a problem. Together they have dealt a devastating blow to the electricity marketplace.

This is the big picture. It is the true picture.

Leave it to politicians running scared and looking for scapegoats to obfuscate this otherwise obvious reality.

Put simply and bluntly, this reality does not suit the political needs of Governor Davis and his compatriots.

And so, again, and again, and again, conspiracy theorists accuse the independent generators of withholding electricity and of other forms of market manipulation.

Now we have FERC's publication of a law firm's summary of Enron's trading strategies in California. These memos use very colorful language. Some are saying these memos "prove market manipulation" and, therefore, provide the proverbial "smoking gun."

Perhaps, but are we certain? First, let me be clear—I am not here as a defender of Enron. There are plenty of legal investigations into the legality of Enrons activities and if the results of any one of them results in criminal convictions, I, for one, will not be saddened.

However, we here on the Energy Committee are not in the business of criminal investigations. We are in the business of developing sound public policy. For us to competently assess the public policy implications of these recently published memos requires some knowledge of the California energy markets and economic markets in general.

A very recent memo prepared by Jonathan Falk, Vice President of the National Economic Research Associates, analyzed these "smoking gun" memos and found, on balance, "there is no evidence that Enron's activities in California had any deleterious impact." He also provides some instructive advice for public policymakers:

> It will require large amounts of data and sophisticated analysis to calculate a net effect, but the assumption of a net adverse effect through a combination of outrage and succumbing to the public relations effect of the names of strategies is unworthy of serious consideration in the making of public policy."

So we have our work cut-out for ourselves, Mr. Chairman. I still strongly suspect that California's problem is a fundamental problem of supply and demand. What do we need to do to solve it?

Obviously, more power plants and transmission lines need to be constructed. And, the fact of the matter is, this is happening, at least with respect to power plants.

In addition, the crisis has spurred California to accelerate its permitting processes, and the Governor is publicly touting the addition of 5000 MW of new capacity and another 5000 MW sometime this year.

One wonders, if prices had been reduced by government intervention to the extent demanded by the conspiracy theorists—

- Would all or any of this investment in new power plants have taken place?
- Would the Governor of California have acted to expedite the permitting process?

- Would Gray Davis, a committed environmentalist, have issued the order last year that waived air emissions restrictions and penalties during power supply emergencies?

I doubt it.

What this robust new construction market evidences is the timeless law of supply and demand at work. Prices have been high mainly because demand has outpaced supply. These high prices have in turn stimulated development of additional supply, as I stated above.

It would be high irony, not to mention stupidity, to eradicate the market signals that have caused this investment to take place. Yet, that is exactly what the conspiracy theorists seek to accomplish.

- They want to cap prices and thereby discourage further investment.
- They want to kill the goose just as it is laying the golden egg.

Another bit of evidence that the market works, and is working in California is the recent downturn in market prices and absence of blackouts.Of significance has been the return to service of several large generating facilities, including some nuclear plants, a reduction in consumption, and mild weather.

In other words, California has seen an increase in supply and a reduction in demand and that has lowered the wholesale price. Imagine that!

Finally, I want to say a few words about a much-maligned agency—FERC.

FERC has come in for almost as much vilification as the generators. The conspiracy theorists argue that FERC has done next to nothing to police and restrain the wholesale electricity market. Governor Davis claims to have everything under control, except for the runaway prices in the wholesale market, and he blames FERC for allowing this situation to persist.

As I stated earlier, I believe that reasonable minds may differ in evaluating FERC's actions. Given the enormity, complexity and difficulty of the issues presented by the crisis in California, it would almost be asking too much to expect the agency to have made every decision correctly.

Further, it is important to note that many of the key actions that need to be taken to alleviate the shortage and price crisis are actions that only the state, not the FERC, can take.

- FERC does not license new power plants.
- FERC does not license new transmission lines.
- FERC does not regulate retail rates and thus cannot impose rates that reflect the true cost of electricity and induce conservation by consumers.

Finally, while I am on the topic of the limits of FERC's authority, I should mention that FERC doesn't even have the legal power to regulate all sellers of wholesale electricity. FERC doesn't regulate sales by municipalities, such as the City of Los Angeles, which is a major participant in the wholesale electricity market in California.

Nor does FERC regulate sales by Canadian companies, who sell significant amounts of electricity in California and the rest of the West.

And FERC has only limited ability to regulate the rates charged by the Bonneville Power Administration—so long as the rates set by BPA recover all of that agency's costs, FERC must approve them.

But it is a horrible distortion to say that FERC has not done anything to help out in California. To the contrary, FERC has taken many steps which, in conjunction with actions at the state level, will put the market back on the path to normalcy.

Perhaps the most important step was taken by the agency in December 2000, when FERC ordered the California utilities to stop selling to, and buying from, the spot market power exchange.

You see, under the California restructuring plan, the local utilities, which still control over 25,000 MW of supply in the state, were required to sell and then repurchase, on a spot market basis, all of their own power resources.

FERC put an end to this. As a result, the spot market—where the highest and most volatile prices are found—is now much smaller than it was over a year ago.

Further, FERC has encouraged the state to procure more of its power needs in the long-term bilateral contract market. This will stabilize and lower prices going forward.

Every expert commentator, and many who are not experts, have identified the state's own decision to rely almost exclusively upon the spot market to serve the electric load, and to forsake long-term contracting and hedging, as the key structural mistake made in California's restructuring. FERC has done everything in its power to rectify that mistake.

FERC has taken other actions.

FERC has authorized the alternative power producers—the so-called Qualifying Facilities—that have contracts with the California utilities, to sell their power that is beyond their contractual commitments to the utilities directly to the open market.

FERC instituted a tough, price mitigation plan for purchases of power by the California ISO in the real-time market. And FERC is investigating spot sales transactions both within California and throughout the entire western interconnection for compliance with the just and reasonable standard of the Federal Power Act.

Finally, FERC is moving aggressively to investigate the cause of sky-high natural gas prices, the fuel source for much of the power generation in California.

I could go on and on about FERC activities. But the point is that the agency is working at a frantic pace to investigate the charges of market abuse, order refunds where appropriate, and institute structural reforms.And I would be remiss if I did not also point out that FERC has been sued numerous times by various parties in California over its decisions and has yet to be reversed by a court, even a California-based court.

It is too bad that Governor Davis and others haven't spent more time working with FERC and the generators, and less time speaking to the press about villains and conspiracies.

I will close by calling upon my colleagues in the United States Senate to join with me in working toward constructive solutions based upon the facts, not the myth, of the California electricity crisis. Reasonable men and women, working in good faith, can solve this crisis.

It is not too late to begin.

Senator SMITH. I will paraphrase, in the interest of time, an experience I had in the midst of the California-west coast energy crisis. I was talking to some people in an energy-sensitive business, and they indicated to me dismay that power prices could go up 1,000 percent but their products never could and wondered why, in a highly regulated industry, that that would be possible.

Pat, thank you in your capacity at FERC for responding to the repeated call that Senator Feinstein and I made to bring some stability into west coast markets by putting on some price caps that frankly are counter to my ideological makeup, but as a free-marketer, I believe in free markets. I do not believe in rigged or broken markets. I think what these memos indicate is that is what we had and that is why Senator Feinstein and I, on a bipartisan basis, were screaming that something be done because people's lives were being dramatically and negatively impacted.

And I want to thank a couple of Oregonians who are here who are on the witness list because I think it took them some courage, Christian Yoder and Stephen Hall, for being willing to put their names on a very blunt memo. I can imagine that Christian faced angering his employer and Stephen risked losing a client. But as we talk about them, we need to remember that the focus is on those who broke the law, not on those who reported the breaking of that law. So, I want to thank them for the courage of being here and for their honesty.

But clearly, terms like "fat boy," "death star," and "get shorty" ought to involve Hollywood productions, not power company productions.

So, I want to thank our witnesses for being here, and I had a particular question for Pat. As you know, Mr. Wood, the current price cap for the West Coast energy market expires on September 30 of this year, and I am concerned about what we will do after that. I am specifically concerned about a very volatile market returning. I am concerned about historically high rates in the Northwest, even with those caps in place. So, I am wondering if you can

predict how the FERC is going to ensure that just and reasonable pricing remain in effect after 2002.

Mr. WOOD. Senator Smith, the CalISO filed on May 1 a request to continue the market mitigation that we adopted last June—and that was their preference—but in lieu of that, to consider some other measures that had been discussed with their market oversight committee and others.

The implications of those for States outside of California are unknown quite frankly. We have not, to my knowledge, heard from people other than the CalISO about what happens when that order expires. I fully expect that utility commissions in your State and others that are interested, as well as market participants, will file in the California filing and discuss with us the pros and cons of that being West-wide as opposed to just California only.

That is an open proceeding. It just got noticed in the first part of this month. I believe there is a 30-day comment cycle. We are committed to acting on that very quickly so that if there are any changes to the regime, that they be announced early enough so people can adapt to them.

As I have said publicly, before the filing was even made, to people from the Governor of California on down to my colleagues, I fully expect we are not going to go from the regime we had to nothing. I mean, we do not have that even in the well-functioning markets over on this half of the continent. So, I would expect—and I cannot project because I have got my colleagues here. We are going to look at all the pleadings from all the parties and make the best judgment we can based on the record. But that is what I expect that we will get from people both in and outside of California, a lot of feedback on that.

We will put the appropriate regime in place to make sure that just and reasonable rates continue to happen. We are committed. That is why we took the steps. I mean, I personally did. I am like you. That was the very first vote I had to make as a member of this Commission, and it was pretty different than the philosophy I have had to live under. But at the end of the day we have got to do what is appropriate for the situation. And what was going on there was an out-of-control marketplace that needed, quite frankly, a cooling off period. I think that has happened.

I have attached to my testimony a number of plans. I do note that probably uniquely in Oregon and in Wyoming, the only two States out here that do not have plant cancellations or plants on hold, but do have new plants that have been built and are operational now in the past 2 years. So, something is going right in, interestingly enough, your two States, that people are building plants there and not canceling them.

But I think it is important to maintain the infrastructure investment that we need so badly. It is not just a new plant. It is a new plant to keep up with the fact the old plant is finally closing down because it is so old. The economy coming back to life, load growth increasing. So, there are needs that never go away for new infrastructure, and that is an important part that we do not talk about a lot. But just and reasonable rates also need to be reasonable enough for investors to come in and make the commitment to a certain region of the country.

Senator SMITH. Well, I want to thank you again for what you did. I would point out that from April 2001 and on, Oregon was losing roughly 3,100 jobs a month. Senator Wyden and I represent a State that lamentably leads the Nation in unemployment right now. I think a lot of it can be tied to this period of time when many businesses, small businesses, especially were pushed over the brink and into bankruptcy and a lot of people lost a paycheck.

I would also like to thank your colleagues, Chairman Wood, Mr. Massey, Ms. Brownell, and Ms. Breathitt, who voted with you to do what you had to do. Again, I thank you because I think we showed that we have a Federal law in place for a good reason.

I would like to make note of the fact that you are from Texas. Is that correct?

Mr. WOOD. Yes, sir.

Senator SMITH. There is a lot of media commentary about Texas pirates, and I think President Bush took a lot of heat at the expense of some of these editorialists. But you are his nominee. You are his Chairman and you acted. I want to, for the record, say that all Texans are not pirates. We have got one in front of us and President Bush is another one. I thank you and him for acting and using Federal law to bring stability to a very reckless situation on the West Coast.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Feinstein.

Senator FEINSTEIN. Thanks very much, Mr. Chairman.

Mr. Chairman, it has been about 2 years now since the Western power crisis, and I think all of us have had a very good opportunity to observe what has been happening. I want particularly to commend Mr. Wood because I think he is really leading the Commission on a new path and that that path is really fully carrying out the Federal responsibilities of the Power Act. However, I have got some real questions as to whether those are adequate.

I have distributed to the committee—and I know Mr. Wood has a copy of this and I know Mr. Winter has just been given a copy of it—a document entitled "California Electricity Markets: Issues for Examination." What is interesting is that this document is dated August 17, 2000. The document comes from one of California's investor-owned utilities, namely Southern California Edison. It is divided into two parts.

The first part is "Observed Abuses," and they catalog "get shorty," "death wish," "DEC," "INC," "ricochet." So, it is no secret that this has been going on. Clearly this was given to the Commission on August 17, 2000.

It secondly has in it a section, "Arenas for Investigation," and it gives the Commission an outline of areas that, at least in the view of Southern California Edison, deserve investigation.

Now, we heard Mr. Winter speak about market power. It is going to be one thing if market power includes gaming and manipulation as acceptable practices under Federal law. So, "get shorty" and "death wish" and "INC" and shutting down a third of the power in the State to make money from the shutdown under the auspices of maintenance is something that we are going to permit to happen on a regular basis.

I have asked the Attorney General to investigate not only Enron, but the whole industry for criminal illegality. It seems to me that if the Federal Power Act does not recognize these practices as illegal under Federal law, we ought to make them illegal under Federal law. If FERC does not have the power to adequately regulate, we either have to give FERC the power to adequately regulate or, in my view, forget deregulation and reregulate.

I frankly am shocked by these abuses. I do not know any other sector of the economy that this blatantly for years could get away with this kind of what Mr. Winter I think rather loosely called market power and not have citizens get up in arms all across this great country, but we find, under the guise of market power, give false information. We find under the guise of market power it is okay to manipulate the cap. We find under market power that it is all right to say you are relieving congestion and do nothing to relieve that congestion and, more fundamentally, get paid for it. As I said before, in my book that is outright fraud, and if Federal law does not mark that down as outright fraud, we ought to.

Now I want to ask a couple of questions. If you go to the bottom of page 1 of the paper, it speaks to unscheduled/scheduled maintenance of reliability must-run units. This was brought to FERC's attention again in August 2000. "Units under contract to relieve local reliability problems have simultaneous outages, both scheduled and unscheduled. The ISO must find another unit to resolve the problem; often"—strangely enough—that is my addition—"there is only one owner to solve the problem. This other units plays the INC or DEC game and receives payments at the cap."

Now, Mr. Winter, I spoke to you about this awhile back in December 2000 precisely. We discussed plant outages. I think at one point you informed me that 15,000 megawatts were off line at one time because of some sort of needed maintenance. This at the time was a third of the generation of the State, and it occurred at a time when California was in the middle of a daily stage 2 and stage 3 energy emergency.

FERC investigated back in February 2001, and as I understood their report, they found nothing wrong. In June 2001, the GAO did a report on the FERC investigation, finding simply that FERC did a poor investigatory job.

What I would like to ask Mr. Winter is, is it normal to have 15,000 megawatts off line at one time in California for maintenance?

Mr. WINTER. No. That is a rather high figure, although I will tell you today, we have around 15,000 megawatts of power shut down in California. Approximately 2,500 to 3,000 of that is forced outage. Another 3,000 to 4,000 is planned maintenance, and the remainder of that is what we are calling economic shutdown because we are blessed right now with having heavy imports from the Northwest and from Arizona.

When we ran into this problem, one of the things that we did not, at the ISO, have the authority to do was mandate schedules. Since that time, FERC has given us that authority so that we can now demand that plants go out at different times.

Senator FEINSTEIN. So, these outages are planned.

Mr. WINTER. About 6,000 of them are. Then you have forced outages; a unit is running and it breaks, so it comes out, which would another 3,000 megawatts normally in our system that occurs.

Senator FEINSTEIN. Were the outages of 15,000 planned at the time I spoke to you?

Mr. WINTER. No, they were not.

I think we have to look back at what those reasons were. There are some valid and there are some invalid. I think when we talked, I pointed out that a lot of people were "not getting paid" at that time and so they were taking units off. Now, if they claimed they were maintenance, we would follow up and see whether or not they were doing maintenance.

But there was the financial area. Also we had the qualifying facilities who were not being paid, and so they were choosing not to run.

And then a more realistic figure is we had a lot of those units off for maintenance for two reasons. No. 1, there was a summer that—when I was in San Diego, I used to run two or three of those units maybe 50 hours out of the year because they were 1954 units. Well, during that summer of 2000, we literally had all of those units running all day long, and when you do that to a 50-year-old unit, you have to take maintenance on it or it is going to go on forced outage.

Senator FEINSTEIN. But what I am trying to point out is in this from Southern California Edison—and I think some of these units were units that were directly purchased when Southern California Edison was required to divest, and then they went out. And what Southern California Edison was pointing out to FERC back in December is that this was a gaming technique. Now, you are the ISO and you are excusing it.

Mr. WINTER. Well, let me go on. I am giving you reasons for it and then I will get back to why I am excusing it or not excusing it.

The other reason that we had so many units out was the buyers of those units, the IOU's, had committed to an air quality program and that meant that they had to do retrofits on these units to get them in compliance with the air quality district.

Senator FEINSTEIN. Even if it meant going into a stage 3 emergency and a blackout?

Mr. WINTER. Well, the problem was that some of those take 6 months, and so they would have started early in the year before we knew we were in that problem and then find out that we did not have enough.

Now, having said all of that and appearing that I am excusing the high level, let me also say that we were very aware of the game where the generator would take an RMR unit out and then replace it with another unit that was in the market and they could get whatever price the market had to be paying. I do not remember, but I thought FERC did fine some people for having taken that practice and maybe Pat will remember. But we brought that to their attention and I thought they did take some action against the generator who was doing that. We certainly made it an activity that we monitored and asked them not to do it. And if the unit did

go down, we sent an inspector down there to make sure the unit was legitimately out.

Senator FEINSTEIN. Thank you.

Mr. Wood, the question that is raised—because as you know, Enron was not really a generator in California, but Dynegy and Reliant and others were. I gather in an article in the *Houston Chronicle* this morning, Reliant admits to at least two of the items on the Enron list. I think one can assume that these practices were much more generalized than just with Enron and most probably were utilized—I say most probably—by other energy generators in California at this time.

In your opinion, should practices such as those depicted by "fat boy," "death wish," "ricochet," "get shorty," be made specifically illegal?

Mr. WOOD. In other words, if they are not already?

Senator FEINSTEIN. If they are not already, should they be illegal?

Mr. WOOD. I think so, yes. I think that is taking advantage of a system to the detriment of others. I will just leave it at that.

Senator FEINSTEIN. Well, you give me hope. I thank you for that.

The CHAIRMAN. Senator Feinstein, should we go and do another round here?

Senator FEINSTEIN. Yes, thank you, Mr. Chairman.

The CHAIRMAN. Senator Thomas.

Senator THOMAS. Thank you, Mr. Chairman.

Sorry I missed part of your testimony. We had a little vote and some other things.

Mr. Wood, do you think FERC has the tools to get to the bottom of this controversy that continues to go on?

Mr. WOOD. I do. I would like to point out one issue of interest because this has been such a huge issue across the entire West. As I have admitted to you all before, we have a ways to go developing our skill set internally. It is hard to find people on the outside who can help us manage this mountain of data who were not already conflicted out. We have tried to obtain the assistance of some people who have been involved in various aspects of the California proceeding and have, quite honestly, gotten some opposition.

Senator THOMAS. Do you think you have the tools under the law?

Mr. WOOD. We have the tools under the law with the changes that came out of the Senate electricity title. If those are enacted, yes, sir, I think that is definitely an improvement.

Senator THOMAS. ISO data suggests that Enron was a relatively small player. So, even if all these allegations are true, what kind of impact do you think Enron had on this California market?

Mr. WOOD. We will have to see as we are going through the investigation, Senator. That would be certainly kind of a fallout item. This could have happened. Okay. Did it happen? The data can probably pretty much tell you yes or no. And then adding that up is something I hope we can have ready for the report to the committee this summer.

Senator THOMAS. Do you have quite a bit more work to do in terms of putting it all together?

Mr. WOOD. Yes, sir. We are going to need every day we can get.

Senator THOMAS. What in your opinion is California's relationship to the Western energy market? California is kind of an electric island, is it not?

Mr. WOOD. Oh, I do not think it can be an island. I think when they import 20 to 25 percent of their summer peak from outside the State, they are——

Senator THOMAS. They are an island, depending on somewhere else for the source. And they have not been moving very fast to get something done.

If California had used a standard design like locational marginal pricing, would that have reduced the opportunity for scheming on these prices?

Mr. WOOD. I think reduced, yes. I think I would agree with Terry's assessment, and it is one I did mention in my testimony, that if you fix things structurally, you are in a lot better shape, but you still do need somebody walking the beat to make sure that those get done. To their credit, they have got a pretty good shop out there that is smart and gets it. We need to make sure they have the right tools. That is something we are working with them on.

Senator THOMAS. Mr. Winter, do you think the strategies that Enron has talked about and alleged are illegal under your rules, under your ISO rules?

Mr. WINTER. Again, I am not an attorney, but certainly falsifying information to the ISO to me is an unacceptable practice.

Senator THOMAS. Is it illegal?

Mr. WINTER. I am not an attorney. I am afraid I cannot go there. I hope it is.

Senator THOMAS. Well, my point is why did you not do something about it if you knew that was the case.

What was the impact of utilities' under-scheduling on the functioning of your market?

Mr. WINTER. Well, on the market, of course, it had a tendency to end up with us having to buy in real time, which theoretically would be the most expensive market you could be in because it is done in 10-minute intervals. From an operating standpoint, it put us in a horrible position because then we were out scrambling looking for between 20 and 25 percent of the needs of the State in literally hours before we needed to use it.

Senator THOMAS. Are you not responsible for the rules in terms of the ISO?

Mr. WINTER. We certainly are. And we filed and made the under-scheduling issue front and center, and FERC gave us a decision that people did have to schedule in more.

On the other hand, when we tried to enact the penalties for doing that, what we found was that we had several bankrupt or near bankrupt utilities that could not afford to go out and buy the power. So, you could fine the utilities for not bidding their full load in, but it did not do much good because, in fact, they could not pay for what they were getting.

Senator THOMAS. Well, I guess the question that arises is somebody is in charge. That is why you have independent operators.

Mr. WINTER. Right.

Senator THOMAS. And when something is going wrong, it is your responsibility to either do something about it or go to somebody who can.

Mr. WINTER. Yes.

Senator THOMAS. And it seems to me there was quite a lag between when you knew something and when something happened.

Mr. WINTER. Yes, I guess I would disagree respectfully with that. When we became aware of under-scheduling, we filed asking for under-scheduling penalties.

Senator THOMAS. Filed with whom?

Mr. WINTER. With FERC.

Senator THOMAS. And how long did that take to get a reaction?

Mr. WINTER. Well, I cannot remember the exact date. I could go through the list of filings we had, but I would assume we would have gotten it in 60 to 90 days.

Senator THOMAS. I guess when you look at this, here are some things that did not go well. Some are allegedly illegal, certainly inappropriate. But over here you have an apparatus that is supposed to be operating there, both the State functioning and your functioning, and it did not seem like there was much going on in terms of taking care of yourselves. First of all, you changed the rules. Right?

Mr. WINTER. Right.

Senator THOMAS. You took the prices off and so on, which is fine. But when you did that, you had a responsibility to see that it worked properly.

Mr. WINTER. That is correct.

Senator THOMAS. You mentioned apparently some legal authority for the ISO. We have in the bill some legal authority to the Reliability Group. Would you imagine that they should have legal authority as you have suggested?

Mr. WINTER. Yes. I think that they have to to get the reliability and pass on the requirements to ensure that we have sufficient power to run the system. It is an absolute requirement. Now, whether they get that through FERC or directly to the Reliability Council is——

Senator THOMAS. I know this is hard, but if you both could just—what do you think should be the outcome of these hearings? What should happen as a result of these hearings?

Mr. WOOD. The committee's hearings or the FERC's investigations?

Senator THOMAS. Our hearings today when we are looking at the problem, what caused it, what should be done about it. Just in general, short, what do you think ought to happen?

Mr. WOOD. Quite frankly, I think it already has. I mean, by calling the hearings, you have sent certainly to us—and we knew it was important to you all, but you sent to the rest of the world that this is not just another administrative affair. This is a big deal and you want it fixed.

Senator THOMAS. So, you do not need anything done particularly.

Mr. WOOD. I just would hope that the bill that I know you all worked so hard to get out has some supportive language for efforts to give markets some discipline, and I would hope that that ends up on President Bush's desk as soon as possible.

Senator THOMAS. Mr. Winter.

Mr. WINTER. I, this morning, went over all the key components of the Senate bill. I think that they cover most of the things that I would hope this group would do probably from an operator's standpoint. I certainly want visibility into the participants that are coming into the market that I do not now have, be that either municipalities or out-of-State entities. It is kind of hard to run the market when you do not know what outside is happening. Inside I know because I have telemetry on all the units. I know exactly what their status is, what they are producing.

Senator THOMAS. Can you not get some information before they get on your system?

Mr. WINTER. Pardon?

Senator THOMAS. Can you not get some information as a condition of getting on the system?

Mr. WINTER. Yes, on in-State units I can. Out-of-State, I am just doing a schedule with an adjacent control area telling me here is what they are providing in megawatts.

Senator THOMAS. Sounds good, Mr. Chairman, in terms of the energy bill.

The CHAIRMAN. All right. We hope so.

Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman.

Mr. Wood, between this morning's Commerce session and this afternoon's Energy hearing, I am now in my 6th hour of hearing testimony on this. I will tell you what I have learned today seems pretty gross, even by Enron's standards. If you look, for example, at these notes, these handwritten notes—you do not need to look. I am just going to summarize a couple of them because I want to give you some background—the handwritten notes surrounding the preparation of the December 6 memo, it says, for example, "Portland deals, remove the notes, exclamation point," which sure looks like a coverup to me.

In another area, the handwritten notes say, "no one can prove, given the complexity of our portfolio." These are what the handwritten notes are about.

You and I have already talked about what the head of Enron's litigation unit told me earlier. He said that they sold non-firm, interruptable BPA power as firm power, and you said—and I will quote you here—is it looks like a fraud and you are going to look into it.

So, this has been a pretty gross day in my view, even by Enron's standards. And I think what I want to ask now is some questions about really where we go from here.

For example, we have been talking about the role of the lawyers on all of these matters surrounding the December 6 memo, but I want to know where we are with respect to your investigating the Enron traders themselves. It sure looks like Tim Belden was directing these Enron schemes to manipulate the markets. What are you doing as of now to get at the records of the traders on these issues?

Mr. WOOD. Because this is a pending investigation and we are coordinating with other investigation agencies and sometimes talking to a lot of the same people, let me demur on the specifics of what they are doing. Let me just confirm to you that it is a comprehensive investigation, and probably everything you are reading

about is something that either we have looked at or will look at because we are hearing about it through that means. But let me, if I could, sir, hold on and answer that question when we do provide the full report and work it with the other agencies that are investigating.

Senator WYDEN. All right.

The law firm in Portland has repeatedly said that they advised Enron that all of the practices or the vast majority of the ones that they have been describing were deceptive. They showed them copies of criminal statutes that the practices violated. Has FERC referred evidence to the Department of Justice at this point that Enron's practices may have violated criminal laws?

Mr. WOOD. I think I can answer that question, and the answer at this point is no.

Senator WYDEN. There has been no referral as of now.

Are any enforcement proceedings underway against Enron or any of its traders that were described in the various schemes as of now?

Mr. WOOD. That is what I expect could potentially follow. We have got here the road map. What we need to add to the road map is the data that we have got from the markets to ascertain did it happen, how much, how often, who was involved, what days, what utilities. So, at this point that process is not complete, and so enforcement proceedings have not begun as to specific counts.

Senator WYDEN. Do you dispute that what Enron was doing to manipulate the California market had very painful consequences for the Pacific Northwest?

Mr. WOOD. Do I——

Senator WYDEN. Yes. They manipulated the California market. I think it was a west coast protection racket. Given the fact that we basically heard about fraud this morning, I would like you to just give me your opinion.

Mr. WOOD. I think the interconnectivity of the markets, as we have recognized when I came in—we really had to put the scheme over the whole West in order to really capture all the activity.

Senator WYDEN. But you do not dispute then that what Enron was doing to manipulate the California market had very painful consequences for my constituents in the Northwest.

Mr. WOOD. Again, I would like to make sure that we ascertain exactly the extent of this activity here. But if it is substantial, certainly it affects not just California.

Senator WYDEN. Our price spikes—and I used charts on this this morning—were just has high and in some case higher than in California. In fact, I will bring that chart out again. How can you conclude otherwise than that the manipulation in California hammered the Northwest?

Mr. WOOD. I have not concluded that, sir. But what I think is important is this subset of activity that is laid out by the memos—I have not come to the conclusion—and I do not know that anybody has—that that activity alone is what is driving that curve. In fact, I just heard my fellow witness here indicate that there are other exercises of market power other than the manipulation of this type that may explain some of that, and I think that is just a fair question. I think they are both behaviors we do not want to have happen. But your question was specifically as to what the manipula-

tion that Enron may have done had to do with that curve, and I think the linkage we will have to keep working on.

Senator WYDEN. This morning, I used a chart prepared by a Portland Energy Consultant, Robert McCullough, that compares actual prices paid by Northwest utilities with the reported prices at the most important pricing location for power contracts in the Pacific Northwest. That is the Dow Jones Mid-Columbia Index. What the data shows is that the reported prices were consistently higher than the prices Northwest utilities actually paid. And it just seems to me that the recent admissions by energy traders that they engaged in these phantom swaps of power and other sham transactions that drove up prices, is a likely explanation for the disparity between reported prices in the Northwest and actual prices utilities paid.

Tell me your assessment of the analysis that I just gave. Is there anything you would disagree with on the basis of what I just told you?

Mr. WOOD. Again, to have a fact and then have that conclusion come from it that that fact alone is what drove that spread, again—this is not data we are keeping non-public, but through our public requests of the constructors of these public indices and through all the underlying market data, making the same comparisons that Mr. McCullough has and really following that through, that is the kind of activity that the investigation team is doing right now. Again, I would like to answer that question more fully when we have looked through all that correlation between reported data going into the index and then what went into the market trades.

Senator WYDEN. You keep looking, but this chart that Mr. McCullough did for me shows that it does not pass the smell test to argue anything other than market manipulation. I have shown you two charts.

Let us review what happened today. Two charts I have shown you just in the last minute or so. You had the head of Enron's litigation unit essentially admitting to, at best, misrepresentation and what you said looks like fraud. I would sure like to have somebody aggressive there say, well, Senator Wyden, at least it points to market manipulation rather than say, well, we are kind of still looking through all this because I do not see how the evidence can point to anything other than market manipulation. And what sure looks like fraud to me pounded the smithereens out of my constituents. And I want to see somebody like yourself go after it and go after it aggressively.

Mr. WOOD. Sir, please know that we are. The only dispute I had is can you attribute all that spike to one particular type of behavior. I think we will get to the bottom of what caused those spikes and report back to the committee. So, please do not misread my answer.

Senator WYDEN. We want to know about the charts that I just showed you because I do not think it passes, as I say, the smell test, as anything other than market manipulation? And this is a huge deal. I mean, just what Mr. Sanders said today with respect to Enron characterizing non-firm power as firm power, which at best is misrepresentation, and you said it looks like fraud.

Do you know what that means for Northwest ratepayers? If Bonneville Power can void the overpriced contracts with Enron because of Enron's market manipulation, our ratepayers, the people that Maria Cantwell and Gordon Smith and I represent, could save more than $220 million. This is a big deal. We need you to go after it aggressively.

I was one of the people who thought you were going to bring a fresh approach to the agency, but I have got to tell you I am disappointed in terms of what is going on with respect to this Northwest investigation. You have told me that you are doing a comprehensive review of that. The California witnesses that came to the Senate Commerce Committee in the past did not seem to agree with it. And I am concerned. Now, the verdict is still out. You have said that you are going to have something for us in a few months. But the storm in California caused a lot of water damage and a lot of people got hurt there, but it caused massive flooding in the Pacific Northwest. And we need you to go after this more aggressively than I have seen in the past.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Cantwell.

Senator CANTWELL. Thank you, Mr. Chairman.

Mr. Wood, I would like to follow on with some questions, and I would appreciate your being as succinct as possible since I have lots of questions. I heard the answer that you gave my colleague about percentages, but I just have some more specific questions.

First, do you think that market manipulation can ever be just and reasonable or in the public interest?

Mr. WOOD. I do not think any of the 10 that were in that memo——

Senator CANTWELL. I am just asking the question in general. I am just asking the question in general. Do you believe—I am talking theoretically here.

Mr. WOOD. Right.

Senator CANTWELL. I know you have cases.

Mr. WOOD. No, no, but I think——

Senator CANTWELL. I am talking theoretically. Do you think that market manipulation—if you find market manipulation, can that ever be just and reasonable or in the public interest?

Mr. WOOD. I cannot think of an instance when it would. I mean, certainly the use of the word "manipulation" would seem to indicate no.

Senator CANTWELL. I think that is a good answer, Mr. Wood.

Do you think that Enron's memo—various memos I should say—represent market manipulation?

Mr. WOOD. I would say yes.

Senator CANTWELL. That is a good answer too, Mr. Wood.

Given that, do you think that the Northwest contracts, the long-term contracts that my colleague referred to, given these memos, that there is a connection between the Northwest and these memos?

Mr. WOOD. I am trying to think. When you say the Northwest contracts, the ones that Mr. Wyden indicated were done—let me make sure I know what you are talking about.

Senator CANTWELL. Long-term contracts.

Mr. WOOD. Just in general? I do not know about in general. If there were some that were provided to——

Senator CANTWELL. Do you think the long-term contracts and what happened in California are related? Do you think these memos show that they are related, that it was all the same market and that we were all affected by it I guess is the question.

Mr. WOOD. I am sorry, Senator Cantwell. The contracts you are referring to are which ones?

Senator CANTWELL. I am saying in general. Okay, sorry. Put the contract issue—I have two questions here, but I guess I spoke a little too quickly on the first one.

There has been some confusion that maybe somehow what has happened in the Northwest was not related to what happened with the California ISO. The fact that we had to go out and buy on the spot market somehow was something that was different than what happened in California and the fact that the prices of long-term contracts were, indeed, affected by what happened in California. Do you believe that the long-term contracts were affected by what happened in California? Those prices?

Mr. WOOD. I think, depending on when they were signed, they well could have been.

Senator CANTWELL. Do you think that the Northwest contracts, given that you have just stated that you think that market manipulation can never be unjust and unreasonable——

Mr. WOOD. Can never be just and reasonable.

Senator CANTWELL. Right, can never be just and reasonable or in the public's interest—and the fact that you just said that you think these represent—these memos do, in fact, represent market manipulation, is FERC going to let the Northwest out of these long-term contracts that we are continuing to pay on that is costing the citizens of our State millions of dollars?

Mr. WOOD. I think a couple of facts have to be shown, and that is the main reason we sent that to the hearing. First of all, we have got the investigation, as I mentioned to Mr. Wyden. We have got to ascertain, yes, this memo happened, what behavior happened, when did it happen in the market. If the behavior was fixed by the changes that Mr. Winter has filed with the commission back before I ever got there and the behavior was, as apparently asserted this morning, terminated in the year 2000, then if a contract was signed thereafter, then I would say that is probably not a direct link.

Senator CANTWELL. Are you talking about process, Mr. Wood?

Mr. WOOD. No. I am talking about——

Senator CANTWELL. I certainly could appreciate process. But you just said that you did not think that market manipulation could ever be just and reasonable.

Mr. WOOD. Right, but——

Senator CANTWELL. And you did not think that this particular case—you agreed that market manipulation had taken place and you agreed that there was a relationship between Northwest contracts and California. What else do you need to know?

Mr. WOOD. Well, the timing. If this behavior had stopped back in the time when apparently, according to the lawyers from this morning, they stopped these things, and all this stuff got kind of

prohibited by rules at the ISO and no longer happened, that is a pretty critical fact. And that is what we are looking at. Yes, these assertions were made and may well have been done, but we have got to find out when they were done. The data is there. I think we will be able to find that when this gaming behavior happened and when that type of thing, INC/DEC game was played, and when death star, whatever it is, did what it did. I think it matters as to the link between when this behavior happened and when it stopped, if has stopped, and what happened in maybe a subsequent period of time. So, again, not knowing the full story about when the unjust and unreasonable market manipulation behavior happened and when a contract may have been executed, those would be pretty relevant facts.

I mean, I understand the point and heard you both loud and clear, but I also recognize we have got to have some process for the people that may not agree with that assessment to go through a factual hearing and have the timing of this stuff be laid out and made cuts on.

Senator CANTWELL. Well, I hope you will not penalize consumers and give Enron the benefit of the doubt. I hope you will look at this and not put dates and say all of a sudden because of contracts—what standard do you plan to apply to this as it relates to the hearing? Unjust and unreasonable as it is in the Federal Power Act?

Mr. WOOD. For the hearing?

Senator CANTWELL. On Northwest contracts, yes, on whether they should be relieved, whether the Northwest should be relieved.

Mr. WOOD. I think to the extent ones have been filed with the Commission, we have sent that over to an ALJ with discussion about what the standard is based on the contract that was entered into.

Senator CANTWELL. Why is there a discussion about what standard when the Federal Power Act is very specific that the standard is unjust and unreasonable, unduly discriminatory, or preferential? The commission shall determine the just and reasonable rates.

Mr. WOOD. There have been subsequent Supreme Court cases that have put that in context. These were called the Mobile-Sierra cases that determine the ability of two contracting parties to preserve their deal up or down.

Senator CANTWELL. I am very well aware of the Sierra-Mobile standard. That was when you reviewed contracts prior to them going into place.

We are in a market rate system. You are not reviewing those contracts in advance. So, to rely on that Supreme Court standard when it is clear in Federal jurisdiction that you should be using unjust and unreasonable as the standard I think is an abrogation of your responsibilities.

Mr. WOOD. I am sorry you feel that way. This is a pending case. We did the analysis. We referred that case to hearing with the appropriate guidance on the standard. I am not sure if the contracts you refer to even had the Mobile-Sierra language or not.

Senator CANTWELL. I think that FERC is trying to use a higher threshold standard to make the people of the Northwest prove that there was abuse when you just said before our committee you answered all the questions, and yet now you are trying to use—even

though the Federal Power Act says, FERC, use this standard of unjust and unreasonable, now you are trying to use a higher standard of legal burden proof for the people of the Northwest. And that is a problem. I do not think you can use that standard. We obviously have filed in this case as well, and we expect to see a response to that particular filing.

I have a last question, but I would appreciate if my staff would bring up the chart. If I seem a little anxious about the situation, Mr. Wood, it is because people in my State have paid such high rates because of these long-term contracts, and I just want to say to the press these are estimates. These are estimates by our staff. I should say the bottom two are estimates from information that has been made public.

I am just talking about Enron long-term contracts. I am not talking about the whole effect of the market on the Northwest. I am talking about Enron contracts have caused a 46 percent rate increase by BPA and 49 percent by one Snohomish County PUD that just happens to be where I live, Mr. Wood. We estimate that those contracts with BPA, about $700 million, with Snohomish County, $300 million—if we were let out of those contracts, as my colleague, Mr. Wyden, said, we would probably be able to buy power at half the cost of that contract.

Now, we are telling you this is very important because BPA is planning another 11 percent increase for this fall. We are not out of the woods. Some of these are multi-year contracts that the ratepayers of the Northwest will be paying for many years. You are the only policeman on this street, and there is a mugging happening in my State. You have to respond, otherwise these taxpayers are going to pay this bill for many years. It is going to wreck our economy.

And I think we will have to as Congress responds with more clear rules and regulations how FERC, the only cop on the block, has to act in protecting consumers in this country. Otherwise, we have failed. Otherwise, we have failed.

I have more questions, Mr. Chairman, but I see my time has expired.

The CHAIRMAN. Thank you.

Let me just alert members here we have eight more witnesses to call in the hearing and it is now 4:30. Should we go to the second panel? Is that an appropriate way to proceed or should we have one additional question from each?

Senator FEINSTEIN. One question.

The CHAIRMAN. Each panel member gets one question and one answer and no follow-ups. Then we go to the next panel. How is that? Senator Feinstein. I will postpone asking any questions myself in this second round. Go ahead, Senator Feinstein.

Senator FEINSTEIN. You are very generous.

Mr. Wood, the memorandum that our office gave to you I think yesterday right after we got it. Could you tell us what was done with this memorandum when it arrived? Now, I know you were not there, but what happened and what actions were taken pursuant to it and when were they taken?

Mr. WOOD. I have got to confess—Senator, thank you for that—I was pretty disappointed not to find that on an internal request

last summer when Commissioner Brownell and I first got to the commission.

But nonetheless, these issues apparently were done in an investigation that the commission staff was instructed to do in the summer of 2000 as a result of all the Western power market issues. This was one of a number of documents that were used to create this November 2000 report entitled "Staff Report to FERC on Western Markets and the Causes of the Summer 2000 Price Abnormalities."

I should say, to their credit, there was a discussion of the underscheduling issue, of all the congestion management, a host of issues, a subset of those are certainly in there. The day-ahead schedules following below forecast issue, and then the exporting power, I think the ricochet format, which were in the issues for investigation. I read this pretty quick after I got your memo, so the other issues may well have been in there.

But this report then became the template for the December 15 order of FERC that really got rid of a lot of the flaws in the market. It has not been fully implemented, but I think certainly that order was a big turning point.

I do not know that everything and, in fact, I do not believe that everything that showed up in this memorandum got fixed by that order. I have not mapped the SOCAL Edison issue to where it got fixed along the way. But in mapping the Enron issues to where things got fixed along the way, which we did last week, the only things we have not gotten at really are the fraud, the issues where they just outright lied. Those are just ongoing things that really the front line folks have to catch. As you catch people lying, you have got to chop something off. But the market flaws that were exploited, which the SOCAL ED paper refers to, in my estimation have been addressed or will have been addressed by the filing that the ISO made 2 weeks ago.

So, I think I will be glad to look at that further from the memo you gave me to make sure that everything there maps to a subsequent fix and let you know what that is.

Senator FEINSTEIN. Just a quick observation. The Enron memo, of course, was far after this.

Mr. WOOD. Yes.

Senator FEINSTEIN. So, clearly whatever FERC did had no deterrent effect.

Mr. WOOD. Actually the memos were dated about the same time of the—I think they were December 6 and 8, and then this was the subsequent week. So, of course, we did not have those memos, but I think it all did happen about the same time.

Senator FEINSTEIN. Thank you.

The CHAIRMAN. Senator Wyden.

Senator WYDEN. Mr. Wood, what policy changes in your view are most likely to prevent future Enrons and Enron-like scams? You have got the three sponsors, led by Senator Feinstein, for example, of efforts to bring more transparency on the derivatives issue. As you know, we have gone back and forth on the question of a Federal ratepayer advocate, something I feel very strongly about. But why do I not let you wrap up by way of giving us your idea of the policy changes that are most likely to prevent future Enrons?

Mr. WOOD. By policy meaning a legislative enactment, or just a change at the agency?

Senator WYDEN. You can reverse the administration's position and support the Feinstein-Cantwell-Wyden derivatives legislation. You can come out for the ratepayer advocate which is in conference. There may be other changes you want.

Mr. WOOD. Senator, I think I wrote you a letter when you asked us to do it at the FERC. I think it is totally appropriate for that ratepayer advocate to be at the Attorney General, as it is in most States, or either as a freestanding agency altogether. I think that is actually a great idea, and we look forward, when that person is getting picked, working with him at FERC or any of the other agencies.

Senator WYDEN. So, the administration is going to support in conference a Federal ratepayer advocate. I mean, you have made my day. You can kind of take the rest of the day off.

Mr. WOOD. I am an independent agency. I think the White House can speak for themselves. You asked me my opinion as the head of an independent agency.

Senator WYDEN. That is a good initiative to support. So, what else?

Mr. WOOD. And we have already spoken. I think I wrote a month or so ago to Senator Feinstein saying how important we think, at the FERC, transparency is to the industry, not just in the cash market, but in the financial market as well. I think to the extent there is a need there—and I am not an expert on CFTC law, but I think to the extent that transparency is garnered by what you all are proposing there, that is needed.

As far as the policy side, we have, I think, done that for the cash market, for the futures, for the long-term contracts, and all the short-term deals by what we enacted 3 weeks ago, which quite frankly was what we thought we had enacted 10 years ago. But people are finding ways around it, so we just gave them a computer sheet and said, fill in the lines here. Do not give us your own format. Fill it in our way. Give that to us on all your transactions. Make that web searchable, and then people have more transparency.

Senator WYDEN. We are going to resurrect the derivatives cause because, if anything, the events of the last 10 days have highlighted how important it is to get openness early on. So, we will look forward to your supporting aggressively those kinds of measures in the conference. It will be very helpful and I appreciate your doing it this afternoon.

The CHAIRMAN. Senator Cantwell.

Senator CANTWELL. Thank you, Mr. Chairman.

Mr. Wood, will you make available to either the Department of Justice or to this committee or other body of the Senate the contracts that you are currently investigating?

Mr. WOOD. Will we make available to?

Senator CANTWELL. The Senate?

Mr. WOOD. The ones that were referred to hearing?

Senator CANTWELL. The Senate or the Department of Justice. Will you make those contracts that you are investigating in some

format—we obviously sometimes obtain information from various agencies that are not made public, but they are reviewed by bodies.

Mr. WOOD. The contracts referring to which ones, Senator?

Senator CANTWELL. The contracts during this time period that are under investigation by FERC.

Mr. WOOD. Again, what we are looking at here, though, Senator, is not the individual—actually we are looking at all the data from the contracts. I do not know that we have got the actual contracts in here specifically unless they have been filed. I think Snohomish has filed. I am sorry. You are talking about contracts. You mean?

Senator CANTWELL. I think the public is looking for information, and obviously I think we were all surprised that these memos existed. Part of proving this case is understanding what is in those contracts. So, I am asking you if you are going to make those contracts available either to the Department of Justice or to a committee of the Senate for our review as well.

Mr. WOOD. The reason I am being a little careful answering this question is because we are involved with the other three investigatory agencies on this, and we have already as a Commission approved contracts to work and exchange documents with each other. So, that actually is going on right now.

Senator CANTWELL. What agencies?

Mr. WOOD. With the SEC, CFTC, and DOJ is not part of that now.

Senator CANTWELL. Will you make it available to the DOJ or to a Senate committee?

Mr. WOOD. Yes, we should have no problem doing that, Senator.

Senator CANTWELL. Thank you very much.

The CHAIRMAN. Let me just ask one final question. We got this fax transmission from the Attorney General of California of all these notes which evidently were taken by—do we know the name of the lady? The testimony at the Commerce Committee this morning was that it was Mary Hain, who I do not know. But at any rate, we got all of this handwritten information here, which quite frankly we have not had time to try to understand. I guess I would just ask if you have had a chance to review this or any of your staff. If you could take this and make it part of your investigation. That is all I am asking.

Mr. WOOD. I would be glad to, sir.

Senator WYDEN. Mr. Chairman?

The CHAIRMAN. Yes.

Senator WYDEN. I would just ask unanimous consent to enter that document into the record. It is really an extraordinary document. I have had a chance to go through it now. It is a very troubling document. It is almost like an autopsy. You know, everybody talks about a smoking gun. I would like to ask unanimous consent that it be put into the record in its entirety.

The CHAIRMAN. Without objection, it will be, but I do think it would be useful if FERC investigators would look at this to determine whether or not there is something in here that is useful.

[The document referred to follows:]

STATE OF CALIFORNIA,
OFFICE OF THE ATTORNEY GENERAL,
Sacramento, CA, May 14, 2002.

Hon. JEFF BINGAMAN,
Chair, U.S. Senate, Energy and Natural Resources Committee, Dirksen Senate Office Building, Washington, DC.

DEAR SENATOR BINGAMAN AND COMMITTEE MEMBERS: I am enclosing a set of documents from Enron's Portland, Oregon offices which were recently discovered as part of the investigation which my office, along with the Attorneys General of Oregon and Washington, is conducting into the manipulation of the Western United States energy markets. These documents include notes relating to the memoranda released last week by Enron, as well as other subjects relevant to your hearings tomorrow.

We believe that these documents may be helpful in aiding the Senate's inquiry into the energy crisis of 2000 to 2001. As you know, the investigation and enforcement efforts of the California, Washington and Oregon Attorney General's Offices are on-going,

Sincerely,

BILL LOCKYER,
Attorney General.

NOTE: The documents that accompanied this letter have been retained in committee files.

The CHAIRMAN. Thank you both very much for your testimony. We appreciate it.

Let me call the second panel. Jean Frizzell, who is an attorney at law with Gibbs & Bruns; Mr. Gary Fergus, attorney at law with Fergus law firm in San Francisco; Mr. Christian Yoder, attorney at law with UBS Warburg Energy; and Mr. Stephen Hall, attorney at law with UBS Warburg Energy. Thank you all very much for being here.

I am told we are going to have another vote over on the Senate floor in about 10 minutes. Why don't we do this? Let me just have you sit down and we will start through your testimony. Let's start going from right to left here, my right to my left, and ask each of you to give us about 5 or 6 minutes of sort of the main points you think we ought to be aware of. I think you can tell from the questions that you have already heard from those of us here the types of questions we are interested in. Any insights you could give us as to what has occurred or what actions the Congress should take or FERC or anybody else would be greatly appreciated. When the vote gets to the midway point, we will have to probably adjourn the hearing for a few minutes to go vote.

Mr. Frizzell, please go ahead.

STATEMENT OF JEAN C. FRIZZELL, ATTORNEY AT LAW, GIBBS & BRUNS, L.L.P., HOUSTON, TX

Mr. FRIZZELL. Thank you, Senators. My name is Jean Frizzell. I am a partner in the law firm of Gibbs & Bruns, L.L.P. Gibbs & Bruns is a litigation law firm. Our practice consists primarily of the prosecution and defense of commercial disputes.

I understand that the committee's inquiry today includes the issue of what additional legislative or regulatory measures might be appropriate in light of Enron's activities in the California market. I am not an energy or regulatory specialist and do not consider myself an expert in that area, so I have no specific policy initiatives to propose. I am able, however, to relate to the committee my role

in connection with the matters that were the subject of the memoranda recently released by Enron.

In late November of 2000, my firm was engaged by Enron to defend Enron Power Marketing, Inc. and Enron Energy Services in previously filed class actions brought in California. Gibbs & Bruns was one of several litigation law firms that Enron retained, including Brobeck of San Francisco. Enron also hired a regulatory firm to represent the Enron entities in related proceedings before the Federal Energy Regulatory Commission. The draft memorandum co-authored by me that is one of the subjects of this hearing was prepared by litigation counsel during the course of preparing to defend those class actions.

As is required in the defense of any lawsuit, one of the immediate tasks undertaken by the defense team was to begin a preliminary investigation of both the potential merits and the potential defenses to the claims made in those suits. In this case, very shortly after we were engaged, Enron provided the defense teams copies of the Stoel Rives' memorandum. I and other members of the defense team were thereafter involved in a series of interviews with a number of Enron traders, wherein the traders described the California market, the strategies outlined in the Stoel Rives' memorandum, and their understanding of the potential impact of those strategies on the California marketplace.

During the course of those interviews, we were informed that Enron had ceased trading in the real-time market, and that the strategies discussed in our draft memo were no longer being used.

Following our interviews, I and the other members of the defense team prepared the initial draft of our memorandum on Mr. Fergus' portable computer. Mr. Fergus agreed to send the draft to us for our review and comments, which he did. However, we decided that before we finalized the status report, Mr. Fergus would have Enron's head trader in Portland review it to make sure that our statements were accurate.

Approximately a week later, I received and reviewed a draft of the status report. About 2 weeks later, I received comments from another member of the defense team. My understanding was that, consistent with our original discussion, Mr. Fergus was going to meet with the head trader to discuss the draft report before finalizing it. However, I did not participate in those discussions and had no further involvement in the draft report.

The defense team, including myself and my firm, were involved in the defense of existing class action lawsuits. As trial lawyers, we were attempting to gather information and develop arguments that would assist in the defense of Enron during a trial or trials of the civil lawsuits brought in California involving strategies that were no longer being used. We were not attempting to and did not condone or authorize the strategies themselves, and we played no part in their development or execution.

In light of the fact that Enron has waived its attorney-client privilege, I am prepared to answer any of the committee's questions regarding my role as a trial lawyer in defense of the California class actions. Thank you.

The CHAIRMAN. Thank you very much.

Mr. Fergus, please go ahead.

STATEMENT OF GARY S. FERGUS, ATTORNEY AT LAW, SAN FRANCISCO, CA

Mr. FERGUS. Senators, I had prepared and submitted written testimony on the five questions that you had posed in the invitation, but I will also refer to the memos.

My name is Gary Fergus. For approximately 21 years, I was a trial lawyer at the firm of Brobeck, Phleger & Harrison, LLP.

My client Enron has instructed me that it is waiving the attorney-client privilege with respect to my testimony before this subcommittee.

Brobeck, Phleger & Harrison was retained in late September 2000 to represent Enron in connection with threatened litigation in California arising out of the high energy prices in the wholesale electricity market during the summer of 2000. Enron used a concept that they called the virtual law firm to assemble a team of lawyers from different firms, each with their own area of expertise. Brobeck was selected because of our jury trial experience in complex matters. Brobeck was not and is not an energy regulatory firm.

By late November 2000, Enron had assembled a defense team that was headed by Mr. Robin Gibbs of the Gibbs & Bruns law firm in Houston, Texas. Mr. Michael Kirby of the Post, Kirby, Noonan & Sweat firm was added to the team as another experienced jury trial lawyer with extensive antitrust experience and familiarity with the San Diego County California courts where a number of complaints had been filed.

In addition, Enron had a number of other firms that regularly advised the company in their areas of expertise.

The CHAIRMAN. We are going to let you complete your testimony and then adjourn for this vote that has just started. So, go right ahead.

Mr. FERGUS. Thank you, Senator.

These other firms included Stoel Rives located in Portland and Bracewell & Patterson has offices throughout the United States. Stoel Rives had energy regulatory experience and routinely advised Enron with respect to such issues. At the time, Stoel Rives had seconded Mr. Stephen Hall, sitting on my right, to Enron to be available on premises in Portland to provide additional resources to Mr. Christian Yoder, sitting on my far right, and to be available on the trading floor to respond to questions from traders.

Brobeck was invited by Enron to attend a large 2-day orientation session in Portland in early October, along with a number of other firms, including Bracewell & Patterson. At this orientation session, there was a presentation from the head trader giving an overview of the electricity market conditions that had prevailed during the summer of 2000.

In early November 2000, I spent an additional 2 days in Portland beginning to learn the details of how the markets operated during the summer of 2000 and beginning to interview individual traders as to how they did their jobs. Mr. Richard Sanders, who is head of litigation for Enron, and Mr. Stephen Hall participated in some but not all of these meetings.

My understanding is that between the meetings in early November and the beginning of December 2000, Mr. Hall continued to

meet with traders and gather more information. As a result of his interviews, he prepared the December 6, 2000 memorandum, which is also dated December 8, 2000.

On December 11-12, 2000, a meeting was held in Portland, Oregon to further investigate the trading practices described in the December 8 memorandum. The meeting was chaired by Mr. Robin Gibbs and Mr. Richard Sanders. I, along with Mr. Michael Kirby and Mr. Stephen Hall, participated. At that time, the decision was made to suspend any of the trading strategies still in use that were described in the December 8, 2000 memorandum.

At the same time, the wholesale electricity market was undergoing extreme volatility. The Federal Energy Regulatory Commission had issued its November 1, 2000 order, and it was known generally that the commission was about to issue an order on December 15. There were also concerns about credit risk of market participants. Because all of these events were consuming the attention of Enron traders, a decision was made to set up a meeting as early as possible in January to further investigate the trading practices that had been used during the summer of 2000.

In early January, there was another meeting in Portland at Enron where trading strategies that were described in the December 8 memorandum were discussed by the defense legal team and the head trader in Portland. At that time, Mr. Richard Sanders reiterated that none of the trading strategies described in the December 8th, 2000 memorandum were to be used by Enron.

The lawyers responsible for defending Enron in the litigation pending in California were assigned the task of investigating the facts and evidence surrounding the events from the summer of 2000. Individual traders were interviewed by a team of defense lawyers from Brobeck, Phleger & Harrison, Gibbs & Bruns, and Post, Kirby, Noonan & Sweat to learn what information the traders had about the events that had transpired during the summer of 2000.

At the end of these meetings, all the defense lawyers, who had been interviewing witnesses, jointly prepared the first draft of the memorandum summarizing what we had learned. This memorandum was circulated only to outside counsel and to Mr. Richard Sanders. There were several revisions that were exchanged amongst the lawyers during the next few days while our interviews were still fresh in our minds. This memorandum was a work in progress. The next step was to check back with the head trader in Portland to make certain that the lawyers understood the facts correctly. Other events, however, such as litigation with the California Power Exchange, its subsequent bankruptcy, the motion practice in California cases, and the retention of experts overtook the defense team.

It was not until April 2001 that the defense team was able to turn back to the draft memorandum. At that time, during discussions with the head trader, I learned that the lawyers still did not have all of the facts correct about what had happened during the summer of 2000. I also asked to see some documentary evidence that was relevant to some of the strategies that had been used during the summer of 2000. What I found were documents that were in conflict with some of the descriptions we had been given.

The draft memorandum was never completed because we had not resolved the factual conflicts. Other events in the litigation took precedence over the factual investigation of what happened during the summer of 2000.

On December 2, 2001, Enron filed for bankruptcy and all defense efforts ceased.

I stand ready to answer any questions that you may have.

[The prepared statement of Mr. Fergus follows:]

PREPARED STATEMENT OF GARY S. FERGUS, ATTORNEY AT LAW, SAN FRANCISCO, CA

My name is Gary Fergus. For approximately 21 years, I was a trial lawyer at the firm of Brobeck Phleger & Harrison, LLP. My client Enron, has instructed me that it is waiving the attorney-client privilege with respect to my testimony before this Subcommittee.

Brobeck Phleger & Harrison, LLP was retained in late September 2000 to represent Enron in connection with threatened litigation in California arising out of the high energy prices in the wholesale electricity market during the summer of 2000. Enron used a concept that they called the "virtual law firm" to assemble a team of lawyers from different firms each with our own area of expertise. Brobeck was selected because of our jury trial experience in complex matters. Brobeck was not and is not an energy regulatory firm.

At the present time, I have started my own firm. My regulatory expertise is limited specifically to Enron and does not extend to the industry generally. I understand that the committee is interested in information on five topics. My comments are set forth below:

1. Are current disclosure rules sufficient to discover the kind of behavior referred to in the documents and if not, should disclosure rules be strengthened either by rule or statute?

My understanding is that there already is a tremendous volume of data that I understand is already required to be disclosed. Because of the complexity of the transactions involved, I am uncertain whether additional disclosures would be helpful with respect to discovering behavior.

2. Are there behavior patters that, in and of themselves, should be considered presumptively manipulative? If so, what kinds of behavior?

I am sure there must be such behavior patterns, but I do not have an opinion as to how to specifically define such patterns.

3. Are FERC's market rules sufficient to ensure that markets are not manipulated?

One of the most significant issues in this area is the intersection of the jurisdiction between FERC and the California ISO. At times, it appears that the two entities have not agreed upon the appropriate method for handling the California electricity market. I have no opinion on how those rules should be changed.

4. What actions are being taken to change the rules, if they are not now sufficient? Is further statutory authority necessary?

I have no information about potential rule changes. I have no opinion as to whether further statutory authority is necessary.

5. What is the division of responsibility for oversight between the CALISO and the Commission? Are those roles properly structured?

In my experience, the roles seemed to be confused and at times at odds with each other. I have no other opinion on this subject.

The CHAIRMAN. Well, thank you very much. Let us take a short recess here. We will be back in 10 or 15 minutes.

[Recess.]

The CHAIRMAN. Why don't we go ahead. We have still got two witnesses to give us their testimony. Mr. Hall, please go ahead with yours, take 5 or 6 minutes, and tell us what we need to know.

STATEMENT OF STEPHEN HALL, ATTORNEY AT LAW, UBS WARBURG ENERGY, LLC, PORTLAND, OR

Mr. HALL. Thank you, Mr. Chairman. My name is Stephen Hall.

The CHAIRMAN. Let me also say if any of you want to take your jackets off, go ahead. It is a little hot in this place.

Mr. HALL. It is a little warm in here. Thank you, Senator.

As an attorney at the law firm of Stoel Rives, LLP, which served as outside counsel to Enron North America on certain regulatory matters, I was asked in October 2000 to research and prepare a memorandum describing certain wholesale energy trading practices at Enron. That memorandum, delivered to Enron on December 6, 2000, characterized certain of those practices as deceptive. At the same time, we advised Enron in a face-to-face meeting that deceptive trading practices could violate the ISO tariffs, as well as State criminal laws.

Enron has waived the attorney-client privilege with respect to these matters, and I would be happy to assist the committee in any way in its investigation of trading practices in the Western wholesale energy markets.

I would like to provide some brief background regarding the preparation of the memorandum. In fall 2000, as an associate as Stoel Rives, I did work for various clients of the firm in the energy industry, including Enron. I worked under the supervision of Marcus Wood, a partner at Stoel Rives with many years of experience in the energy industry.

In October 2000, at a meeting convened by Enron's litigation counsel in Portland to address the company's response to a subpoena from the California Public Utility Commission, Enron traders began describing certain strategies used in the California wholesale energy market. The strategies presented were extraordinarily complex and the descriptions given were highly technical.

Following that meeting, Enron's counsel asked me to review the applicable tariffs, interview Enron traders, and seek to develop for the first time a written description of the trading strategies that were identified at the meeting. Subsequently I talked with traders at Enron and, working with Mr. Wood and Enron inside counsel, Christian Yoder, who is also testifying today, developed the memorandum that has been provided to the committee.

As I learned about Enron's trading practices, I became increasingly concerned. In the course of my discussions with traders, I became aware that certain of these trading strategies involved deception. As I learned of deceptive practices, I advised the traders with whom I spoke that such practices were deceptive and that they should stop such practices immediately. I also attended meetings in which Enron traders provided assurances that such practices had been discontinued.

In addition to the descriptions of trading practices I had been asked to prepare, I included in the memorandum a summary of the ISO tariff rules against gaming or deceptive practices to ensure that Enron would understand the ISO standards applicable to these practices and the sanctions for violations. Mr. Wood, my supervising partner, revised the memorandum to emphasize the deceptive nature of certain of these strategies and provided Enron counsel copies of California criminal statutes on fraud and theft, to make it clear to Enron that deceptive practices could constitute violations not only of ISO rules but also possibly of criminal statutes. Subsequently, Mr. Yoder and I met with the head trader at Enron in Portland to communicate Stoel Rives' findings and conclusions

to ensure that he understood our belief that many of the trading practices involved deception.

In June 2001, I accepted a position as an in-house attorney at Enron where I remained for 8 months. From the time I delivered the memorandum through my brief tenure at Enron, I saw no evidence or received any indication that the deceptive practices which I discussed in my memorandum ever resumed.

In sum, I was asked to talk with Enron's traders to learn about and summarize the trading strategies used. In the course of my review, my law firm developed an understanding of those strategies, identified in writing certain practices that appeared deceptive, advised Enron traders that these practices must be discontinued, understood that Enron had discontinued these practices, and advised our client that the future use of deceptive trading practices could violate ISO rules and/or criminal statutes.

I understand that this committee is conducting a review of whether actions taken and under consideration by the Federal Energy Regulatory Commission are sufficient to prevent manipulation of the Western energy markets. I would respectfully inform the committee that I have been an attorney for only 6 years and have practiced energy law for only 4 years. I am not an economist or a public policy expert and do not feel qualified to opine on public policy issues. With that caveat, I would be happy to discuss my findings regarding Enron's practices and to assist this committee in any way I can.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Mr. Yoder, go ahead.

STATEMENT OF CHRISTIAN G. YODER, ATTORNEY AT LAW, UBS WARBURG ENERGY, LLC, PORTLAND, OR

Mr. YODER. Thank you, Mr. Chairman. For the record, thank you, Senator Smith from Oregon, even though he is not here, for his kind remarks earlier.

Good afternoon. My name is Christian Yoder. I am currently a director in the Legal Department of UBS Warburg Energy, LLC, in Portland, Oregon. Prior to joining UBS Warburg in February 2002, I worked for Enron Corp. where, from 1994 to February 2002, I was employed as senior counsel. I worked in Enron's Houston offices from 1994 to 1998, at which time I was relocated to its Portland, Oregon offices.

As a lawyer for Enron, my job was to provide legal advice to the company on transactional matters, including the negotiation and drafting of master agreements with other wholesale power trading entities. I did not specialize in Federal Energy Regulatory Commission law.

In September 2000, Stephen Hall, a third-year associate attorney at the Portland law firm, Stoel Rives, LLP, outside counsel for Enron, was detailed from his law firm to work in Enron's Portland office, although he remained an associate of Stoel Rives and was not an Enron employee at that time.

Around that time, I and other members of Enron's legal department anticipated that litigation might be commenced against Enron and other power traders who conducted business in the

Western United States and especially in California. I asked Stephen Hall to attend litigation preparation meetings, perform some basic factual research, and draft a memorandum regarding Enron's trading practices, including any problematic aspects he might identify. In connection with this assignment, Mr. Hall produced a memorandum dated December 6, 2000. There is also a December 8, 2000 version of the same memorandum, but I believe that only the date is different. Although Mr. Hall drafted the memorandum, my name was added as a co-author to indicate that I had participated in discussions regarding its preparation and content.

When I received the memorandum from Mr. Hall sometime in early December 2000, I provided a copy to my supervisor, Mr. Mark Haedicke, the managing director of the legal department of Enron North America. I also believe that Richard Sanders, the associate general counsel, who had responsibility for overseeing litigation matters, also received a copy, although I cannot recall whether I or Mr. Hall provided it to him.

With respect to the issues the committee is examining, I am here voluntarily and intend to fully cooperate with this committee and any other congressional investigation into these matters. Because I learned much of the information in my possession in my capacity as a lawyer for Enron, under Texas and Federal law, the attorney-client privilege would normally prevent me from disclosing privileged information. However, Enron has provided me with a waiver of the attorney-client privilege that enables me to answer the committee's questions even if my answers disclose attorney-client privileged material.

I welcome the opportunity to answer, to the best of my ability, any questions that the committee may have for me.

Thank you.

The CHAIRMAN. Thank you. Thank you all very much for testifying. I acknowledge everyone is here voluntarily. We have subpoenaed nothing and we have subpoenaed nobody. So, I appreciate that. And I also appreciate the fact that Enron has chosen to waive the attorney-client privilege. I think that is to be commended.

Our purpose in a lot of what we are trying to do, both with the hearings and with the electricity title that we have in the energy bill that we passed through the Senate and is now in conference with the House, or will be, we believe, this summer—but our purpose in there is to ensure that, to the extent deregulation occurs, to the extent that States determine to proceed with deregulation, that it not result in the consumer or the ratepayer being disadvantaged and that the benefits of competition that are supposed to result from deregulation actually have a chance to happen.

In light of that, obviously the revelations about these so-called deceptive practices—I think that is the phrase that everyone has used since that does not prejudge whether they are illegal or legal. They are just deceptive, but the existence and the pattern of deceptive practices that is discussed in the memos that we have talked about here is a concern. I would like to be sure that the Federal Energy Regulatory Commission has full authority to impose civil penalties on people, firms, or individuals who do trade in energy markets and use these deceptive practices. And I would also like to be sure that, where appropriate—and I am not sure it is appro-

priate in every case—but where appropriate, there be criminal penalties that also could be pursued by the Department of Justice.

I would just ask each of you if you have reached a conclusion about whether FERC has adequate authority to impose civil penalties for these deceptive practices and/or whether the Department of Justice has adequate authority to pursue criminal penalties for some of these deceptive practices, if some of them should be subjected to criminal penalties.

Mr. Frizzell, did you have any opinion on this? If you do not have opinions, you can state that. But obviously this is a central issue I think for our committee to decide.

Mr. FRIZZELL. Senator, I am sorry. I am not a FERC lawyer. I do not know what their power is, and so I do not have an opinion on that.

The CHAIRMAN. Okay. Do you have any view on this, Mr. Fergus?

Mr. FERGUS. Senator, I do not. My expertise in dealing with FERC matters has been very narrow, having to do with the refund cases, and I just have not looked at the penalty provisions, so I cannot comment. I am sorry.

The CHAIRMAN. Mr. Hall, do you have view on this?

Mr. HALL. Senator, I would be reluctant to comment given that I have not looked into this matter with any consideration.

The CHAIRMAN. How about you, Mr. Yoder.

Mr. YODER. I am sorry. I cannot say that understand the implications of what kind of power FERC has or does not have. I cannot really help in that.

The CHAIRMAN. Let me ask a slightly different question. Would you agree with my statement that these deceptive practices should be subject to civil penalties that could be uniform around the country? That is my concern here, that if we just leave it up to each ISO, each regional transmission organization to decide whether or not to allow particular practices, I think we are less likely to have a system that people can have confidence in. For that reason, it seems to me logical that we should have a pretty clear definition of what is proscribed, what is prohibited by FERC, and what penalties will be imposed if practices occur. Do you any of you have views on that?

Mr. FRIZZELL. Well, without any specific expertise I can say it does seem logical, and I would agree with that.

The CHAIRMAN. Mr. Fergus?

Mr. FERGUS. One of the things that struck me about learning the California organization is how the markets operated. It was very different than how it is done elsewhere in the United States. I have not studied it elsewhere, but it has been described to me by those that I believe know, mostly other lawyers who practice in the area, that it is very different. So, I start with the premise that uniformity would be a very good thing, but the way the systems operate, there is such a thing as three-part bidding, two-part bidding. There are some intersections that are related to how California was organized. So, that is about as far as I can go, Your Honor—excuse me, Senator. You can tell I am used to being in a court—without further study.

The CHAIRMAN. All right.

Mr. Hall.

Mr. HALL. I think that the suggestion for uniform rules—there are good reasons for that and I would not suggest that I could list them all. But electricity is a commodity that travels across State lines and through different control areas, like Mr. Fergus was suggesting, and to the extent that the rules were uniform with respect to penalties, it would seem to make sense because the commodity travels freely. So, if it was subject to a single set of rules, it would make it much easier to determine what the rules were of the market.

The CHAIRMAN. Mr. Yoder, did you have a view?

Mr. YODER. I would tend to support the view of consistent rules too. I mean, one of the legal realities that exists in the West is you have the California ISO tariff and its provisions, which is FERC approved tariff, very thick pages, and then you have other control areas that have different rules. There is obviously room for problems when you have different areas and different rules. So, consistency legally is always something that appeals to lawyers I think as a general matter.

The CHAIRMAN. Yes, I think particularly if you are identifying practices that you want to prohibit and you are stating what the penalty is going to be for anybody caught engaged in those practices. It seems to me if you have got one set for a company that trades in several ISO's or has business in various parts of the country—it is not a very useful way to proceed to think you can get away with something in one part of the country, but not in another part of the country.

Senator Feinstein.

Senator FEINSTEIN. Yes. I do have questions.

Mr. Chairman, I would like to begin by asking you to include a statement from the Governor of California in the record.

The CHAIRMAN. We are glad to do that.

[The prepared statement of the Governor of California follows:]

PREPARED STATEMENT OF HON. GRAY DAVIS, GOVERNOR, STATE OF CALIFORNIA

I am pleased to submit the following statement for the record.

Thank you for holding these important hearings. In the last week, documents released by the Federal Energy Regulatory Commission (FERC), the Securities and Exchange Commission (SEC) and announcements by individual companies have revealed a disturbing pattern of deception and abuse by energy traders. The people of California and the U.S.—as consumers, taxpayers, businesses, retirees and shareholders—have been hurt. It is time to get to the bottom of these practices, ensure that they come to a stop and that the guilty pay.

As I have said many times before, California's electricity market was and is broken. Traders and sellers have engaged in market manipulation and taken advantage of the flaws in the market to line their own pockets. Protections supposedly built into California's market design and subject to federal regulatory approval failed. Federal regulators for too long overlooked the obvious signs of market abuses and manipulation and ignored their own regulatory mandates. And it cost California consumers, businesses, treasury and economy literally billions of dollars in the last three years.

We have been saying as much since 2000.We have been accused of blaming others for problems of our own making. We have been told repeatedly to "trust the market." But FERC's revelation last week of Enron's confession to abusive, manipulative and possibly illegal electricity trading practices bear out what California has been saying. There is reason to believe that other traders engaged in similar practices. Also, the SEC announced it was investigating a practice by Dynegy and CMS Energy called "round trip" or "wash" trades—a kind of financial shell game where companies traded equal amounts of energy to inflate their trading volumes. Reliant

Energy admitted it also engaged in "wash" trades. Now we learn that Enron has admitted to overstating the value of its assets by up to $24 billion.

Electricity is too important to our economy and indeed our health and safety to tolerate the games these traders have been playing. It is time to insist that these industry trading practices be thoroughly investigated, those who did wrong be held accountable and that California consumers be made whole for the billions of dollars that flowed out of state as a result of these deceptions. It is also time for the regulators to step up to their responsibilities to ensure that consumers' interests are put first.

There are three fundamental actions that must happen—first, there must be a thorough accounting and remedy of all these abusive and corrupt practices; second, there must be actions to ensure that effective protections are put in place and stay in place and third, there must be effective mechanisms to hold traders accountable for their actions.

Enron's confession memos are truly astounding only in how many abusive practices they reveal. Unfortunately, we have long understood the effects of their manipulations—wildly volatile energy markets, unreasonably high prices, forced blackouts and tight supplies. We have also long known that these problems were not merely the consequence of the supply and demand situation in California and the West, but of deliberate attempts to manipulate the market to the detriment of our people and economy. We have taken steps to make sure there is enough electricity in California. We have built eleven new power plants with more coming on-line this summer. We have invested historic amounts in energy efficiency and in 2001, Californians achieved heroic levels of conservation.

Some have labeled the Enron memo a "smoking gun," but I believe it is also something else—the tip of the iceberg. Enron's memo labeled these fraudulent practices—Fatboy, Ricochet, Death Star and Get Shorty—trading practices that drove California to the brink of blackouts by creating "phantom" power supply shortages and congestion of power lines to drive up prices.

According to the Enron memo, the only downside as one trading strategy was described was a "public relations risk arising from the fact that such exports may have contributed to California's declaration of a Stage 2 emergency yesterday." The Enron memos allege that others in the industry engaged in these practices FERC should follow up thoroughly. Asking other traders and sellers to admit to whether they engaged in similar practices as FERC did on May 8 is a good start but it is not enough. We believe and have submitted to FERC evidence of other abusive practices, such as withholding of power. FERC must thoroughly investigate and remedy any and all market abuses.

Enron's influence went beyond just leading other traders in deceptive and fraudulent activities. It is well known that Enron sought to make political, legislative and regulatory changes to support their version of the brave new world. They tried through every means possible to unravel any regulatory oversight. Enron attempted to ensure they could conduct their business behind a veil of secrecy. They sought to convince regulators that price controls and effective market surveillance were unnecessary and would in fact harm competition. We never believed that the electricity market could function like that. Now the rest of the world knows that the deregulation Enron advocated was all just a part of Enron's deceptions.

I applaud these committees' investigations of abusive practices. I urge you to call on federal regulators, both FERC and the SEC, to ferret out these market manipulations by energy traders, remedy them and put protections in place to make sure it does not happen again. If they do not act decisively, the Congress should.

Last week, I joined members of the California Congressional delegation in calling on Attorney General Ashcroft to initiate a criminal investigation of Enron's activities.

In a May 7, 2002 letter to FERC Chairman Pat Wood, I outlined the steps we believe FERC must take:

1. FERC must thoroughly investigate these practices by all energy traders, not just Enron. We are heartened to see that FERC is asking all energy traders and seller whether they engaged in these practices.

2. FERC must allow the California Independent System Operator (CAISO) to adopt stronger rules to discourage, prevent and punish abusive trading behavior. In the past year, FERC has rejected some CAISO proposed rules—rules FERC allowed other ISOs to use.

3. FERC must continue west-wide price caps and must offer requirements beyond September 30, 2002. Not only do California's markets continue to be vulnerable to manipulation, but also it is clear from the Enron memo that a California-only solution will not work.

4. FERC must act on California's refund request. California is appealing an earlier FERC decision to exclude billions of dollars from the refund proceeding.

5. FERC must also reform the long-term contracts as California has requested in a proceeding brought by the Public Utilities Commission and the Electricity Oversight Board.

Today, I sent another letter to Chairman Wood, in light of the revelations of other abusive trading practices by Dynegy and Reliant Energy, asking FERC to broaden its investigation beyond the Enron memo activities.

This is not just California's plight. We know from the memos that Enron perpetrated its dirty tricks throughout the West. Also, the New York Times reported on May 12 that during a test of their system last summer, Texas officials found that companies exaggerated their demand and drove prices higher. With brazen arrogance, this was during a test when the companies knew the regulators were watching.

We welcome your investigation. We urge aggressive Congressional, FERC and SEC oversight of electricity traders. Experience shows that traders will create and exploit new market flaws as soon as the old ones are stopped.

Electricity is not just any commodity. It is essential to health and safety. It literally powers our economy. We must have reliable, stable and reasonable priced electricity.

Thank you.

Senator FEINSTEIN. Thanks very much.

My first questions are to Mr. Yoder and to Mr. Hall. If I understand correctly, you are both now employed by UBS Warburg. Is that correct?

Mr. YODER. Yes.

Mr. HALL. Yes, Senator.

Senator FEINSTEIN. Does UBS Warburg, either today or in the past, employ any of the schemes mentioned in the December 6 and 8 memorandum?

Mr. YODER. No.

Mr. HALL. Not to the best of my knowledge.

Senator FEINSTEIN. And that goes for the past or the present.

Mr. YODER. That is my understanding, yes.

Mr. HALL. Yes, Senator.

Senator FEINSTEIN. I would like to read you a section from the December 6, 2000 Enron memo in reference to the strategy to buy power in California and send it out of the State. You wrote—and I quote—"This strategy appears not to present any problems other than a public relations risk arising from the fact that such exports may have contributed to California's declaration of the stage 2 emergency yesterday." Do you recall that?

Mr. HALL. Yes, I do, Senator. Would you like me to respond?

Senator FEINSTEIN. Not quite yet.

As it turns out, this strategy may have led to far more serious events than just a stage 2 emergency. In fact, the next day, December 7, California experienced its first-ever stage 3 emergency, forcing State and Federal water pumps to be shut off, and soon after came the blackouts.

So, my question is, how do you characterize the damage done to families and businesses as a result of the Western power crisis as a mere public relations risk for Enron?

Mr. HALL. Senator, the practice that you are describing there is the export of power out of California. At that time, my understanding is that——

Senator FEINSTEIN. To avoid the cap.

Mr. HALL. To avoid the cap. My understanding is that at that time there was a price cap in place in California, but not in the

rest of the West. And my understanding at the time was also that it is legal to export power from California as well as to import power into California. And because of the loophole created by having a price cap in one State and not having a cap in the other States, that encouraged people to export power from California.

The point that I was trying to draw my client to, when I made the statement there, was to point out that even though the strategy was completely legal at the time, there were adverse results that could result from this. And I was trying to say that even though it was legal, there were other considerations to be taken into account.

Senator FEINSTEIN. Now, I would like to go to the handwritten documents that the chairman referred to, which I only received last night. But in these notes, a Ms. Hain appears to be laying out a strategy to defend deceptive trading practices in court, as well as in the court of public opinion.

Mr. Hall, Mr. Yoder, and Mr. Fergus, you were all mentioned in these notes that appear to be dated October 3. And on the page with your names, Ms. Hain made the following notes about Enron's defensive strategy. "Look like we're forthcoming." "Show the Power Exchange/Williams-hogs at trough." And then this note, "No e-mails except to Richard at his direction." And later on, "No one can prove, give complexity to our portfolio."

Were the three of you at a meeting with Ms. Hain when she made these notes?

Mr. YODER. I was at the October 3 meeting. It was an all-day meeting. The litigation team had come in from Portland and California. Many law firms were there, regulatory people. It was a big meeting. I was in and out of the meeting all day long, and that was the meeting when the traders began to describe the trading strategies to the legal team. That is when we first heard those offensive names and so forth. So, I was there at that meeting, yes.

Senator FEINSTEIN. Mr. Hall.

Mr. HALL. Senator, I too was at the meeting. Christian and I were working together that day, and I was definitely at the meeting for the discussion of the trading strategies. I was not there all day.

These notes are new to me. The first that I have heard of these notes was today. Obviously, I do not know that they are Mary Hain's notes or anyone else's notes.

What I do know is that following that meeting, I took it upon myself and Christian Yoder took it upon himself to write a memo describing those trading strategies and, when we felt that they were deceptive, to bring them to the client's attention and to ensure that those strategies were stopped.

Senator FEINSTEIN. Mr. Fergus.

Mr. FERGUS. Yes, Senator, I was at that meeting. It was as described, that it was an all-day meeting. There were lawyers there from the Bracewell Patterson firm. I was there. Mr. Richard Sanders was there. There were a number of business people there. That was my first introduction to anything really having to do with the electricity markets.

First of all, before I guess last night, I did not see those handwritten notes either.

But I think that in my experience and as I recall, there were individuals who were there who were trying to adjust to the litigation to what was going on, and there were all sorts of ideas that were tossed out. The idea with respect to Power Ex being at the trough or whatever, that is a comment that I remember. As the meeting went on and as there were discussions, I would not describe what is down there at all as any plan of how the litigation would be defended.

One of the reasons I say that is, I have been introduced to, I know Ms. Hain. She was a FERC regulatory lawyer who was in, I believe, Enron's governmental affairs. I have no idea why she wrote down what she wrote down, but there were many discussions.

For example, a lot of the information—there were concerns about trade secrets and commercial information that if others in the industry were made aware of, what prices things were being sold at, that as I understand it, would have been a violation of various regulations. So, there was lots of free interchange amongst a large group of people with varying degrees of experience. So, that is what I remember as I sit here right now.

Senator FEINSTEIN. Mr. Chairman, I see the red light, but if I could just quickly continue.

The CHAIRMAN. Go ahead.

Senator FEINSTEIN. I am going to ask you each the same question, and if you would just answer it, I would appreciate it. The question is, did you suggest or agree to withhold information in any way?

Mr. Yoder.

Mr. YODER. No.

Senator FEINSTEIN. Mr. Hall.

Mr. HALL. I am not sure I understand your question. To withhold what information?

Senator FEINSTEIN. Essentially I think it is related to no one can prove because of the complexity of our portfolio.

Mr. HALL. No. Never at any time did I agree to withhold any information.

Senator FEINSTEIN. Mr. Fergus.

Mr. FERGUS. That is correct, Senator. I would not and I did not suggest withholding information.

I do have to tell you I have further recollections about that meeting, though. This was in the context of, I believe, a subpoena that had been issued by the California Public Utilities Commission which, if read literally, would have called for hundreds of gigabytes of data. So, there was a selection process going through what was asked for by their subpoena and there were negotiations that Michael Day and I did—I am sorry. I cannot remember his last name. His first name is Harvey. He is a lawyer at the Public Utilities Commission—as to what we would do when we would do rolling productions. So, there was certainly a selection of information because there was extreme pressure to get it quickly, but there was not any decision made. In fact, there were e-mails I believe that followed up on conversations that said Enron was not waiving whatever objections it had to producing to jurisdiction, but we would go

ahead and produce on a rolling basis. So, there was an ongoing dialogue as to what would be produced.

A similar issue has come up, I know, in the FERC investigation where there are such enormous quantities of data. A question that says, please provide all transaction information, literally would call for lots of data. So, that is my recollection.

Senator FEINSTEIN. On the subject of death wish, there is a page that lists one name——

The CHAIRMAN. This is "death star." Right?

Mr. FERGUS. That is correct, Mr. Chairman.

Senator FEINSTEIN. "Death star." There is a page on "death star," and then it lists something I cannot make out, and then it says, "Coral, Power Exchange also do."

Mr. FERGUS. I am sorry. I did not hear you, Senator.

Senator FEINSTEIN. It says, "Coral, Power Exchange also do." The implication is someone suggested that they also carry out the "death star" practice.

Mr. FERGUS. Without seeing the document——

Senator FEINSTEIN. You do not know, and you did not suggest that they also participated in this.

Mr. FERGUS. I am sorry. The words that you read I just do not recognize, and I am not sure I understand. I would have to see it.

Senator FEINSTEIN. Well, this is somebody's notes. What I am drawing from them is that someone at the meeting indicated that these companies also practiced the scheme known as "death star." Was that discussed?

Mr. FERGUS. I have no recollection of any discussion at that point.

Senator FEINSTEIN. Fine.

Mr. Hall.

Mr. HALL. By "Corral," do you mean "Coral"?

Senator FEINSTEIN. Excuse me. Coral. That is correct.

Mr. HALL. This was an issue that came up earlier this morning in reference to a question from Senator McCain. There had been a statement in the memo that possibly other traders were using these strategies at other companies, and it all arose from a comment of, I think, just one trader who said, you know, there used to be a gal or a guy who worked here who went to go work for Coral. Maybe they are doing this too. And I think that that was about the extent of it. It was speculation.

Senator FEINSTEIN. And Power Exchange? How did that come into it?

Mr. HALL. California Power Exchange?

Senator FEINSTEIN. It just says Power Exchange. I do not know.

Mr. HALL. I do not know, Senator.

Senator FEINSTEIN. Mr. Yoder.

Mr. YODER. Well, I would like to help and disclose as much as I can, but I have not seen those notes and I do not know about that comment. We have heard testimony and you yourself brought some evidence today that other companies out there may or may not have been using these strategies. I think I would not have been surprised had I heard somebody in that meeting say somebody else is doing it too. But I am not an expert on facts of what happened exactly with that particular company.

Mr. FERGUS. Senator, I do have a recollection similar to what Mr. Hall said, that there was a description of an employee who had left and the speculation that maybe they were using it where went. But that is all I remember.

Senator FEINSTEIN. On one of the pages, the notes say, "Tim's list strategies." Who was Tim?

Mr. FERGUS. I do not know for sure, but there is a Tim Belden who is the head trader, and that would be consistent, but I cannot say——

Senator FEINSTEIN. At Enron.

Mr. FERGUS. Yes, in Portland.

Senator FEINSTEIN. Is that your understanding, Mr. Hall?

Mr. HALL. Yes, it is. Tim explained some but not all of the strategies.

Senator FEINSTEIN. Mr. Yoder.

Mr. YODER. Yes. I think the logical person with the name Tim would have been Tim Belden there.

Senator FEINSTEIN. I think I may have covered it.

Let me ask your comment. There is some anecdotal evidence that manipulative trading strategies still persist, and let me just give you an example because I suspect one day we will get at it. But the example is a *Washington Post* article over the weekend that noted that there are plenty of signs that traders still engage in manipulation, and that article pointed out a $20 million fund that Texas created to compensate providers for clearing congestion was to have lasted 18 months and it was depleted in 2 weeks. Do any of you know anything about that?

Mr. YODER. I do not, Senator.

Mr. HALL. I do not, Senator.

Mr. FERGUS. Senator, the only thing that I can recall, at one point in time I received a phone call from Enron's trading desk in Texas, and I believe that ERCOT is the acronym for it. There was a question about it was starting. And I do not even remember what the legal question was, but before responding, because I was being called, in essence, by the business types, I checked with Mr. Richard Sanders, and his comment was it did not make a lot of sense to have a California lawyer investigating or giving advice on a Texas issue. But that is all I remember.

Senator FEINSTEIN. Thank you.

I am going to ask you now for you opinion, particularly you, Mr. Yoder and Mr. Hall. Now that you have left Enron and you are working for a firm that you indicate to me does not indulge in any of these practices, either in the present or the past, do you think these practices should be legal?

Mr. YODER. My view, Senator, is any practice that involves false information should be illegal and have civil and possibly criminal sanctions. If there is false information that is being submitted to a public agency, that is wrong.

Senator FEINSTEIN. How about a practice like saying you are clearing congestion, you make up the congestion, you are going to clear it, you do nothing, and you make money from it?

Mr. YODER. Well, the difficulty I have with that is I am not a trader that understands how to—I do not really know what happens when those strategies really occur. So, it is difficult for me to

understand the physics and the operational side of it. I am an attorney and I know that false information is bad. It is wrong.

Senator FEINSTEIN. But I am just asking you. You deal in this area. You still do. Right? I am just asking you what you think about it. As an individual, we all have opinions, and I am asking for your opinion on how you feel about trading something that really is not there in the first place.

Mr. YODER. Well, I have asked traders and people that do those kind of things, and there are arguments that are given for whether or not power is really moving or not. So, you can immediately get into the complexities of what is really going on there on a system. I do not want to give an opinion on something that I am not qualified to understand.

Senator FEINSTEIN. Mr. Hall.

Mr. HALL. Senator, any practice that involves deception is clearly wrong.

Senator FEINSTEIN. Thank you for being direct.

Mr. Fergus.

Mr. FERGUS. I think the same answer, Your Honor.

Senator FEINSTEIN. Mr. Frizzell.

Mr. FRIZZELL. I would agree with that as well.

Senator FEINSTEIN. Thank you very much. Thanks, Mr. Chairman.

The CHAIRMAN. Thank you very much. I thank all four of you. I know the hearing has taken a long time. We have one more panel, so I will dismiss this panel and ask the final panel to come forward.

Ms. Cynthia First, who is commissioner with Snohomish Public Utility District in Everett, Washington; Gary Ackerman, who is executive director of the Western Power Trading Forum in San Mateo, California; Lynne Church, who is the president of the Electric Power Supply Association; and Henry Martinez, assistant general manager of Power Services with the L.A. Department of Water and Power.

Thank you all very much for staying and giving us the benefit of your views. Ms. First, let me just advise you that Senator Cantwell is presiding over the Senate, and she asked if she could be able to come back so that she could hear your testimony. So, we are going to try to put you last in this group and hear from the others first. Then we hope that by the time they are through, she will have arrived, and we will do it that way.

Mr. Martinez, please start and we will go across this way.

STATEMENT OF HENRY MARTINEZ, ASSISTANT GENERAL MANAGER, POWER SERVICES, L.A. DEPARTMENT OF WATER AND POWER, LOS ANGELES, CA

Mr. MARTINEZ. Well, thank you very much, Senator. My name is Henrique Martinez. I am the assistant general manager for Power Services for the Los Angeles Department of Water and Power. I appear here in response to a request of this committee sent to the department on May 10, 2002. Obviously, since we only received the invitation last Friday, we were unable to prepare written comments for distribution, as requested in the committee's letter.

LADWP is a vertically integrated, municipally owned electric utility. LADWP owns and operates generation, transmission, and distribution facilities, and the primary purpose is to provide affordable electric power to the community we serve. LADWP provides electric service to more than 3.8 million customers behind 1.4 million meters, and the customer base represents approximately 10 percent of the total electric market in California.

Participation in the wholesale market is not the primary business of the Department of Water and Power. LADWP's system has been built to serve its retail customers, and at its peak, only 10 percent of our energy was sold to the wholesale market, representing only 1 or 2 percent of the total load in California.

LADWP supported the State of California during the State's energy crisis and help mitigate the crisis. The department's sales of surplus energy in excess of the requirements for Los Angeles were intended to and did assist the State in its efforts to prevent and delay rolling blackouts caused by energy shortages in California. During this period of crisis and rapid changing market circumstances, most notably the loss of credit worthiness of the California ISO and the California Power Exchange, LADWP sought to balance its responsibilities to the city and its customers with its ability to provide excess power to the California ISO and the California PX. LADWP took extraordinary measures to help out during the energy crisis in California.

In sum, we have been part of the solution and not part of the problem.

Thank you for the opportunity to make these remarks, and I will answer any questions you may have.

The CHAIRMAN. Thank you very much.

Ms. Church, thank you for being here.

STATEMENT OF LYNNE H. CHURCH, PRESIDENT, ELECTRIC POWER SUPPLY ASSOCIATION

Ms. CHURCH. Thank you, Senator and Senator Feinstein. I am Lynne Church, president of the Electric Power Supply Association, which is the trade association representing competitive generators and marketers. Thank you for this opportunity to comment on recent developments in the Western markets.

The three internal Enron memos raise very serious questions about the operation of the California market in 2000-01 that need to be fully investigated by the FERC. The competitive power industry supports, without hesitation, FERC's aggressive inquiry into this matter and its review of practices. The facts should be determined and the results laid out before the American people. The commission should be allowed, however to conduct its inquiry in a complete, fair, and dispassionate probe without a rush to judgment that could prove premature.

We have always supported fully competitive and transparent energy markets. Practices designed to manipulate customer prices create unfair advantages for specific market participants or threaten the reliability of the electric grid absolutely cannot be condoned. If anyone ultimately is found to have engaged in such practices, we certainly support FERC's issuance of appropriate individual and structural remedies.

However, the alleged manipulative Enron practices should not be considered an indictment of the competitive electric market as a whole. An analogy is the New York Stock Exchange. Over the years, some members of the exchange have broken the rules. They have been caught and punished. But the exchange was not shut down nor the trades unraveled because a few members were guilty of misconduct.

It is also crucially important not to let the flurry of attention over Enron's alleged market manipulation obscure the real drivers of the electricity shortages and high prices in California and throughout the West. Enron was neither responsible for the drought in the Northwest nor the accompanying widespread heat wave.

Worsening the situation in California was the absence of truly competitive markets. The rules prohibited the utilities from exercising basic risk management and they could not sign long-term contracts at a time when prices were low. Instead, they were forced to buy all of their power supplies in the spot market until sometime in 2001, which exacerbated price volatility.

Other rules made it difficult for suppliers to build new plants in the State at a time when California's high tech boom was causing demand to go up.

Also unchanged is the fact that all of these conditions, as well as a 10-fold increase in natural gas prices, the need to buy unanticipated NO_X emission credits, and the failure to be paid in many cases—and to this day to be paid—resulted in the wholesale power prices experienced by customers in the region.

We should not ignore that consumers generally have greatly benefitted from competition. The historical data are clear. The nationwide average price of electricity for all customers has gone down as much as 35 percent since the introduction of wholesale competition into the electric market in the mid-1980's. In fact, retail prices for Pacific Gas and Electric and San Diego Gas and Electric went down 41 and 49 percent, respectively, between 1985 and the end of 2000. On the other side of the ledger, the so-called good old days of traditional cost-plus regulation produced waste and stranded costs estimated to be almost $29 billion, which California ratepayers have been paying.

The practices outlined in the Enron memo show the critical importance of good market structure. Most of these practices would not have happened had there been a seamless, integrated regional market with good rules. And FERC's existing initiatives to create independent and multistate regional transmission organizations, a standard market design, and good congestion management are all critical to well-functioning markets.

The West needs to become a seamless, integrated electricity market, and the California ISO needs to become truly independent. The key is to get the market rules right and then to put in place structures that provide certainty, transparency, consistency and that prevent abusive behavior and assess significant penalties for wrongdoing.

In conclusion, we strongly support, without reservation, FERC's aggressive investigation, and FERC's initiatives to develop seamless, integrated regional markets with standardized rules should be

encouraged. As Senator Bingaman said in his opening statement, we do need a strong regulator.

Also, the energy conference committee should recognize that a number of provisions in the Senate's energy bill enhance FERC's authority to ensure a well-functioning market, as Senator Murkowski also stated, including greater access to market participant data, added FERC jurisdiction over the transmission facilities of the public and Federal utilities, and enhance FERC's civil and criminal penalty authority.

Competitive power suppliers recognize that our customers and other stakeholders need to have confidence in our industry, and we stand ready and willing to do what is necessary to ensure that trust.

[The prepared statement of Ms. Church follows:

PREPARED STATEMENT OF LYNNE H. CHURCH, PRESIDENT, ELECTRIC POWER SUPPLY ASSOCIATION

Chairman Bingaman, Senator Murkowski and members of the Committee, I am Lynne H. Church, President of the Electric Power Supply Association (EPSA) and am here today representing EPSA's member companies. EPSA is the national trade association representing competitive power suppliers, including independent power producers, merchant generators and power marketers. These suppliers, which account for more than a third of the nation's installed generating capacity, provide reliable and competitively priced electricity from environmentally responsible facilities serving global power markets. EPSA seeks to bring the benefits of competition to all power customers. On behalf of the competitive power industry, I thank you for this opportunity to comment on recent developments concerning the Western electricity market.

The three internal Enron Corp. memos raise serious questions about the operation of California's electricity market in 2000-2001 that need to be fully investigated by the Federal Energy Regulatory Commission. The competitive power industry supports, without hesitation, FERC's aggressive inquiry into this matter and its review of practices in other markets.

The facts should be determined and the results laid out before the American people. The commission should be allowed, however, to conduct a complete, fair and dispassionate probe without a rush to judgment that could prove premature.

The competitive power supply industry has always supported fully competitive and transparent energy markets. Practices designed to manipulate customer prices, create unfair advantages for specific market participants or threaten the reliability of the electricity grid absolutely cannot be condoned.

If anyone ultimately is found to have engaged in such practices, we will support FERC's issuance of appropriate individual and structural remedies. We also support a review of FERC's penalty authority during the upcoming legislative conference to determine whether such authority should be enhanced.

What's important is that the activity alleged in the Enron memos, even if it took place, in no way is an indictment of the competitive electricity market as a whole. And the remedy, if found to be necessary, should fit any practices found to be inappropriate.

An appropriate analogy is the New York Stock Exchange. Over NYSE's history, some individuals have broken the rules. Those individuals were caught and then punished. Sometimes they were fined, sometimes they were banned from the Exchange and sometimes they went to jail. The NYSE wasn't shut down or trades unraveled because a few members were found guilty of misconduct.

It's also crucially important not to let the flurry of attention over Enron's alleged market manipulation obscure the real drivers of the electricity shortages in California.

Let me be explicitly clear: whatever else Enron might have done to profit improperly from the power supply shortages in California, Enron was neither responsible for the drought in the Northwest nor the accompanying widespread heat wave.

Worsening the situation in California was the absence of true competitive markets. The rules prohibiting energy utilities from exercising basic risk management meant that they couldn't sign long-term contracts at a time when prices were low. Instead, they were forced to buy all their power supplies in the spot market, exacerbating price volatility.

Other rules made it difficult for suppliers to build new plants in the state, at a time when California's growing high-tech boom caused energy needs to increase at an unanticipated rapid rate.

Also unchanged is the fact that all of these conditions, as well as a ten-fold increase in natural gas prices and the need to buy unanticipated emissions credits, resulted in the wholesale power prices experienced by customers in the region.

Regardless of alleged market manipulations by Enron, we should not rewrite history in a way that ignores or forgets the root causes of California's troubles—the supply shortages and the structure of the market that existed at the time.

Also, we should not ignore that consumers generally have greatly benefited from competition. The historical data are clear: The average price of electricity has gone down as much as 35% since the introduction of wholesale competition in the 1980s.

Electricity in the so-called "good old days" of cost-plus regulation was much more expensive than in today's competitive marketplace. Between 1970 and 1985, inflation-adjusted electricity prices nationwide increased 25 percent for residential customers and increased 86 percent for industrial/commercial customers.

These price increases and inefficiencies drove the start of electricity competition in the mid-1980s. In California alone, ratepayers were obligated, because of the bloated regulatory structure, to pay stranded costs estimated to be over $28.8 billion (in 1996 dollars).

With wholesale and some retail competition, inflation-adjusted electricity prices *decreased* from 1985 to 2000 on average by 35 percent for all customers, 31 percent for residential customers and by 36 percent for industrial/commercial customers. (The chart in the Appendix of this testimony shows the decline in real residential prices since the introduction of wholesale competition.)

The problems faced in California show the critical importance of good market structure. From the beginning, our industry has been at the table identifying potential market problems and recommending improvements.

The Enron memos demonstrate the value of FERC's existing initiatives to create independent and multi-state regional transmission organizations, a standard market design with appropriate market monitoring, and good congestion management rules. We strongly endorse FERC's ongoing reforms and urge the continued evolution of efficient, integrated transmission grids.

Standard market design will ensure more consistent and transparent market rules, promoting greater regional trading on a level playing field. In addition, the commission has undertaken a major effort to enhance market oversight. Those efforts are critical to ensure that all market participants have confidence that markets are being operated fairly and according to known and established rules.

New regional transmission organizations (RTOs) need to be flexible enough, if necessary, to seek changes of rules that aren't promoting robust competition. Indeed, both the Texas ISO and the Mid Atlantic-based PJM have aggressively proposed rules to prohibit alleged gaming in their markets. They have made structural changes that prevent such practices in the future and have recommended penalties against the companies that engaged in them.

The key is to get the market rules right—that is to put in place structures that provide certainty and consistency, that prevent abusive behavior and assess significant penalties for wrongdoing.

Energy traders and marketers in truly competitive markets provide real value by managing customer risk and reducing long-term volatility. Trading allows customers to reduce risk by developing a portfolio of long, medium and short-term power contracts. The high volatility found in the daily spot markets can also be dampened by allowing utilities and other retail providers to hedge their market risks through financial transactions, thereby keeping the price of power more consistent for end users.

Where should the industry go from here? FERC should be allowed to follow through on its broad investigation. FERC should also be encouraged to continue its development and implementation of a standard market design for use in RTOs.

Next, the West needs to become a seamless integrated electricity market. For that to happen, the California-ISO must become truly independent, with an independent board. New market rules, such as improved congestion management policies, must be developed. FERC has long since ordered this to take place and the CAISO continues to drag its feet.

If there's a true regional market in the U.S., the West is it and has been for a long time. The region's climate balances electricity usage through the year. During the cold winter months, the Northwest imports power to cover its highest levels of demand. In summer, the Northwest and Southwest export power to California. A seamless regional market helps all sides because fewer power plants can serve more people all year round, and power can move easily to where it is needed.

That greatly reduces costs. Neither Arizona nor Washington ratepayers want to pay for more local plants to cover their peak demand seasons only to have them sit idle half of the year if they can't sell their power through regional markets to other customers during their lower demand season.

In conclusion:

1. We strongly support, without reservation, FERC's aggressive investigation into alleged market abuses. The probe needs to proceed on a full and fair basis, and the findings placed squarely before the American people. The truth about what did or did not take place in California and elsewhere should be completely and accurately disclosed.

2. The competitive power supply industry has always supported fully competitive and transparent energy markets. Practices designed to manipulate customer prices, create unfair advantages for specific market participants or threaten the reliability of the electricity grid absolutely cannot be condoned.

3. The Energy Conference Committee should recognize the following improvements, among others, that have been included in the Senate's energy bill. They would:

a) Give FERC greater access to market participant data thereby improving market transparency;

b) Broaden FERC's jurisdiction to include the transmission facilities of the public and federal utilities, eliminating holes in the regulation of our national transmission system; and

c) Extend FERC's civil and criminal penalty authority.

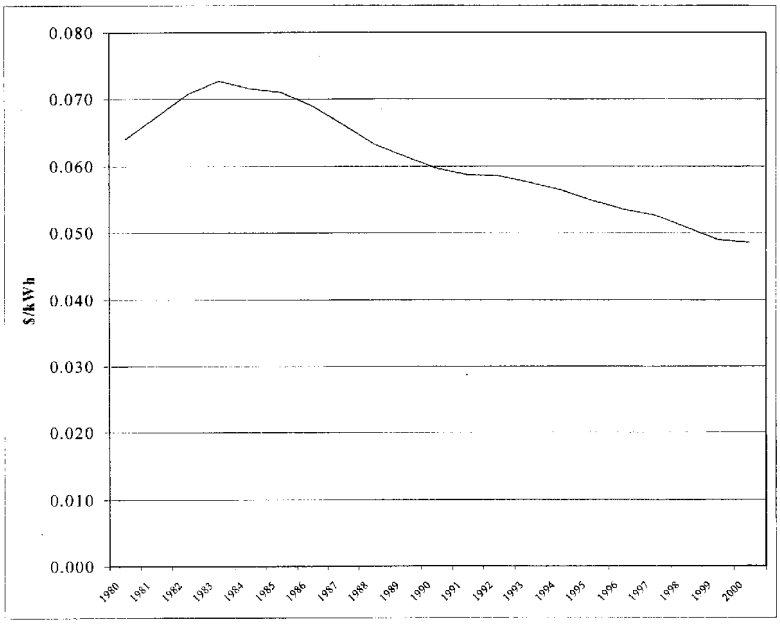
Competitive power suppliers recognize that our customers need to have confidence in our industry. We stand ready and willing to do whatever is necessary to ensure their trust.

Appendix A

Competition Works For Consumers

The real price of electricity has declined on average by 31 percent for residential customers since wholesale competition was introduced

RESIDENTIAL CUSTOMERS CLASS:
YEAR-BY-YEAR REAL PRICES



Source: Boston Pacific Company, Inc, 2002

APPENDIX B

ATTACHMENT TO LYNNE H. CHURCH'S TESTIMONY BEFORE THE SENATE ENERGY AND NATURAL RESOURCES COMMITTEE RESPONSE TO THE SENATE ENERGY AND NATURAL RESOURCES COMMITTEE REQUEST DATED MAY 10, 2002

Are current disclosure rules sufficient to discover the kind of behavior referred to in the documents and, if not, should disclosure rules be strengthened either by rules or statute?

Under the Federal Power Act, FERC has the full investigative powers needed to get to the bottom of any allegations of market manipulation. 16 U.S.C. 825f provides the Commission with the authority to subpoena witnesses, compel attendance, take evidence, and require the production of books, papers, correspondence, memoranda, contracts, agreements or other records which the Commission finds relevant or material to its inquiry.

Are there behavior patterns that, in and of themselves, should be considered presumptively manipulative? If so, what kinds of behavior?

Certainly collusive behavior to fix prices is illegal under antitrust statutes. In addition, the abuse of market power, defined as the ability to profitably raise prices above competitive levels on a sustained basis, is unacceptable and should not be permitted. Further, actions which violate ISO rules and tariffs should not be tolerated. However, in the absence of a Standard Market Design, those practices vary from ISO to ISO.

Are FERC's market rules sufficient to ensure that markets are not manipulated? What actions are being taken to change the rules, if they are not now sufficient? Is further statutory authority necessary?

As noted above, FERC has adequate authority to investigate allegations of market manipulation. In addition, under 18 U.S.C. 825o, FERC has authority to assess civil penalties against those who violate the Federal Power Act.

As to market rules, FERC's Standard Market Design efforts are a work in progress and not yet complete. The final rules, however, will certainly include extensive market monitoring and mitigation procedures.The competitive power supply industry has been actively engaged in FERC's SMD development process and just released some principles for market mitigation as part of the SMD. We look forward to working with the Commission and the industry to complete the SMD process as quickly as possible.

Passage of the Senate Energy Bill's electricity title, which includes important provisions to extend consistent regulatory oversight over the entire interstate transmission grid, will be very helpful to prevent manipulation. The presence of regional regulatory "seams" creates confusion and the opportunity for misunderstanding or mischief by market participants. The additional clarification that FERC has the authority to compel participation by transmission owners in an approved RTO would be helpful, but not essential.

What is the division of responsibility for oversight between the CALISO and the Commission? Are those roles properly structured?

There has been a serious problem with the lack of independence of the California ISO Board for some time. The state of California is now a major player in the energy markets through the Department of Water Resources, and the ISO Board members are appointed by and accountable to the Governor. Other market participants are obviously skeptical of the ISO's ability to serve as the unbiased monitor of market behavior. This is an untenable situation and the ISO Board must be disbanded and replaced with an independent entity.Once an independent ISO Board is in place, the role of the ISO Market Monitoring Unit will be to review and assess the behavior of all players in the energy market—generators, marketers, load, and the ISO itself—to ensure that the rules are in place to encourage robust competition and that all market participants are following those rules. If the ISO MMU identifies anomalous rules or market behaviors, those problems should be brought to the attention of the ISO and to FERC to determine the appropriate remedies.

The CHAIRMAN. Thank you very much.

Mr. Ackerman, why don't we go to you next.

STATEMENT OF GARY ACKERMAN, EXECUTIVE DIRECTOR, WESTERN POWER TRADING FORUM, SAN MATEO, CA

Mr. ACKERMAN. Thank you, Mr. Chairman and members of the committee. My name is Gary B. Ackerman, and I am executive director of the Western Power Trading Forum, a nonprofit trade association of 38 buyers and sellers of wholesale power across the Western region.

Today, I wish to express, on behalf of my membership, our regret and sincere concern for the situation that brings us together. Many of my members were disappointed and disheartened by the tone of the Enron memos. The nicknames used in the memos to describe different trading strategies are not standard industry terms. I have been in the power industry for 26 years, and 5 of those years I have been working with power traders certainly in the West. And the first time I ever heard or read those names to describe trading strategies was a week ago Monday when the memos were first made public.

Because my organization is a trade association and not a trading entity, I cannot comment directly on any one company's trading practices or strategies. Antitrust laws explicitly prohibit conversations among and between the membership regarding terms of service and trading practices. We work together, however, to analyze a wide range of regulatory matters and present a common voice for the thousands of businessmen and women who play a role in providing competitive products for electricity consumers, much like insurance companies do for their policyholders. In other words, we can absorb the variation in day-to-day prices so that consumers may have the certainty of fixed prices.

With your permission, Mr. Chairman, I would like to put a chart up, if I may.

The CHAIRMAN. Yes, go right ahead.

Mr. ACKERMAN. I hope you can see that. What this does is show, for the 4 years since competition began in California, three things: what the weekly wholesale prices were, spot prices, that is; what the historical average generation procurement cost was for the three electric utilities in the State of California; and the red line there that you see very low at the beginning and then over time it goes above the blue line and then meets it is the cumulative average of the competitive wholesale prices.

Since competition began in California in 1998, the average competitive wholesale power price to date is the same as the investor-owned utilities' historical average costs for generating and procuring electricity. That is even after the immense price increases that we witnessed in 2000 and 2001.

You might ask, so what does competition provide that tired and true cost-of-service regulation cannot if the two indices are the same after 4 years? As my chart shows you, the average competitive price is falling as market prices continue to hover in a range less than half of what the pre-1998 costs were. That is what that blue line or the blue shaded area represents, less than half of what the blue line running all the way across is. And it is easily one-third of the regional price cap imposed by FERC last year. Our index will soon be lower than the historical investor-owned utility cost benchmark.

Second, markets move much faster than regulatory agencies. The power markets were quick to respond when there was scarce supply and economic growth increased electricity demand. However, people should also recognize that prices under the competitive system were quick to fall, as they did a year ago, and have remained at the lower levels for almost a year.

With respect to the business practices of the many companies that trade power, my other purpose today is to express the fact that there is a wide range of attitudes and behavior among the diverse membership I represent. Trading organizations not only follow the rules of the California ISO, but also abide by the spirit of what the ISO is trying to achieve. WPTF seeks trading rules that are fair, reasonable, and give consumers confidence that they are getting something from the new way power is provided to their homes and businesses. Commodity exchanges in operation today all have rules to guide trading behavior, and we are no different in that respect.

We believe that the Federal Energy Regulatory Commission is doing everything it can to quickly uncover the deficiencies in the California ISO rules and work with all parties to correct any apparent shortcomings. However, long before the Enron memos were written, it was apparent to people in my industry that there were flaws in the California market design. There are still flaws in place that need immediate attention.

Finally, our goal is to work with the California ISO and Federal agencies to get California back on track. There is much to be done. Chief among the tasks we must cooperatively undertake is to simplify the trading rules, institute a system of regional—and not State, but regional—oversight of the bidding behavior of market participants and, equally important, reestablish the independence of the California ISO Governing Board. In its current form, the mix of State versus Federal interests is causing deep friction and impeding quick progress in getting California's power markets on a better basis for consumers to enjoy the benefits of competition.

Thank you for inviting me to join this panel, and I look forward to answering your questions.

[The prepared statement of Mr. Ackerman follows:]

PREPARED STATEMENT OF GARY ACKERMAN, EXECUTIVE DIRECTOR, WESTERN POWER TRADING FORUM, SAN MATEO, CA

Mr. Chairman, and members of the Committee, my name is Gary B. Ackerman, and I am executive director of the Western Power Trading Forum ("WPTF"). WPTF is a California non-profit, mutual benefit corporation. The membership of WPTF includes energy service providers, scheduling coordinators, generators, federal power agencies, municipal utilities and a power exchange, all of which are active participants in the restructured California electricity market. WPTF has a vital interest in the development of a competitive electric market and in the reduction of barriers that may exist in the structure of new markets. Please note that my testimony represents the sentiments of our organization as a whole and not the opinion of any individual member.

Our broadly based membership organization is dedicated to enhancing competition in Western electricity markets in order to minimize the cost of electricity to consumers throughout the region while maintaining the current high level of system reliability. WPTF actions are focused on supporting development of competitive electricity markets by developing uniform, non-discriminatory and practical operating rules that will promote efficiency, liquidity and transparency for participants in wholesale electric markets in the western region of the United States. WPTF pro-

vides a voice through which members can contribute to the development of viable and cohesive market structures throughout the region.

My purpose here is to express on behalf of my membership our regret and deep concern for the situation that brings us together today. Many of my members were disappointed and disheartened by the tone of the Enron memos. The nicknames used in the memos to describe different trading strategies are not standard industry terms. I have been in the power industry for more than 26 years, and have worked with power traders for more than five years, and the first time I ever heard or read those names to describe trading strategies was a week ago Monday when the memos were made public. It is very unfortunate that so many companies are being tainted by the actions of one.

Because WPTF is a trade association, and not a trading entity, I do not have information about any individual company's trading practices or strategies. Antitrust laws explicitly prohibit conversations about prices, the terms and conditions of service and individual trading strategies or practices and such conversations are banned when the WPTF membership meets or discusses issues. We work together, however, to analyze a wide range of technical and regulatory issues and present a common voice in regulatory proceedings in support of competitive markets.

I would like to make three points regarding the competitive process in wholesale power markets. First, since competition began in California in 1998, the average competitive wholesale power price is comparable to the California utilities' historical average cost for providing electric generation service. That comparability has occurred even with the scarcity and regulatory-induced price increases of 2000 and 2001. One might ask, so what does competition provide that tried and true cost-of-service regulation cannot, if the two indices are the same after four years? The answer is that each month the competitive price is falling as market prices continue to hover in a range that is less than half of the historical generation component of cost-based utility rates were, and approximately two-thirds below the regional price cap imposed by FERC last year. The wholesale power price index will soon be lower than the historical utility cost benchmark.

Second, competitive commodity markets move much faster than regulatory agencies in response to changing market conditions. The power markets were quick to respond when there was a supply shortage in the West and economic growth increased electricity demand. With such conditions in place, it was no surprise that power prices rose dramatically. People should also recognize, however, that prices under the competitive system were quick to fall, as they did a year ago, before FERC-mandated price caps were imposed in the region, and have remained at the lower levels for almost a year.

Third, it is important to understand that there is a clear distinction between the price arbitrage that is common to all commodity markets, which contributes to market efficiency and stability, and the type of behavior that artificially affects market stability and promotes market dysfunction. It is critical to develop rules that deal with the latter behavior and not the former. With respect to the business practices of the many companies that trade power, we generally agree on certain basic principles.

Trading organizations should not only follow the rules of the California ISO, but also abide by the spirit of what CAISO is trying to achieve. WPTF seeks and prefers market rules that are fair, reasonable, and give consumers confidence that they are receiving benefits from the change in the way power is provided to their homes and businesses. Finally, we note that all commodity exchanges in operation today have rules that guide trading behavior and that the California power market is no different in that respect.

However, it has been recognized for at least two years that there were flaws in the California market design. There have been efforts underway to correct these flaws, which were commenced well before the Enron memos were disclosed. The process is moving along to address and resolve these concerns. WPTF believes the FERC is doing everything it can to quickly uncover the deficiencies in the California market rules, and work with all parties to correct any apparent shortcomings. However, we note that it is important to focus on developing effective rules and not simply castigate those who abuse them.

Ultimately, our principal goal is to work with the California ISO and federal agencies to get California back on track. There is much to be done. Chief among these tasks is the need to cooperatively undertake a simplification of the market rules, especially those that affect trading, institute a system of regional (not state) oversight of market participant behavior and, equally important, re-establish the independence of the California ISO Governing Board. In its current form, the mix of state vs. federal interests is causing deep friction and impeding progress in getting

California's power markets on a better basis for consumers to enjoy the benefits of competition.

WPTF appreciates the opportunity to participate and hopefully contribute to the national dialogue regarding the structure and operation of our country's vital electricity markets. Our invitation to speak today included a request that we respond to certain questions. Our responses are provided below.

Are current disclosure rules sufficient to discover the kind of behavior referred to in the documents and if not, should disclosure rules be strengthened either by rule or statute?

We believe that FERC is on top of this issue and note that on April 24 it announced the replacement of a number of reporting filings with a quarterly electronic report. The FERC stated that this would equalize reporting requirements for both traditional utilities and power marketers, making information more easily available to the public. Moreover, the new reporting is designed to "provide greater price transparency, promote competition, enhance confidence in the fairness of the markets and provide a better means to detect and discourage discriminatory practices . . ."

Additionally, although the existing CAISO rules may be sufficient, the agency tasked with collecting the data and evaluating the same must continuously monitor the information. The information is too often unexamined until there is an official investigation in response to an event that is reported in the public media. The Enron memos in fact describe in detail the authority that the CAISO had, and still has within its tariff to address "gaming," and "anomalous market behavior."

WPTF supports the FERC efforts to enhance reporting and advocates that there should be an independent market monitor for all West-wide transactions. Market monitoring and enforcement is not solely a California concern. Experience demonstrates that the Western markets are interconnected and that consumers throughout the West will benefit from a West-wide approach to market monitoring and enforcement.

Are there behavior patterns that, in and of themselves, should be considered presumptively manipulative? If so, what kinds of behavior?

"Manipulative" is, of course, a term that is difficult to define. While it makes for dramatic headlines, it is not the firmest of foundations to use for making decisions about statutes or rules. The evaluation of arbitraging behavior as "manipulative" must be done in the context of the tariff that governs both the grid operator, and the market participants. The tariff, which is subject to FERC approval, must be precise in detailing what it considers to be acceptable versus unacceptable behavior. The activities in the Enron memos ranged from items that are routine and acceptable business practice to those that were ethically dubious (such as intentionally scheduling transactions that the company never had any intention of fulfilling). In fact, the failure to perform has explicit penalties in the CAISO tariff that would be incurred for such behavior.

As a bottom line, we believe the focus should be on getting the market rules right, based on benefit or harm to consumers and other market participants, and the needs of system operation. In any market, parties will try to operate within the rules by engaging in transactions that maximize their economic benefit. If their behavior exposes flaws in the rules, however, then the rules should, and must, be changed.

Are FERC's market rules sufficient to ensure that markets are not manipulated?

The FERC is in the process of developing a standard for market design. That standard will be publicly debated for several more months, and is expected to be approved by the Commission late this year or early next year. Until such time, existing competitive power markets operate under unique, highly detailed tariffs, protocols, and operating procedures. The tariffs are subject to FERC review and approval, whereas the protocols and operating procedures are filed with the Commission. We note that CAISO Governing Board has not been terribly cooperative with this process and in fact earlier this month, at FERC's express order, CAISO very reluctantly filed a proposed market-redesign plan described as "hypothetical." This type of behavior demonstrates a lack of commitment to the type of state-federal cooperation that is absolutely necessary to resolve these issues.

What actions are being taken to change the rules, if they are not now sufficient? Is further statutory authority necessary?

As noted above, redesign of the California market has been underway for two years now. CAISO was ordered by the Commission to submit a comprehensive market redesign, which was filed on May 1, 2002. While the form of the market design is not yet final, we anticipate that the redesign effort will lead to a market that benefits consumers by eliminating inappropriate incentives.

WPTF believes that in order to implement a proper market design, the basic governance structure of the CAISO needs to be reworked. The CAISO must become truly independent of all market participants, as are ISOs in other parts of the country, rather than an extension of the California state government, as it is now. In our February 21 filing at FERC this year, we wrote that, "Independent ISO governance has long been advocated by WPTF, and we believe it to be a prerequisite to the resolution of market design problems."

We describe in greater detail in response to the next question our concern with the lack of an appropriate governance structure for the CAISO, which has contributed mightily to the politicization and co-opting of the independence of that organization.

What is the division of responsibility for oversight between the CAISO and the Commission? Are those roles properly structured?

Thomas à Klempis once wrote that, "Man proposes, but God disposes." Not to impute divine insight to the FERC, nonetheless the proper division of responsibility here is for CAISO to propose oversight rules and to monitor performance and for the FERC to finalize such rules and direct how the markets will be overseen. FERC has a broader, national perspective and it properly seeks a national uniformity that is essential for an interstate market such as electricity. Indeed, as you know, individual state controls of interstate commerce run a serious risk of violating U.S. Constitutional protections.

The FERC has deliberated too long on the lack of independence of the CAISO Governing Board. WPTF has aggressively and repeatedly sought remedies to the violation of independence. Our organization filed comments at FERC on July 22 and September 7 of 1999, November 22, 2000, January 16, February 26, March 22, April 20, 2001, May 22, June 19 and October 29 of 2001, and January 18, February 21 and March 1 of this year, in which we stressed this point. In our most recent filing, on March 1 of this year, we commented on the retention of Vantage Consulting, Inc. to perform an Operational Audit of CAISO. It was a well-done report, and the conclusions confirmed many of the statements WPTF made to the Commission in previous filings. WPTF particularly supported the Audit's findings and recommendation to establish a new and independent Board of Governors, along with a formal Stakeholder Committee. In our comments filed less than three months ago, WPTF wrote that:

> The Operational Audit supports the conclusion reached long ago by most stakeholders, that is, the CAISO is in appearance and reality essentially an instrument of the State of California and, as such, fails to satisfy the core principal underlying the formation of both ISO's and RTOs—independence from market participants. Accordingly, the WPTF emphatically supports the auditor's recommendations to establish a new and independent Board of Governors, along with a formal Stakeholder Committee. Because other problems in California and throughout the West cannot be effectively and efficiently resolved until CAISO's governance problems are addressed, the WPTF respectfully urges the Commission to expeditiously develop and implement procedures to replace the existing, California-controlled BOG with an independent board as soon as possible.

We continue to urge that the FERC move forward on issues of independence and governance of CAISO. WPTF also urges CAISO and FERC to devote more time and effort to the creation and enforcement of market rules that ensure a fair and competitive market that results in the lowest prices for all consumers, both in California and the rest of our country. Moreover, as noted previously, the entire market monitoring function ought to be a West-wide function and not simply a California-only exercise.

Thank you very much for the opportunity to speak today with regard to these important issues.

The CHAIRMAN. Well, thank you very much.

I had hoped we would have Senator Cantwell here. She is not here, so why don't you go ahead, Ms. First.

STATEMENT OF CYNTHIA FIRST, COMMISSIONER, PUBLIC UTILITY DISTRICT NO. 1, SNOHOMISH COUNTY, WA

Ms. FIRST. Thank you, Senator. My name is Cynthia First. I am one of three elected commissioners for the Snohomish County PUD District No. 1 in Washington State. We are the second largest pub-

lic utility in the State. We are the 12th largest public utility in the United States, and we are Bonneville Power Administration's largest customer.

In 1936, the people voted to create us to give them cost-based public power. Our main goal is to be reliable. We rely on BPA for 80 percent of our load. 10 percent of our own generation, including the Henry M. Jackson hydroelectric plant. You may have heard of him. And 10 percent, we go to the market for the rest of our power.

For the first time in 5 decades of us being in service to our customers, our ability to provide low-cost, just and reasonable rates to our consumers has been compromised. Why has it been compromised? Because of the disintegration of the wholesale Western markets. And lest there be any question whether or not California's problems have affected us, they certainly have and I will share the reasons for that throughout my comments today.

We also attribute out inability to provide just and reasonable rates to our customers to FERC's unconscionable delay to fix the problem. We three commissioners had to raise rates 60 percent over the last 12 months even though our non-power costs have remained steady over the last 5 years. There is really nothing else to attribute this to except the market situation.

During the crisis period of May 2000 through June 2001, prices increased 5, 10, up to 100 times greater than the average in the region. I have also brought with me—if I could share this with you—just a brief chart showing you the price increases at the Mid-C, which is where we receive our power. This big spike in the middle is what happened in December of the year 2000. We can talk about 5, 10, 100 times an increase in power, but until you see it actually in arithmetic form, it is hard to imagine what we are talking about.

The analogy that I use when I talk to our customer-owners is that if you went to your gas station for gasoline today and it cost you $1.25 per gallon, and you went by tomorrow and it was $500 a gallon, that is about exactly what we are talking about.

Unfortunately, whereas we can decide to ride a bike or walk or carpool to work or to the store or something, we do not have the luxury with electricity. And we, as a publicly owned utility, do not have the luxury of deciding not to provide electricity to our customers. We have a legal obligation to serve. Unfortunately, we have a legal obligation to serve at any price.

BPA was hit by this problem that I just shown you. Because we buy 80 percent of our power from BPA, there was an indirect effect to us. As Senator Cantwell pointed out, BPA is talking about, in addition to an original 49 percent increase in their rates to us, another 11 percent in October.

But we were also affected directly with that 10 percent of our power we receive from the market. We had in December of 2000 no choice but to go to the market for some of our power. On December 22, we sent out 17 requests for proposals for a mere 100 megawatts of power. Out of those 17 requests that we sent out, we got three responses: one from Enron, one from American Electric Power, and one from Morgan Stanley. Together they barely offered us enough to meet the load that we needed to cover. The initial prices they offered were at 6 to 10 times the normal for the region.

None of those suppliers were willing to hold their prices long enough to have the contracts actually negotiated. In 1 day, one supplier added another 10 percent to its price, and the others increased their rates 12 to 15 percent over a 3-day period.

We had no choice but to sign the deals and enter into long-term contracts, which is, by the way, what the commissioners at FERC were requesting that we do, enter into long-term contracts, because we could not risk getting into the short-term market. Again, I want to remind you we have a legal commitment to serve and we have to serve at whatever price it is.

We similarly could not wait for FERC to act. At the time, in fact, FERC refused to act. Then FERC Chair Hebert issued his famously Antoinette-like pronouncement that Californians had to get out their shovels and start digging because generation was the only way that was going to help them.

As a result of the inaction by FERC, consistent with Senator Cantwell's chart, our customers have to pay $300 million more than what they would have paid if the market had remained the same as it has been for 19 of the last 20 years. $300 million. That comes out to $1,100 per household, and that is why we had to make a 60 percent rate increase.

If I might just give you a few examples of the impact this has had on our customers, I would like to do that. I have personally heard from hundreds of people about the devastating effects of the situation, and I am sure you all have your own horror stories. But while the voices of consumers are not often heard above the din of abstract policy debates in Washington, D.C., their cries for relief and their anger are very real. We have schools who are choosing between electricity and books. And I have included some of these letters in my packet to you. We have a mom who wrote to us. She has to choose between electricity and buying her senior daughter a prom dress. We have people at the AMPM's who will not serve our linemen because they are so angry. We have people who are threatening to throw their meters through our windows. We have elderly people who are choosing between medicine, food, and electricity.

We have violence threatened against us and our staff. Some of these letters are just enough to scare the tar out of you, and if you do not live with it every day, if you do not walk through the lobby and see those customer service reps doing their best to help these people while they are angry and screaming and crying and throwing things, it is something that you have to see. I will not go through the letters that we reported.

The net result, according to the *Wall Street Journal's* recent article, is that disposable income in Washington State is going to be cut by $1.7 billion over the next 3 years, and we are going to lose 43,000 jobs in our region. In our State, not just even in our region. In our State.

Three things in conclusion. We need greater market transparency to prevent the abuse of market power, and I will not go into that in great detail. Many of the speakers today have talked about the transparency that we need to have.

I want to just point out, though, that the objections that we received from marketers that they do not want their contracts being

made public contravenes their legal obligation to publicly report contract information under the Federal Power Act, section 205(c). Power marketers should not be able to write this provision out of the FPA and FERC should not let them do it.

Let us see. Second, FERC's market rules are obviously not sufficient to ensure that markets are not manipulated. But despite their apparent inability to restrain the market abuse, FERC is going forward with nationwide what they call standard market design and regional transmission organizations. They cannot get this right and they are going forward into two new, huge, complicated forays into national energy policy. They need to hold their horses, if you pardon the colloquialism, and get this right before they go forward with any other things. We have some discussions going on now about how in the Pacific Northwest especially—BPA presents us with a unique situation in terms of our transmission, and to include us in an RTO situation, like they are trying to do with the rest of the United States, is just not what we need to have happen.

Finally, a very gentle comment. Third, FERC needs to have more balance in its composition. There is no one on the Commission now that lives west of Texas, and in the last several decades, we have had no one west of the Rockies on FERC. So, when you are considering putting other people on FERC, filling potential vacancies, please consider putting somebody on from the West who understands hydro, who understands relicensing, who understands BPA, who understands California. That is very, very important.

We have yet to sort out what has happened to us. It seems to me that at a minimum, though, we need to learn our lessons before we go forward.

To follow up on Senator Cantwell's earlier analogy about we are being mugged and we do not have the cop on the block to stop what is happening to us, if FERC cannot do it, Congress needs to do it. We know who the robbers are in this situation. It is Enron. It is American Electric Power. It is Morgan Stanley, and we desperately need FERC to step in and help us stop the crime that is happening right under their noses.

Thank you very much for letting me go over my time. I appreciate it.

[The prepared statement of Ms. First follows:]

PREPARED STATEMENT OF CYNTHIA FIRST, COMMISSIONER, PUBLIC UTILITY DISTRICT NO. 1, SNOHOMISH COUNTY, WA

Good afternoon and thank you for the opportunity to appear before you today. I am Cynthia First, Commissioner of Public Utility District No. 1 of Snohomish County, Washington (the "District"). As on of the three elected representatives of the electric ratepayers of Snohomish County, I would like to, first, describe to you the devastating effect the dysfunctions the Western wholesale power markets have had on the consumers of Snohomish County and, second, explain our deep and continuing concern that the Federal Energy Regulatory Commission's ("FERC") rules on disclosure and market design are not adequate to ensure there is no repeat of the disaster of 2000-01. Our skepticism is only deepened by recent revelations demonstrating that FERC knew as early as 1999 of the kinds of abuses detailed in the recently-revealed Enron memos yet turned a blind eye for two years while consumer losses in the West mounted into the tens of billions of dollars and tens of thousands were thrown out of work.[1] FERC continues to engage in the kind of large-scale ex-

[1] Bob Keefe, "Federal Power Regulators Were Told of Price Schemes in 1999," Cox News Service, May 11, 2002.

perimentation, like California's failed experiment in deregulation, that may go rapidly and drastically wrong, with economically and socially devastating consequences. Its inability or unwillingness to police and remedy fundamental abuses of market rules despite its apparently detailed knowledge of those abuses has caused the consumers I represent to call into question whether FERC can be trusted to protect consumers from the kinds of rampant abuse that occurred in California and that wrought havoc across the West.

ABOUT SNOHOMISH COUNTY PUD

Snohomish County PUD was formed by a vote of the people of Snohomish County in 1936 based upon the promise of a cost-based, publicly-owned electric power system. The District is the second-largest publicly-owned utility in Washington State and the nation's 12th largest publicly-owned utility. We serve approximately 270,000 homes, businesses, and schools over a system encompassing 5,323 miles of electric lines and a service area of 2,200 square miles in Snohomish County and on neighboring Camano Island, which is just north of Seattle.

In the more than five decades since the District has operated as an electric utility, the District has consistently delivered on the promise of cost-based, publicly-owned power, providing its citizens-owners with highly reliable service at rates among the lowest in the country. Our ability to continue to provide reliable and inexpensive service, however, has been compromised by the disintegration of the Western wholesale power markets and by FERC's unconscionable delay in acting to correct a fundamentally dysfunctional market. Because of the Western wholesale power market dysfunction, Snohomish has been forced to raise its retail rates nearly 60% despite holding its non-power costs steady. I have attached as Exhibit A[1a] a chart showing the drastic price increases Enron-style abuses caused in the Western wholesale power markets.

THE WESTERN POWER CRISIS AND SNOHOMISH PUD

As a consumer-owned utility, the District is exempt from FERC jurisdiction. Nonetheless, the District is dependent upon effective FERC regulation of interstate transmission and the wholesale power markets because it depends upon generation resources remote from the county for approximately 90% of its supply. Specifically, we must purchase power directly on the wholesale market to cover the difference between our loads, the power we receive from the Bonneville Power Administration ("BPA"), and our own generation located at the Henry M. Jackson Hydroelectric Project in Snohomish County. Currently, about 80% of our power supply comes from BPA, but we are indirectly dependent on the wholesale markets because BPA must purchase power on the markets to cover the difference between what it can generate from its own resources and its commitments to serve Northwest loads. The District and its customers have been drastically affected by the persistent crisis in Western electricity markets, and we are concerned that FERC's current policy direction may portend further drastic disruptions in our ability to serve our load economically and reliably.

It has now become clear that a combination of withholding of generation to drive up market prices in California, combined with strategic "gaming" of the market rules in California, drove electric prices into the stratosphere, not only in California but also in markets across the West that are interconnected with California, including the Pacific Northwest. In the Pacific Northwest, during the "crisis period" from May 2000 to June 2001, prices on both the short-term and long-term markets were regularly five to ten, and at times 100 times above the long-term historical average in the region. Specifically, wholesale power prices in the Pacific Northwest historically have averaged about $24 per MWh and since FERC's belated intervention in mid-2001, prices have returned to near the historical average. However, during the crisis period, prices for short-term power in the Pacific Northwest were regularly above $100/MWh and at times reached $500/MWh. In the first two weeks of December, spot prices increased to stratospheric levels. For several days the price hovered around $1000/MWh. Spot prices during that period as recorded by Dow Jones reached as high as $3300/1VlWh. In fact, during much of late 2000 and early 2001, spot market prices in the Pacific Northwest were the highest in the country, turning the historical pattern on its head.[2] This would be like finding that the price of gasoline at your local service station went overnight from $1.25 per gallon to $5 per gallon, then to $25 per gallon, and then to $50 per gallon. As a load-serving entity, Snohomish is unlike an ordinary consumer of gasoline because we cannot simply

[1a] Attachments A, B, and C have been retained in committee files.
[2] Hal Bernton, "NW Utilities Get Socked the Hardest," *Seattle Times, (Apr. 13, 2001).*

choose to walk or ride a bike when prices get too high. We have a legal obligation to ensure an adequate power supply to serve our customers. Accordingly, we cannot simply say "no" even when the prices demanded by power marketers like Enron are outrageous, as they were during the 2000-01 crisis period.

There is no real question that the 2000-01 power market crisis was caused by strategic withholding of power supplies and abuse of market power rules. The power marketing lobby has often blamed the huge price increases and market instability on shortages of power caused by a drought in the Pacific Northwest and lack of generation supply in California. Recent evidence demonstrates that this explanation simply does not wash. A paper published by Northwest energy economist Robert McCullough in April demonstrates that power supplies were in fact better during the crisis period than during previous droughts in the West. Indeed, the crisis began in 2000, during an ordinary water year, and ended promptly with FERC's price cap and "must-run" orders in June 2001, even thought the Pacific Northwest was in the midst of the second-worse drought ever recorded.[3]

A recent study by economists Paul Joskow and Edward Kahn examines each of the causes for high prices that have been identified—high gas costs, pollution control costs, etc.—and concludes that the huge run-up in prices during the summer of 2000 cannot be explained by these "market fundamentals." On the contrary, the study concludes, "The evidence that there was a significant market power effect reflected in market prices in California during Summer 2000 is overwhelming. Indeed, no comprehensive studies exist that come to a different conclusion."[4]

Even in the midst of the crisis period, there was solid evidence of market power abuse and gaming of market rules. In May 2001, a group of ten of the nation's leading. economists, including Dr. Alfred Kahn, father of the deregulation movement, and nine economists with direct involvement in the California market experiment, wrote a letter to the President, Congress and FERC explaining that:

> Numerous . . . studies based on actual market behavior and performance have identified a number of serious problems of market design, supplier behavior, and market performance that were not anticipated or considered in FERC's initial market-structure screens. . . . We cannot expect a market to operate to benefit consumers or for the resulting wholesale prices to satisfy the requirements of the Federal Power Act if effective competition does not exist. . . . California's markets are not characterized by effective competition.[5]

The extent of the market dysfunction was confirmed by the Commission's own staff in a recent report to Congress, which noted that after the market dysfunctions in California occurred, "energy prices in the long-term, short-term and spot markets were high throughout the [Western] region."[6]

The internal Enron memos not only confirm this evidence, but provide the "smoking gun" to demonstrate how market power and market rules were abused. The memos also show whose hands held the smoking gun—power marketers like Enron. The memos explain in some detail the strategies used by Enron, such is "inc-ing," which the memo defines as "artificially increas[ing] the load on the schedule submitted to the ISO" so that the ISO would pay Enron an artificially inflated price for the excess of generation over scheduled load on the real-time market.[7] Another strategy "used by Enron's traders is to relieve system-wide congestion in the real-time market, *which congestion was created by Enron's traders in the PX's Day Ahead Market. . . . Because the congestion charges have been as high as $750/MW, it can often be profitable to sell power at a loss simply to collect the congestion payment.*"[8]

Enron developed a number of these strategies to game California's market rules, many with colorful nicknames like "Fat Boy" and "Death Star."[9] The common elements of each strategy, apart from their deviousness, were to game the California market rules to artificially inflate prices while delivering little or nothing of value to the Western electric system. The memo describes the "Death Star" strategy, for example, as "earn[ing] money by scheduling transmission in the opposite direction

---

[3] Robert McCullough, "Revisiting California," Pub. Utils. Fortnightly, April 1, 2002.

[4] Paul Joskow & Edward Kahn, "A Quantitative Analysis of Pricing Behavior In California's Wholesale Electricity Market During Summer 2000: The Final Word," Feb. 4, 2002 (available at http://econ-www.mit.edu/faculty/pjoskow/papers.htm).

[5] Letter from Dr. Roger Bohn et al. to President George W. Bush et al., May 25, 2001, at 2 (emphasis in orig.) (Exhibit B).

[6] "The Economic Impacts on Western Utilities and Ratepayers of Price Caps on Spot Market Sales," FERC Staff Report to the United States Congress, at 14 (Jan. 31, 2002).

[7] *Id.* at 1-2.

[8] *Id.* at 3 (emphasis added).

[9] *Id.* at 3-6.

of congestion . . . and then collecting the congestion payments. *No energy, however, is actually put onto the grid or taken off . . . The net effect of these transactions is that Enron gets paid for moving energy to relieve congestion without actually moving any energy or relieving any congestion.*" [10] Other strategies involved not just gaming of market rules, but outright fraud. The memo states that, for the "Get Shorty" strategy (i.e., selling ancillary services into the day-ahead market, then cancelling the commitment and buying ancillary services in the real-time market) to work, "*it is necessary to submit false information that purports to identify, the source of the ancillary services.*" [11] In fact, these gaming strategies became so sophisticated that Enron's traders were able to anticipate how other market participants would game the market and take advantage of those strategies to further enhance the profits from their own gaming:

> The traders were able to anticipate when the dec price will be favorable by comparing the ISO's forecasts with their own. When the traders believe that the ISO's forecast underestimates the expected load, they will inc load into the real time market because they know the market will be short, causing a favorable movement in real-time ex post prices. Of course, the much-criticized strategy of California's investor-owned utilities ("IOUs") of underscheduling load in the day-ahead market has contributed to the real-time market being short. The traders have learned to build such underscheduling into their models, as well.[12]

The memo leaves little doubt that the effect of these gaming strategies was to artificially inflate market prices. In describing the "Load Shift" strategy, for example, the memo states that "by knowingly increasing the congestion costs, Enron is effectively increasing the costs to all market participants in the real time market." [13] The memo further makes clear that many other traders were using the same or similar tactics to game the California market. The memo reports, for example, that the "incing" strategy "is the 'oldest trick in the book' and, according to several traders, it is now being used by other market participants." [14] Similarly, with respect to the strategy of selling non-firm energy as firm, "[t]he traders claim that 'everybody does this.'" [15] In fact, gaming was so widespread, according to the memo, that "Enron's traders have used these nicknames with traders from other companies to identify these strategies." [16] One experienced energy trader reported that pressures to create profits were so intense that "if you didn't manipulate the market and manipulation was accessible to you, that's when you were yelled at." [17] In fact, in an article in this past Sunday's New York Times, the Director of Market Analysis for the California ISO reports that traders continue to exploit loopholes in the California rules: "They keep testing us any way they can, in big ways and small . . . Unless we are more diligent, we could have the same kind of crisis all over again." [18] The article reports that regulators in deregulated markets around the country complain that "they still lack the tools to properly manage competitive power markets" and that schemes similar to those employed by Enron "remain in wide use, because energy markets remain flawed." [19]

Nor was the damage inflicted by the schemes concocted by Enron to game the California market confined to California's borders. The memo explains how Enron, for example, shipped power out of California to escape prices caps that were in place in California.[20] Likewise, the "Death Star" strategy exploited transmission constraints arising from lines connecting the Southwest and Northwest to California to collect counter-scheduling payments without ever actually either moving energy or

---

[10] *Id.* at 4-5 (emphasis added).
[11] *Id.* at 6 (emphasis added).
[12] *Id.* at 2.
[13] *Id.* at 5. The memo notes that Enron's profits in FY 2000 were increased by approximately $30 million by using the "Load Shift" strategy.
[14] *Id.* at 1.
[15] *Id.* at 7.
[16] *Id.* at 3.
[17] Joseph Kahn, "Californians Call Enron Documents the Smoking Gun," New York Times, May 8, 2002 (quoting R. Martin Chavez, former head of risk management in energy trading at Goldman, Sachs).
[18] Joseph Kahn, "With Markets Flawed, Enron's Tactics May Live On," New York Times, May 12, 2002 (quoting Anjali Sheffrin, Director of Market Analysis, California ISO).
[19] *Id.*
[20] *Id.* at 3. Interestingly, Enron saw no problem with this strategy "other than a public relations risk arising from the fact that such exports may have contributed to California's declaration of a Stage 2 emergency." *Id.*

relieving transmission constraints.[21] As noted above, the gaming and abuse of market power rules in California produced startling results both in California and in the Pacific Northwest. In short, the recently-revealed Enron memo reveals how Enron and other power marketers were able to abuse the rules of California's restructured market to create the appearance of a shortage and to artificially inflate market prices.

The severe market dysfunction in California, and the spill-over effect of that dysfunction in the Pacific Northwest, has forced utilities across the region to drastically increase retail rates. For utilities like Snohomish, which rely heavily on BPA for their power supply, BPA's wholesale rates have reached historic highs because BPA was forced to purchase large amounts of power to supplement its base supply at a time when the wholesale markets across the West were severely dysfunctional. Indeed, in late 2001, BPA predicted its rates could increase by as much as 400% because of the costs of purchasing overpriced supplemental power. Only extreme and heroic, and in many cases economically damaging, efforts across the region to reduce the electric load placed on BPA prevented triple-digit rate increases. Even with these extreme measures, BPA was forced to implement a 46% rate increase on October 1, 2001. In the absence of the Western wholesale power crisis, its rates would have remained essentially unchanged.

The Westwide market dysfunction also drastically impaired Snohomish's ability to obtain power on reasonable terms during the crisis period. In fact, Snohomish had no real choice of suppliers and had to take power on the terms offered by those suppliers, including Enron, or else risk being unable to serve its load. Snohomish could not continue to rely on short-term purchases to fill its needs. Any question about the risk of continued reliance on the short-term market for even a small amount of power was erased after the severe price spike experienced in December 2000. During that episode, it became clear that attempting to meet Snohomish's load during a similar cold-weather episode could result in a power cost increase in the range of $25 million for only a few days' worth of power, potentially wiping out Snohomish's rate stabilization fund, threatening its financial position with respect to its bond holders, and forcing large and unpredictable rate increases on its customers.

Nor did Snohomish have any real choice in terms of the power suppliers. Following a strategy urged by FERC, after the huge price spike experienced in Western spot markets in December 2000, Snohomish quickly moved to fill out its supply portfolio with long-term contracts. On December 22, 2000, Snohomish issued a Request For Proposals ("RIP") to 17 potential sellers seeking up to 100 MW of power. Only three parties, Enron, Morgan Stanley Capital Group, and American Electric Power Corp., were willing to sell power to Snohomish in the shape and time frame needed during 2001, and, taken together, the amount of power these parties were willing to sell Snohomish was barely enough to meet our needs. Thus, to obtain enough power to meet the needs of its customers and maintain reliable service, Snohomish was forced to contract with all three parties.

The course of negotiation with respect to the price term similarly demonstrates the seventy of the market dysfunction that occurred at the time and the almost complete lack of bargaining leverage suffered by Snohomish. The prices initially offered by the suppliers were extremely high, in the range of six to ten times the long-term average for the region. Arid yet none of the three bidders were willing to hold their initial price offer even for long enough to contracts to be negotiated. In the space of a single day, one supplier ratcheted the already-exorbitant price term of its initial offer more than 10%. Similarly, the available pace offers from other suppliers were ratcheted up 12-15% over the course of a few days. Snohomish had no choice but to take these offers because there were no alternative suppliers at any price and Snohomish could not risk either continued reliance on the wildly dysfunctional spot market. Nor could it risk being unable to meet its legal commitment to serve its native load.

Nor could Snohomish wait for FERC to take meaningful action to correct the pervasive dysfunction of the Western electric markets. Even a single additional surge in the short term markets could have devastated Snohomish financially. Yet, at the time Snohomish entered these contracts, it was clear that FERC intended to take no meaningful action to reign in the runaway West Coast markets or to correct the structural flaws in the California market that were at the root of the West Coast crisis.[22] Indeed, that policy was directed from the highest levels of the federal gov-

[21] *Id.* at 4-5.

[22] Al Gibbs, "Analysis: Bush Offered Almost No Help to Public Power During Energy Crisis," Tacoma News-Tribune, April 1, 2002 ("I . . . walked out of that room with the message: 'Don't

ernment: "Throughout California's energy crisis last year, President Bush and Vice President Dick Cheney strongly opposed any government interventions or price controls intended to rein in the surging costs of electricity."[23] That policy was confirmed only a few days after the three contracts were signed, when then-FERC Chairman Hebert issued his famously Antoinette-like pronouncement that Californians ought to "get out their shovels and start digging" because building new plants was the only way out of the crisis.

FERC Commissioner William Massey's recently captured how the dire circumstances of Western wholesale power crisis of 2000-01 made it difficult or impossible to negotiate power supply contracts on reasonable terms:

> The atmosphere in which these contracts were negotiated was unprecedented. The California spot markets were out of control—this Commission declared them dysfunctional—and they were driving prices throughout the West. There was an urgent need to get load off of the spot market and into forward contracts. Yet it must have been extraordinarily difficult for the contracting parties to negotiate long-term contracts under these circumstances. After all, the most influential benchmark in negotiating forward contracts—the spot market and expectation of future spot prices—was wildly dysfunctional. The Commission has explicitly recognized this critical relationship. In the AEP Power Marketing order issued just last Fall, we recognized that 'maintaining an accurately priced spot market is the single most important element for disciplining longer term transactions.' Yet this single most important element was out of control when the contracts at issue were negotiated. Unfortunately, this agency failed to intervene forcefully and effectively until June 20, 2001, more than a full year after the market dysfunction began.[24]

In sum, the Western power crisis of 2000-01 forced huge rate increases on Snohomish and its customer-ratepayers. As we detail in the next section, the results of these rate increases were devastating economically, socially, and personally to hundreds of thousands of citizens in our county and to millions of citizens across the West.

CONSUMERS IN SNOHOMISH COUNTY AND ACROSS THE WEST HAVE BEEN DEVASTATED BY THE WESTERN MARKET CRISIS

I have heard personally from hundreds of citizens in Snohomish County about the devastating effects of the rate increases we have been forced to impose on them by the Western wholesale power crisis. I have attached hereto a few of the hundreds of letters we have received. Some of these letters are from senior citizens, low-income citizens, and others living on fixed incomes who have been pushed to the brink of poverty by high electric bills. Regrettably, threats of violence against our employees and facilities have become common. I attach, as well, a few examples of the threats we have received. While the voices of consumers are not often heard above the din of abstract policy debates in Washington, D.C., their cries for relief and their anger are very real, as the following excerpts from local newspapers illustrate:

Snohomish Co. utility discusses lowering rates, Seattle Post—Intelligence Reporter (March 6, 2002)

> Like a lot of people north of Seattle this year, Linda Harrison and her family are having a rough go. Her husband, a computer technician at the Everett Boeing plant, was laid off last Friday. Her 84-year-old mother is entering the early stages of Alzheimer's. Then came the blow she didn't expect—the power bills. The two-month tab for her mother's modest, double-wide home in south Everett shot up to $747 this winter. That's three-quarters of the woman's monthly Social Security check and 66 percent more than her normal bill from last winter.

The "immoral" cost of energy, Everett Herald, Local News (April 20, 2001)

---

count on this administration to help out with your current crisis,'" [Seattle City Light Superintendent Gary] Zarker said. "You'll get no cap or intervention").

[23] Don Van Natta, Jr., "Bush's California Energy Stance Faulted," New York Times, May 8, 2002.

[24] *Nevada Power Co. et al.*, 99 FERC ¶61,047 (2002) (Comm'r Massey, concurring in part, dissenting in part) (footnote omitted). *See also GWF Energy, LLC*, 98 FERC ¶61,330 (2002) (Comm'r Massey, dissenting in part) ("It is a well accepted maxim that a good spot market will discipline the forward market. Indeed, the Commission expressly recognized and accepted this relationship in a recent order . . . By the Commission's own clear findings, the spot market conditions needed for disciplining the longer term contract prices were not present in the California market").

The Edmonds School District's Energy costs have climbed from $400,000 last year to $600,000 this year. That $600,000 would pay for 10 or 12 teachers, says district budget and finance chief Bill McKeighen. Or 28 teachers aids. Or half of the district's interscholastic sports program. Or all of this year's textbook allotment. So how do you choose between books and heat? Asked William Massey, a member of the Federal Energy Regulatory Commission. "That's an impossible choice," he added. It's probably going to mean staff cuts, McKeighen replied. "We could not just not buy textbooks." The exchange came Thursday at a forum on federal power policy sponsored by U.S. Rep. Jay Inslee at the Snohomish County PUD auditorium in Everett.

Most, including Inslee and Gov. Gary Locke, called for some sort of power price cap. "This is not an abstraction, some kind of economic theory or bar graph," Locke said. "These people are living the energy crisis every day." Massey agreed.

"I see no reason to protect a dysfunctional market when this dysfunctional market is putting people out of work," [Massey] said following the forum. "I was moved by the testimony I heard from real people, real businesses."

One of the real people to speak Thursday was Don Paterson of Bellingham, who lost his job when Georgia Pacific closed its pulp and chemical mill there. Georgia Pacific historically had paid 4 to 5 cents a kilowatt-hour for electricity, he said. "When it jumped up to 4 to 5 dollars, they shut the door."

Soaring power costs cut into first-quarter profits by 20 percent, said Diane Symms, owner of the Lombardi's Cucina restaurant in Everett—even though the staff has cut energy use as much as 15 percent. They've done all they can do to conserve power, Symms told a forum on federal energy policy Thursday. But a restaurant has to cook and boil water, and that requires natural gas. And food has to be refrigerated, and that requires electricity. So in response, Symms said, she's cut her restaurant hours, and cut back on staff. "We suspect we're going to have to do more of that to keep the business open."

Struggling to keep heat, lights on: Calls swamp energy assistance offices, Seattle Times, Local News (December 21, 2001)

Caseworkers say they're hearing from people who are returning Christmas presents, borrowing money from relatives and selling their cars to keep the heat on. One Snohomish County woman burned cardboard boxes in her wood-burning stove for heat when she ran out of money for wood. Seniors on fixed incomes are particularly squeezed. An elderly woman with health problems called a Snohomish County aid program after setting her heat at 60 degrees and putting on three pairs of overalls and two sweaters to keep warm

---

People who run utility-assistance programs say they're worried about the spring. "I can guarantee you we'll run out sooner this year because of Boeing," which is still in the process of laying off thousands of workers, said Dennis Smedsrud, who oversees PSE's Warm Home Fund. Bill Beuscher, who runs Snohomish County's federal energy-assistance program, said he's likely to be out of funds by the end March, right before what may be his program's busiest week.

Kimberly Clark facing huge hike in PUD rates, Everett Herald (September 29, 2001)

For residential customers of Snohomish County PUD, electricity costs will climb 18 percent starting Monday. But for Kimberly-Clark Corp., a major employer in the county and a major PUD customer, power costs will rise more than four times that amount, or 75 percent. "It's a matter of huge con-

> cern and priority," said Scott Felter, manager of Kimberly-Clark's Everett pulp mill, earlier this week. Felter and Dave Faddis, general manager of Kimberly Clark's waterfront pulp and tissue mills, knew a significant rate increase was on the way. The operation had long had a negotiated agreement for lower rates, but that's expiring. But the increase was larger than expected and will cost the company millions of dollars at a time when it's looking to trim costs as much as possible to remain competitive.

In aggregate terms, as well as in individual terms, rapidly escalating electric rates have caused severe harm across the Pacific Northwest. The *Wall Street Journal* has estimated that, as a result of the Western energy crisis, disposable household income in Washington State will be cut by $1.7 billion and 43,000 jobs will be lost over the next three years.[25]

Put another way, "If FERC had intervened in May 2000, the entire crisis might well have been avoided. . . . [T]he bankruptcy of Pacific Gas & Electric and the closure of industries from Arizona to British Columbia could have been avoided, and thousands of jobs could have been preserved."[26]

This economic devastation is traceable directly to the excessive electric prices arising from the Western wholesale power crisis of 2000-01. Snohomish PUD has held its non-power costs steady, below the rate of inflation, for several years. Yet the rapid rise in wholesale power costs since 2000 has forced it to raise its rates by an aggregate of nearly 60% since the end of 2000.

GREATER MARKET TRANSPARENCY IS KEY TO PREVENTING ABUSE OF MARKET POWER AND GAMING OF MARKET RULES

One key factor that allowed the abuse of market power and the abuse of market rules to go on for so long was that the wholesale power markets have operated under a cloak of secrecy woven from contractual and industry rules that make virtually any market information subject to confidentiality rules. Indeed, as Northwest energy economist Robert McCullough recently wrote, one reason dysfunctions in the Western wholesale power markets reached such serious levels is that "the aggressive use of confidentiality agreements" kept critical market data "out of the hands of the public, the press, and policy makers."[27] Overly broad claims of confidentiality facilitate the ability of power marketers to manipulate prices and impose unjust and unreasonable terms of service on consumers by hiding critical facts from regulators and denying consumers access to meaningful information about their power supply transactions. Again in the words of Robert McCullough, such secrecy rules are "an incentive for abuse."[28]

In recent testimony before this Committee, Mr. McCullough similarly stated that: "Restriction of market information weakened the negotiating position of consumers and made high prices far more likely in these markets. Even today, weak reporting of marketers to FERC and restrictive information rules by ISOs make concentration and abuse in market hubs difficult to monitor."[29] In the absence of "open information" for consumers and policymakers, "market failures are easily disguised and corrective measures are painfully delayed."[30] Simply put, consumers and regulators—such as FERC—cannot effectively detect and correct abuses by marketers if marketers are allowed to function under a cloak of secrecy.

Indeed, as FERC itself has recognized, "[p]ublic reports [of price and revenue data] are likely to result in increased competition in the marketplace."[31] As the Commission also has ruled, public availability of price data is "essential to enable the Commission . . . and the public to detect undue discrimination . . ."[32] In the Commission's own words, access to price data should not be limited to only the Commission staff because "fellow [market] participants and other interested parties are best situated as competitors and customers . . . to identify actual discriminatory practices."[33] Particularly when a seller is a power marketer, like Enron, the Commission "and other interested parties" need access to contract information to detect

---

[25] "Rising Energy Prices Could Tip Washington Toward a Recession," *Wall Street Journal*, March 13, 2001.
[26] Robert McCullough, "Revisiting California," Pub. Utils. Fortnightly, April 1, 2002, at 36.
[27] *Id.*
[28] Testimony of Robert McCullough Before the Subcommittee on Energy and Air Quality of the House Committee on Energy and Commerce (Feb. 13, 2002).
[29] Testimony of Robert McCullough Before the Senate Committee on Energy and Natural Resources (Jan. 29, 2002).
[30] *Id.*
[31] *Western System Power Pool*, 64 FERC ¶61,063, at 61,603 (1993) (emphasis in original).
[32] *Id.* at 61,604.
[33] *Id.*

abuses of market power because the means by which power marketers acquire and exercise market power is through their purchase and sales contracts.[34]

Power marketers have insisted on confidential treatment of their contract information on what we believe to be a flimsy basis—that disclosure of contract information after the contract is signed might somehow prove harmful to competition by allowing power marketing competitors to "reverse engineer" the proprietary pricing models used by such marketers. In fact, because of the many different elements of such pricing models, this is unlikely to be so. In fact, the courts have rejected such claims, concluding that proprietary information is unlikely to be gleaned from contracts in analogous circumstances.[35]

Indeed, a U.S. Department of Energy Office administrative hearings board recently rejected just such a claim by the Bonneville Power Administration ("BPA"). That panel found that the "[c]onclusory and generalized allegations of substantial competitive harm" frequently voiced by power marketers "are unacceptable and cannot support" the withholding of such information.[36] The panel further observed that "Courts have traditionally viewed with great skepticism the claim that the release of past pricing and quantity data would allow competitors to predict an entity's future pricing strategy."[37] Hence, the Board concluded, BPA "has not shown how its customers' competitors could use past pricing and quantity information to predict BPA's future offering prices for resales of electric power or for sales and goods and services produced with the electric power purchased from BPA."[38]

The power marketers' assertions of confidentiality in fact contravene their legal obligation to publicly report contract information under the Federal Power Act ("FPA"). Section 205(c) of the FPA requires all public utilities, including power marketers, "to file with the Commission for public inspection all rates, charges classifications, and practices, as well as any contracts that affect or relate to such rates, charges, classifications, and practices."[39] Power marketers should not be allowed to write this provision out of the FPA through contractual language and administrative acquiescence by FERC.

THE COMMITTEE SHOULD INSIST ON ADMINISTRATIVE RULES THAT GUARANTEE TRANSPARENT MARKETS

In light of the above discussion, Snohomish would like to provide its answers to the questions posed by the Committee in it letters of invitation to the PUD to testify:

1. Are current disclosure rules sufficient to discover the kind of behavior referred to in the documents and if not, should disclosure rules be strengthened either by rule or statute?

The most urgent reform FERC ought to undertake is to immediately make all critical contract terms (price, length of contract, and quantity) at issue in its Enron investigation, as well as critical underlying documents such as internal Enron memoranda, immediately public. The pall cast upon those contracts by the recent revelations of Enron's systematic abuse of market rules removes any justification for keeping those contract terms confidential. Further, the most recent contracts at issue in the FERC investigation are nearly a year old and there is no reasonable argument that any meaningful proprietary information will be revealed by disclosure of such stale contracts, especially in light of the fundamental changes that have occurred in the Western power markets since that time.

In addition, we believe that FERC's market disclosure rules must be significantly strengthened. As noted above, Enron and other power marketers have used contractual confidentiality provisions aggressively to make sure critical market information does not become public, which has crippled the ability of both government regulators and power purchasers to detect market power abuse and gaming of market rules. It is therefore essential for power market information to be readily available. We believe that all power marketers and generators should be required to file a publicly available report with FERC at least quarterly identifying all final power sales trans-

---

[34] *Citizens Power & Light Corporation*, 48 FERC ¶61,210, at 61,778 (1989).

[35] *GC Micro Corp.*, 33 F.3d at 1114-15 (contract price term is "made up of too many fluctuating variables for competitors to gain any advantage from the disclosure"); Acumenics Research & Technology v. U.S. Dept. of Justice, 843 F.2d 800, 807-08 (4th Cir. 1988) (same).

[36] *Id.*, slip op. at 3. *See also id.* at 5 (noting that privilege for commercial information ordinarily ends once process of awarding a contract is concluded).

[37] *Id.*

[38] *Id.* at 3.

[39] *National Electric Associates Limited Partnership*, 50 FERC ¶61,378, at 62,157 n.15 (1990)(citing 16 U.S.C. §824d(c)(1988)).

actions entered into during that quarter, and the critical terms of those sales—price, contract quantity, contract terms, market hubs, receipt and delivery points—should be disclosed in a uniform, meaningful, and easily accessible format. While FERC has recently issued rules tightening up on power market disclosure requirements, we believe disclosure rules contain significant loopholes that must be closed. For example, FERC's rules do not require the disclosure of long-term contracts. While we recognize that the terms of offers must be remain confidential during the process of power contract negotiations to prevent collusion and manipulation, once the contract is signed, there is no good reason to prevent disclosure of critical contract terms. Indeed, consumer-owned utilities such as Snohomish operate under public disclosure statutes that ordinarily require all contracts to be public once the negotiation process has concluded.

2. Are there behavior patterns that, in and of themselves, should be considered presumptively manipulative? If so, what kind of behavior?

The most destructive behavior that occurred in the California market was economic withholding of power; that is, the intentional withholding of power to artificially drive up market prices. In addition, the recently-revealed Enron memo lays out a number of different strategies used to game the California market to artificially enrich power marketers at the expense of consumers. The common elements of these behaviors, besides their deviousness, was the fact that Enron was able to profit while providing little or nothing of value to the system. These types of behaviors must be outlawed, those guilty of such abuses should be punished, and remedies to consumers who suffer because of such abuses must be assured of effective remedies.

3. Are FERC's market rules sufficient to ensure that markets are not manipulated?

No. There are credible charges of market manipulation in every market where deregulation has been tried, including FERC's current "poster children" for deregulation, ERCOT in Texas and the PJM Interconnection in the mid-Atlantic. Despite the apparent inability to restrain these kinds of market abuse, FERC is plunging ahead with a nationwide "Standard Market Design" and with Regional Transmission Organizations, both of which entail a large, complex, and convoluted system of market rules—a playground for marketers to devise new strategies for abuse of these rules. FERC should immediately suspend these rulemaking initiatives and should not continue with them until it has satisfied itself, this Committee, and Congress that it has workable rules in place that will prevent the kinds of abuse that occurred in California, Texas, PJM, England, New Zealand, and numerous other jurisdictions around the world that have attempted to implement new rules for the power markets.

4. What actions are being taken to change the rules, if they are not now sufficient? Is further statutory authority necessary?

Apart from a recent order tightening somewhat the rules for disclosure and the current investigation of California market power abuse, in our view FERC is doing little to ensure that the kinds of rampant abuse of market rules that occurred in California does not occur elsewhere. In fact, as noted above, FERC is moving in the wrong direction by attempting to institute national rules of the kind that were so skillfully manipulated by Enron and other power marketers in California. In our view, FERC has adequate statutory authority to prevent these kinds of abuse, but if it refuses to exercise that authority, or to provide adequate remedies to protect electric consumers. If FERC refuses to fulfill its Congressionally-mandated mission to protect electric consumers, Congress should not hesitate to mandate appropriate rules.

In addition to the actions recommended above, two other actions would be helpful in our view. The first is that the Commission should have more balance in its composition. FERC has been without a representative from the Western United States for decades. This has resulted in an institutional lack of knowledge about the Western power system, which has, evidenced itself most recently in Standard Market Design and Regional Transmission Organization rulemakings that threaten many of the unique aspects of the Pacific Northwest electric system, such as the predominance of hydroelectric power, coordinated operation of the Columbia River system, and long distances between generation supply and load. The value of more diversity in the Commission is also important with regard to other matters at FERC, such as hydroelectric facility licensing and relicensing. The majority of the hydroelectric capacity that is coming up for relicensing in the next several years is located in the West. The Commission today has no members from west of the Rocky Mountains, as has been the case for many years, and the new nominee is similarly from the East. Representation of the Western United States at FERC is long overdue.

We also strongly recommend that FERC slow down its sprint toward implementing Standard Market Design policies and the forced formation of Regional Transmission Organizations. These policies are generally intended to further open markets and encourage competition. We have no quarrel with open markets and competition per se, but it occurs to us that we ought to understand how to effectively operate open markets and ensure fair and transparent competition before we throw yet another round of free market ideology onto American consumers and the American energy system. Further, as noted above, FERC seems intent on implementing these policies in the Pacific Northwest with very little knowledge of those policies will affect the unique operations of the Northwest's electric system and, worse, little apparent inclination to learn.

We have yet to sort out the disastrous impacts of the last round of "market design" and to sort out the lessons learned from those mistakes that were made in the last round. It seems like we should do that, at the very minimum, before we launch into another round of sweeping change that my customers fear is simply going to be the basis for another round of bureaucratic bungling that ends up costing them more money. We owe it to them to do better, so let's slow down and make sure we get it right, if we do it at all. We simply have to remember that the interests of native load-your average electricity consumers-and the utilities that serve them have to be addressed at the same time you are trying to improve the world for new market entrants like Enron, Calpine, Morgan Stanley, Dynegy and the like. These entities may have a place in the world, but they are not load serving entities with an obligation to serve-and I suggest to you that we ignore the well being of the load serving entities and their average customers at some great risk to yourselves.

The CHAIRMAN. Thank you very much. Thank you all very much for your testimony. Let me ask a few questions and then defer to Senator Feinstein.

Mr. Ackerman, what is your explanation for why prices went the way they did there?

Mr. ACKERMAN. Scarcity of supply. There were very poor hydro conditions in the Northwest. There was no new generation to meet the vastly increased amount of demand for electricity, which took place in the Western States. It was taking place across the Western region all at once, so that every megawatt, for example, in Arizona, Nevada, or Oregon that was used to meet its own economic growth and growth in electricity demand was one less megawatt that could come into California. So, there was a supply shortage, and there was no way for people to see the higher prices which you can see on my chart there on their bills because people in California, at least those who were served by the investor-owned utilities, were under a rate freeze. So, we had a situation where demand could not respond and a supply shortage, and those are the fundamentals which drove prices up.

The CHAIRMAN. It is your view that there was a genuine shortage, not a contrived shortage.

Mr. ACKERMAN. Yes, sir.

The CHAIRMAN. Let me ask any of the other witnesses if they have a point of view on this subject.

Ms. Church.

Ms. CHURCH. Senator, I absolutely agree. There was a real shortage in California, and I think it is very troubling to hear some of the State officials say that, in fact, that shortage did not actually occur because they are basically setting themselves up for additional problems.

What we saw was the hydropower that normally is imported from the Northwest was unavailable due to the drought, and a lot of power that normally is imported during the summer from the Southwest from your State and from Arizona and Nevada was not

available because the increased load within their own States and the fact that the heat wave was very widespread.

I absolutely agree there was a shortage. I think the Governor has recognized that because he has tried to have new plants built in that State.

The CHAIRMAN. Mr. Martinez, did you have a point of view?

Mr. MARTINEZ. I can agree with the comments earlier made in regards to the hydro shortage. It was a drought year. California has always relied on imports of hydro from the Pacific Northwest to fill in the gaps. Indeed, the economy in California had also gotten to a point where the demand was there.

The department, looking at the portfolio generation that we had, decided in early 2000 to reactivate two out-of units that we had mothballed for several years because we saw not only a need for our system, but potentially for the Western States to provide that type of capacity. So, we brought back to service 350 megawatts of capacity that had been out-of for many, many years.

The CHAIRMAN. Ms. First, did you have a point of view on this?

Ms. FIRST. I do, Senator. The power marketing lobby has often blamed the huge price increases on market instability, on shortages of power caused by a drought, which we certainly had in the Pacific Northwest. But the recent evidence and even evidence as late as this week clearly demonstrates that this explanation is not the only reason. If you look at Mr. McCullough's report, which I believe has been provided to the committee, in April demonstrates that power supplies were, in fact, better during the crisis period than during the previous droughts in the West. They cannot just lay it off on the hydroelectric production.

The CHAIRMAN. So, what is the explanation? If it is not an actual shortage of power, what was the explanation for those dramatic increases?

Ms. FIRST. Oh, I think it was a shortage of power, but I think that shortage was manipulated.

The CHAIRMAN. So, you think it was withheld from the market, although it was available to be provided.

Ms. FIRST. Absolutely. You heard testimony this afternoon that a third of the generation in California was off line at one time I think in response to Senator Feinstein's questions. Was that usual? Well, no, they had to admit it really was not.

The CHAIRMAN. But you think it was withheld in order to drive prices up.

Ms. FIRST. I do.

The CHAIRMAN. Ms. Church.

Ms. CHURCH. Senator, there is no evidence of that happening. In fact, the only evidence from any government agency that has looked at this issue was a FERC report, albeit not a very expansive report, which found to the contrary.

A number of State agencies, including the CPUC, have actively investigated whether or not there was any withholding of power in order to manipulate prices. They or no other agency have issued any reports that found any such withholding.

Mr. Winter himself earlier here today said, yes, 15,000 megawatts were off. Some were off because they had not been paid. Now, I do not know any industry in this country where if you do

not think you are going to be paid because you do not have a credit worthy seller, that you have to run and incur the cost of buying power, buying the fuel, hiring people and running that plant, buy the emission credit, and not be paid.

Secondly, as Mr. Winter said earlier, many of the plants that we are talking about are very old natural gas, middle cycle and peaking units. Some were literally Korean War era. They were used to running 50, maybe 200 hours a year, and all of a sudden, they are being asked to run 24/7. No 50-year-old man or woman can run that much without having to stop for some rest, seeing the orthopedic doctor, and some other things, and certainly a 50-year-old plant cannot be asked to run that way either.

The CHAIRMAN. Let me ask just one question about these recently disclosed deceptive practices that have been described here at length at our hearing and then at the Commerce Committee hearing this morning. One of the witnesses at the Commerce Committee hearing is Dr. Frank Wollak, a professor of economics at Stanford. He says in his written testimony, "The above logic implies that the strategies described in the Enron memos are at best a small part of the cause of the California electricity crisis. Of the more than $10 billion of refunds that the California ISO has calculated are owed to California consumers from paying unjust and unreasonable wholesale electricity prices over the period June 2000 to June 2001, the strategies outlined in these memos at most account for $500 million, when aggregated over all California market participants."

Do any of you have views as to whether he is correct in that, or do you have a different point of view on this question of how significant these deceptive practices were in causing the exorbitant prices that occurred in California or the Northwest?

Mr. Ackerman.

Mr. ACKERMAN. My response to that, without commenting on Dr. Wollak's numbers, because I believe Dr. Wollak has a good grasp on the numbers and I would agree with those, is that for the case of manipulation to be made, one would have to go to this pricing cycle over the last 4 years, hypothesize that no deception took place from April 1998 until May 2000, and then for a period of 1 year, deception took place which caused those higher prices, and then in May 2001, it suddenly disappeared. That is the case for manipulation, and I do not see it.

The CHAIRMAN. Do any of you have a point of view on this?

Ms. CHURCH. I will hazard a comment. I cannot comment on Mr. Wollak's number of $500 million—$500,000.

The CHAIRMAN. No. It is $500 million. Out of the $10 billion which he cites here as $10 billion in refunds that the California ISO has calculated are owed to California consumers.

Ms. CHURCH. I can say that given what we know about Enron's participation in that market, certainly Enron cannot be responsible for the $10 billion. The ISO's own numbers or estimate back about a year ago of the excess prices charged by both FERC jurisdictional and publicly owned utilities was about $6 billion. That was into the ISO. Of that amount, $40 million was credited to Enron, less than 1 percent. Enron was not that big a player in the California market. They did not own generation which others have said. As I said,

I cannot comment on his numbers, but I think it sounds roughly about right.

The CHAIRMAN. Yes, Ms. First.

Ms. FIRST. I cannot comment on his numbers either, except just to make this one observation very quickly. Ultimately it does not matter why those rates went up that high, whether it was market manipulation or something else. The fact remains the wholesale rates were unjust and unreasonable, and it is up to FERC to figure out why and how much should be refunded.

The CHAIRMAN. Yes, and he makes that point elsewhere in his testimony. That is a very good point. I agree.

Did you have a comment?

Mr. MARTINEZ. Again, I just want to emphasize at the Department of Water and Power, the trading portion of our business is a very small portion, and we do not analyze a lot of the transaction that go on in the market. Basically we are bread and butter, just put energy into the process, bid it to the system, and if there is a market there to buy it, fine. If not, we will stay out of it. So, we cannot comment on the numbers, and I do not know to what extent these numbers in the ball park or on target.

The CHAIRMAN. Senator Feinstein.

Senator FEINSTEIN. Thanks very much, Mr. Chairman.

I would like to ask each of the panelists the same question I asked earlier. Would you consider the practices outlined in the December 6 and 8 memos as deceptive practices? Mr. Ackerman, yes or no.

Mr. ACKERMAN. Not on all of those practices because the more we look into them, the more we research it, there is one in particular which I think the ISO identified before December of 1998 and said do not do this, which I think is sufficient warning for anybody who did do that, which was identified in the memo you should not be doing it. So, therefore, I would say that is a practice that should not be encouraged.

Senator FEINSTEIN. And the others?

Mr. ACKERMAN. The others. I would have to say the judgment is out. I can construct situations where they could be absolutely legitimate and then I can construct situations where they can be absolutely deceptive. So, I really cannot answer.

Senator FEINSTEIN. So, you think it is legitimate to sell something you do not really intend to deliver?

Mr. ACKERMAN. Much like when somebody shorts a stock and then sells it even though they do not own it. I suppose there is some legitimacy in that because it happens in other commodity markets.

Senator FEINSTEIN. Ms. First.

Ms. FIRST. Based on what I understand about what is in those memos—and I have read them. I have had discussions with my staff about them. I have read lots of things on it—I think they are definitely deceptive. There is no question.

Senator FEINSTEIN. Ms. Church.

Ms. CHURCH. I think the impact of most of the practices, whether or not they are deceptive, really depends on what FERC finds in terms of what happened, when, what the rules were in place in the ISO, and what was the impact on prices or on reliability.

I can tell you, however, I am very disturbed by suggestions that in those memos that misleading information was given to the ISO or that there may have been some joint action with other players. Those two are very troubling.

Senator FEINSTEIN. Mr. Martinez.

Mr. MARTINEZ. Senator Feinstein, yes, we see that as deceptive type of practices that we would not support.

Senator FEINSTEIN. Thank you very much.

See, I guess I am deeply troubled by this industry. If I were to tell you that many of these practices were carried out on-line in futures derivatives trading and there is no record kept, there is no transparency, there is no anti-fraud or anti-manipulation oversight, and there is no requirement for any capital to be put up—and we know for a fact now that the capital issue is in fact an issue. Yet, both your associations opposed it, which in a sense tells me something about the industry. I just want you to know that this Senator from California is very deeply concerned about the ethics, the practices, the deception that is practiced by the energy industry. I do not intend to get off this subject. I intend to follow it, every "i" and every crossed "t", from this point on.

I do not have a lot of questions. I understand you represent other people, but in my reading of this, there can be no justification for practices like these. The thing that concerns me is that both of you say, well, it may be okay under these circumstances and it may be okay under that circumstance. We really have a problem because this points out to me that people are not going to learn and they are going to rationalize and they are going to justify what is basic, I think, fraud, but let us say at the least deception.

We are going to have to come to grips with this one way or another because I do not think the American people want it, and I think that is the ultimate determinator of all of this.

I just say this because in my dealings with business as a mayor and in the 10 years I have been in the Senate, I have never encountered an industry quite like this, the brazenness, the arrogance, the "well, this is the oldest trick in the book, let's do it," that it is all some kind of giant game. And yet, people on the other end really suffer because of it. And then the willingness to blame, never to look in your own shop to see what we can do better or more honestly, but to blame. It is all somebody else's fault.

And I just want to say that to you directly and publicly because I read your comments. Ms. Church, I am reading your comment in *Energy Daily* that high prices are not bad. Price volatility and price spikes are natural in well-performing electricity markets and should be allowed to play their economic role, whatever that is. I really think we are on different wavelengths as to how we see this.

I think you people are really making the best possible case for re-regulation. If this continues, I have no doubt that people in this Nation will want to move to a system which is controlled.

Ms. CHURCH. Senator, may I respond to your comments?

Senator FEINSTEIN. Sure, absolutely.

Ms. CHURCH. First of all, let me respond to the article that you are referring to yesterday. We had an economic consulting firm look at the volatility of spot prices in about eight or nine Eastern markets. Some of them were ISO's like PJM, New England, New

York. Some of them were markets such as into Cinergy, into Entergy which are where the players are primarily vertically integrated, regulated utilities, but those are very liquid markets.

What the data found was that in all periods, peak periods, off periods, peak hours, peak seasons, there is a great deal of volatility if you look at hourly and daily prices. But this is the spot market which, unlike in California during the period we are talking about, is roughly 5 to 10 percent of the market. What the data seem to show is that these price spikes for short periods of time for small parts of the market are very normal, and yet no one is arguing that we have seen and nor has anyone seen the kind of price disruption that we saw in California.

So, the point we are trying to make is we have a commodity that is much like natural gas, much like metals, much like other commodities where volatility in that spot market is very common. And yet, when you are able to exercise—have a lot of markets, have a lot of buyers and sellers, you are able to take advantage of contracts either physical or financial contracts that allow you to hedge your risk, you can get a very smooth—and the title of the study was Still Waters Run Deep, meaning that you can have a smooth top but a lot of volatility going on underneath. And that is the point we are trying to make.

I will be the first to agree with you, Senator, that what happened in California is very unfortunate, obviously, and what I think what FERC, in looking forward, is trying to do is to develop fully integrated, seamless markets throughout the United States on a regional basis with very standardized rules, which would have prevented, which would prevent a lot of the activities we have been talking about today. Certainly as the FERC Chairman said, if the type of congestion management system that they think is the best model had been used in California, Enron would have been unable to have been able to arbitrage differences in congestion management. I agree with you the rules were not good in California, and they need to be changed.

Senator FEINSTEIN. Thanks, Mr. Chairman.

The CHAIRMAN. Senator Cantwell.

Senator CANTWELL. Thank you, Mr. Chairman. I would like to follow up on Senator Feinstein's questions, and I certainly want to associate myself with her remarks because being relatively new to the Senate, this has been a frustrating experience for us.

But I think, Ms. Church, maybe there is a way that the industry can help now, can step forward, and be helpful in this process. You may be familiar that our attorney general has been testifying before the Senate Judiciary Committee, has asked for Enron to turn over relevant documents, which they have not done. So, I am asking you whether your industry association members would be willing to turn over to this committee or to the Department of Justice relevant documents to when and where power capacity—basically when and where their plants were off line in California.

Ms. CHURCH. They have been turning over information to—they have been, quite frankly, sued up the kazoo by State organizations. They have been asked for data from FERC. They have been asked for data from private litigants. I know that they have turned over a lot of information to officials——

Senator CANTWELL. I am specifically asking, would you recommend to your members to turn over to the Western AG's or to the Department of Justice documents about when and where their plants were off line.

Ms. CHURCH. I am certainly not going to recommend to them that they violate some sort of production order. I am not in a position to say whether or not what is being asked of them is appropriate, who is asking. I am just not in a position to answer that question.

Senator CANTWELL. Do you not think that would be helpful for us to know?

Ms. CHURCH. The bilateral contracts that are entered into by individual parties contain a lot of very commercially sensitive information. Certainly appropriate government agencies, State and Federal, may have jurisdiction and may have a need to see those contracts under some sort of protective seal, and I am certainly not going to suggest that that not be done. But turning these contracts over publicly—I do not know what is in them, but my——

Senator CANTWELL. I am not suggesting that. I am talking about the Attorney General or the Department of Justice because it seems to me that the industry is taking a position of, well, we do not really know that this was caused by manipulation. And one thing that you could do to step up in the current situation and be accountable is to provide access to information about whether power was held back. And that seems to me to be a very responsible thing for the industry to do.

Ms. CHURCH. Senator, I will look into it, but I do not really know the circumstances you are talking about.

Senator CANTWELL. You do not know whether they——

Ms. CHURCH. I do not know who is asking for this——

Senator CANTWELL. Okay. We will get that information to you. Thank you.

Ms. First, thank you very much for being here and testifying. I live in Snohomish County, and so I very much appreciate it. I was talking to some of my friends and neighbors whose monthly bills for the last 2-month period went from $363 roughly to about $556, a year ago to this time period. And while somebody thinks, okay, well, that's roughly a couple hundred dollars, that is obviously a huge impact in my opinion. But what people do not realize is that the Northwest took extreme measures to even get to that $200. People had their homes at 58 degrees. People implemented all sorts of plans. People did everything and still got stuck with a high bill. So, I appreciate your comments today to rectifying this problem.

I am most interested in the fact that Enron—Snohomish County had several Enron contracts. How many?

Ms. FIRST. We had one for $2 million a month.

Senator CANTWELL. And that was negotiated?

Ms. FIRST. In December 2000.

Senator CANTWELL. And that contract—if you went out, if that was abrogated—I mean, if you went out and basically voided that contract, what would today's market bring for that power?

Ms. FIRST. What would the equivalent price be?

Senator CANTWELL. What would the cost be.

Ms. FIRST. I cannot really talk to you about the disparity in cost. We are talking about maybe $25 to $30 a megawatt hour. But I cannot really talk to you about the specifics of that contract because, as you pointed out, we have a restraining order that prohibits us from talking about the specifics of each of those contracts. They actually went to court and got a restraining order.

Senator CANTWELL. Who has that restraining order?

Ms. FIRST. Well, my recollection is Enron does.

Senator CANTWELL. So, Enron put a restraining order on you from talking about those contracts even with government entities.

Ms. FIRST. Absolutely. We are a publicly owned utility. We have an obligation to disclose a lot of things in our utility. We have a customer who had a request for the three long-term contracts we entered into, American Electric Power, Morgan Stanley, and Enron, and we were taken to court by two out of the three to basically put a gag order on us so that we could not release that information to the public. We are a public utility.

Senator CANTWELL. Mr. Chairman, this is why I think that either this committee or Senator Lieberman's committee or working with the Department of Justice, we need access to these documents. If Enron is basically stopping legal action from this information being public and then we hear from the industry, well, you cannot prove your case, well, of course, we cannot prove even further the manipulations, although I guarantee you this Congress is going to get to the bottom of this. People are just holding us up from finding out the accurate information. We can take all due steps and processes to make sure that vital competitive information is not released to the general public. But right now withholding the information and stopping individuals—so, have you voided these contracts?

Ms. FIRST. We are asking FERC to void them. We have filed an action with FERC. We are asking them to void our long-term contracts because the rates are unjust and unreasonable, and we are in the middle of that process now.

I will say we are sympathetic to the industry's complaints that they do not want their proprietary information made public. We understand that. Certainly during the negotiation process, that should be private, but once these contracts are inked and we have deals, certainly there can be no harm in revealing the terms of those contracts a month later or 3 months later if they were required, for example, to file quarterly reports with FERC that had all that information in it.

Senator CANTWELL. So, what will happen to your ratepayers if these contracts are not voided? How long will we be paying these——

Ms. FIRST. We will be paying 7 to 9 years. We were, fortunately, in a good position, unlike our neighbors to the south, another publicly owned utility, who had to borrow half a billion with a "B" dollars just to meet their payroll to pay for their electricity. We were not in that position because we were more financially secure, but they are still going to have that in their rate base. We are truly passing on the cost of power to our customers now. A 60 percent rate increase, Senator, living in that district, is just unconscionable.

Senator CANTWELL. So, even though the hydro crisis may be over for the Northwest, at least in providing hydropower, we are now stuck unless FERC voids these contracts.

Ms. FIRST. We are absolutely stuck.

Senator CANTWELL. FERC has already said today, the Chairman, that he does believe that this was manipulation. We are stuck paying for this manipulation for the next 7 to 8 years.

Ms. FIRST. And I will say that we are not a utility that has ever tried to get out of any power contracts, ever before in 50 years. We do not have a choice here. We feel that we had a gun to our head and we had to do this. And it is just not right.

Senator CANTWELL. Thank you, Mr. Chairman.

The CHAIRMAN. Well, thank you very much. I want to thank all of you. It has been a long hearing, and you were very kind to stay and give us your testimony. We appreciate it and we hope we can continue to monitor this situation and find some ways to help remedy it. Thank you.

[Whereupon, at 6:43 p.m., the hearing was adjourned.]

APPENDIX

RESPONSES TO ADDITIONAL QUESTIONS

FEDERAL ENERGY REGULATORY COMMISSION,
Washington, DC, June 5, 2002.

Hon. JEFF BINGAMAN,
Chairman, Committee on Energy and Natural Resources, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: Thank you for your letter of May 21, 2002, enclosing questions from Senator Pete V. Domenici and Senator Maria Cantwell for the record of your Committee's May 15 hearing.

I have enclosed my responses to the questions from Senator Domenici and Senator Cantwell. Please note that the Commission requests CONFIDENTIAL TREATMENT of certain information submitted as part of this letter and the attachment hereto. If you need additional information, please do not hesitate to let me know.

Best regards,

PAT WOOD, III,
Chairman.

[Enclosures]

RESPONSES TO QUESTIONS FROM SENATOR DOMENICI

PROHIBITION ON LONG-TERM CONTRACTS

Background: According to CBO's report, *Causes and Lessons of the California Electricity Crisis*, California's Public Utility Commission (PCU) prevented utilities from entering into long-term agreements with independent producers or obtaining futures contracts. PCU operated under the assumption that significant generating capacity would exist to ameliorate short-term price pressures. However, unfavorable weather conditions reduced supply and the energy demands of California's economy quickly absorbed the excess capacity causing the Power Exchange (PX) to collapse.

Question 1. Long-term contracts allow utilities to lock in future prices now, which facilitates planning and investment in additional energy producing capacity. If the California Public Utility Commission (PCU) had permitted utilities to enter into long-term contracts, is it likely that power generators would have had enough incentive to bring on addition capacity thus reducing some of the upward price pressures?

Answer. Long-term contracts can benefit both sellers and buyers of power. Long-term contracts can provide the financial certainty a generator needs to develop a new facility. In fact, until recently, almost all independent power producers depended on long-term contracts in order to develop new facilities. Similarly, a wholesale power purchaser using long-term contracts to meet much of its load will be less affected by spot price volatility than a purchaser buying all of its power in the spot market. While I cannot quantify in dollars the effect of barring long-term contracts in California, the effect was definitely harmful.

Question 2. A futures contract not only permits an individual or entity to hedge against future risks but also provides markets with valuable pricing information about the future. Did the absence of a well-developed futures market inhibit the ability of producers to anticipate and react to spikes in demand?

Answer. While futures markets have operated at certain locations in the West for several years, California's restrictions on long-term contracting may have constrained trading in these markets and, as a result, impaired the price discovery function of these markets. A robust futures market can provide useful price signals to producers. Price increases in the futures market can encourage producers to develop additional supply. A futures market also can benefit customers, allowing them to buy power at a fixed price months in advance of when it is needed and thus avoid the volatility of the spot market. Customers also can benefit from the price discovery

function of futures markets, since price increases in futures market can lead customers to make investments in conservation or demand response. A well-functioning futures market is a valuable tool in any commodity-based market.

PRICE CAPS

Background: The California energy market-restructuring plan established a set of complex rules and procedures governing auctions conducted on the spot market at the Power Exchange (PX) and California Independent Systems Operator (CAISO). In particular, it required all successful bidders to accept contracts based on the last highest price offered and actually capped prices in the CAISO. CBO's analysis suggests that these rules created an incentive for sellers to bid in such a way as to raise wholesale prices.

Question 3. California's energy deregulation plan appears to have failed because it was poorly designed. In other areas of the country where energy markets were deregulated did any of the other plans include elements that capped prices?

Answer. Price caps are also used in the markets operated by independent system operators (ISOs) in Texas, New England, New York and the mid-Atlantic region operated by PJM. However, the $1,000 "circuit-breaker" price caps in those regions are much higher than the caps were in California in, e.g., late-2000 (as low as $250). The ISOs also use other forms of price mitigation depending on market conditions and participant behavior.

Question 4. If the price caps had been removed from CAISO auctions, would that market have functioned more smoothly?

Answer. I do not know. The functioning of the California and Western markets over the last two years was extremely complex and I cannot identify with any certainty the effect of undoing one aspect of these markets (price caps) but assuming everything else had stayed the same. Ultimately, however, our goal in wholesale power markets should be to encourage development of sufficient infrastructure, adopt balanced market rules and adequately monitor the behavior of market participants. If we accomplish these goals, I believe we can reduce or end our reliance on price caps in most circumstances.

FERC RELEASES

Background: As part of the Federal Energy Regulatory Commission's (FERC) Staff Fact-Finding Investigation of Western Markets, many of the documents it has collected are available online. The three Enron memos discussed at this afternoon's hearing included in your briefing book were obtained from the FERC's website. However, many other documents they have requested have not yet been released.

Question 5. Some have recently criticized the FERC for not releasing more of the information it has requested from other companies involved in the California energy crisis. Is this criticism warranted? If these allegations are correct, what is preventing FERC from releasing the additional documents?

Answer. No, the criticism is not warranted. The Commission is making available documents that have been submitted without claim of privilege in the Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices, Docket No. PA02-2-000. The Commission's data requests acknowledged, however, that a respondent may seek privileged treatment for documents and information by providing an index of those materials that are subject to claims of privilege. The index includes the date of each document, its title, the recipient(s), sender(s), a summary of the contents and the basis for the claim of privilege.

There are several reasons for not releasing privileged information that is obtained in a non-public fact-finding investigation. First, due process requires that the Commission grant privileged treatment where it is warranted under generally accepted rules of civil procedure. In addition, confidential treatment of privileged data responses elicits more cooperation from respondents so as to enable completion of the investigation in a reasonable amount of time. That is particularly pertinent here because the Commission must obtain information quickly, from many sources. In fact, the Commission's regulations, at 18 C.F.R. § 1b.9 (2001), provide that information and documents obtained in an investigation will be kept confidential unless the Commission authorizes a release, release is required under the Freedom of Information Act, or the documents and information are released in the course of an adjudicatory proceeding. Finally, the Commission is conducting its investigation in cooperation with other agencies that are conducting similar investigations (CFTC, SEC and DOJ), and release of non-public information could compromise not only our investigation but also those of the other agencies.

Some respondents have requested confidential treatment by claiming that disclosure of certain documents would result in competitive harm to themselves or to the

market or that particular documents are covered by traditional discovery privileges, such as attorney-client or attorney work product. Rather than adjudicate and possibly litigate individual claims of privilege or competitive harm prior to receiving the documents, the Commission's rule at 18 C.F.R. §388.112 (2001) provides that any person submitting a document to the Commission may request privileged treatment by claiming that all or part of the document is exempt from public disclosure under the Freedom of Information Act. The respondent then files the document in redacted and unredacted forms, and the unredacted version of the document remains in the Commission's non-public files pending a decision by the Commission on the claim of privilege. The Commission has found that this procedure fosters voluntary cooperation with fact-finding investigations while providing due process to respondents.

RESPONSES TO QUESTIONS FROM SENATOR CANTWELL

Question 1. As we discussed at the hearing, FERC has issued data requests to over 100 Western market participants, asking them to affirm or deny whether they employed strategies similar to those contained in the Enron memos in order to manipulate Western power markets. I understand those responses are due by May 22. Please provide those responses to the Senate Energy and Natural Resources Committee as promptly as possible. If it is not possible for FERC to turn over these documents to the Senate in their entirety, please provide me with a legal explanation as to why this may be the case, as well as a briefing on the information.

Answer. Many respondents did not claim privileged treatment for their data responses in the Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices, Docket No. PA02-2-000, and those responses will be posted later this week on the Commission's webpage, www.ferc.gov. Other respondents sought privileged treatment for certain documents or portions of documents. The logs in which respondents identified the privileged documents and the bases for their claims of privilege also will be posted on the Commission's webpage. However, the unredacted versions of the documents for which claims of privilege have been made are being withheld.

Due process requires that the Commission observe its rules, upon which the public has a right to rely. Under 18 C.F.R. §388.112 (2001), any person submitting a document to the Commission may request privileged treatment by claiming that some or all of the information is exempt from mandatory public disclosure under the Freedom of Information Act, 5 U.S.C. §552 (1994). The respondent requesting privileged treatment submits the document in redacted and unredacted forms, and the unredacted version is placed in the Commission's non-public files pending a determination on the claim of privilege. If a request for a privileged document is made, the respondent is entitled to at least five days in which to respond to the request. And if the Commission ultimately determines to release the document, the respondent is entitled to at least five days' notice before release.

The Commission has not had an opportunity yet to rule on the claims for privileged treatment of data responses in the fact-finding investigation. The investigation is ongoing, and the Commission's resources are being devoted to analyzing the data and determining what, if any, additional information is needed. We believe we must focus now on the investigation itself rather than on adjudicating and perhaps litigating individual claims of privilege.

Question 2. What recourse does FERC have should any entity refuse to comply with its data requests?

Answer. Section 307 of the Federal Power Act, 16 U.S.C. §825f (1994), authorizes the Commission to issue subpoenas to compel the production of documents for the purpose of any investigation or proceeding under the FPA and to invoke the aid of the United States District Courts to require such production in the event of a failure to obey a Commission subpoena. In addition, section 314 of the FPA, 16 U.S.C. §825m (1994), authorizes the Commission to bring an action in an appropriate United States District Court to enforce compliance with the orders it issues under the FPA and to seek writs of mandamus commanding persons to comply with those orders. The Commission also may revoke a public utility's authorization to sell power at market-based rates. See, e.g., FactFinding Investigation of Potential Manipulation of Electric and Natural Gas Prices, 99 FERC ¶——, Docket No. PA02-2-000 (order issued June 4, 2002) (requiring four public utilities to show cause why the Commission should not revoke their market-based rates for lack of compliance with a staff data request).

Question 3. How many subpoenas has FERC issued in its staff investigation of Western power market manipulation? To whom has FERC issued these subpoenas?

If it is not possible to provide a list to the Senate, please provide me with a legal explanation as to why this may be the case, as well as a briefing on this information.

Answer. The Commission is working with the CFTC and the SEC, and is providing assistance to United States Attorneys Offices within DOJ in the fact-finding investigation. To date, the Commission has issued 14 subpoenas. Because this is a joint investigation, the Commission cannot unilaterally reveal the names of the persons subpoenaed. We must avoid all actions that would compromise any criminal proceeding that might be initiated.

Question 4. Who has FERC deposed during the course of this investigation? Who does FERC plan to depose? If it is not possible to provide a list to the Senate, please provide a legal explanation as to why this may be the case, as well as a briefing on this information.

Answer. As discussed in response to Question No. 3, the Commission is working with the CFTC and the SEC, and is providing assistance to United States Attorneys Offices within the DOJ. The Commission and the CFTC have deposed 13 people and interviewed 25 other persons. We cannot reveal the names of those interviewed for the same reasons stated in response to Question No. 3, to avoid compromising any potential criminal action.

Question 5. What specific steps can and will FERC take to turn over evidence of possible criminal activities to the Department of Justice?

Answer. The Commission is assisting the United States Attorneys Offices within the DOJ and the FBI. Also the Commission is working closely with the SEC and CFTC. If the Commission finds evidence of possible criminal violations of the FPA or NGA or has other evidence that will be useful to the DOJ, it will provide such information to the DOJ.

Question 6. FERC has recently posted on its Website a report related to an internal investigation of EnronOnline. The names of the memo's author and recipient have been redacted. Would you please provide those names to the Committee?

Answer. Attachment A, for which I request confidential treatment, contains the staff names you request. Before the Commission decided to release the memo with the staff names deleted, the memo was an internal document that would have been exempt from public disclosure in its entirety under the Freedom of Information Act, exemptions five (for deliberative process) and seven (for investigations and enforcement proceedings). This memo was disclosed since some of its content was referred to in correspondence from an elected official, which was publicly released. I request that the members of the Committee keep the names on this internal work product confidential so as not to chill staff candor and effectiveness in internal communications in the future.

Question 7. The EnronOnline report also suggests FERC's Office of General Counsel had initiated a legal opinion or memo on the Commission's jurisdiction over online trading. There are indications this opinion or memo was never completed. Why is this the case?

Answer. In the summer of 2001, the Commission's prior General Counsel assigned an attorney in the Office of the General Counsel (OGC) to draft an analysis of jurisdictional issues related to Enron Online. An initial draft was completed in late August 2001 as an internal OGC document. This was followed by a time of transition at the Commission, including the departure of the then-Chairman and then-General Counsel. It should be noted that, under Commission precedent, the Commission has asserted jurisdiction over only the public utility sellers that sold electric energy for resale through Enron Online and only where such energy went to physical delivery; further, there was no Enron Online itself or over derivatives trading over Enron Online. In recent months, however, additional factual and legal questions have arisen regarding Enron Online's role in power markets. OGC is in the process of finalizing a more comprehensive jurisdictional memo. We anticipate that this memo, which will represent privileged and confidential non-public attorney work product, will be given to all Commissioners in the next few weeks.

Question 8. Please provide a comprehensive list and timeline of FERC enforcement actions (of any sort) taken against participants in Western energy markets, from July 2000 through the present.

Answer. The list and timeline are appended in Attachment B. The Commission seeks confidential treatment of the attached information.

STEPTOE & JOHNSON,
ATTORNEYS AT LAW,
Washington, DC, June 7, 2002.

Hon. JEFF BINGAMAN,
U.S. Senate, Chairman, Committee on Energy and Natural Resources, Dirksen Senate Office Building, Washington, DC.

Re: Senate Energy And Natural Resources Committee Hearing on Energy Price Manipulation in Western Markets

DEAR MR. CHAIRMAN: In connection with the above-referenced hearing, held on May 15, 2002, Senator Cantwell submitted two written requests to, among others, Mr. Stephen Hall. Below are Mr. Hall's responses to those requests.

Request 1. Please provide me with a comprehensive list of the traders with whom you consulted in preparation—or otherwise discussed the contents—of the memos recently released by FERC. To the extent possible, please also provide their titles, current employer and the dates of your interaction with these individuals.

Response. To the best of Mr. Hall's recollection, below is a list of the traders with whom in preparation of the December 6, 2000 memorandum from Stephen Hall and Christian Yoder to Richard Sanders he may have consulted or otherwise may have discussed the contents of the memorandum:

Tim Belden, managing director of Enron's West Power Desk;
Jessie Bryson, Enron real-time trader;
Michael Driscoll, Enron real-time trader;
John Forney, manager of Enron's real-time desk;
Chris Mallory, Enron real-time trader; and
Jeff Richter, Enron day-ahead trader.

Request 2. Please provide a comprehensive list of any other attorneys, Enron or Portland General Electric employees with whom you consulted in preparation—or otherwise discussed the contents—of the memos recently released by FERC. To the extent possible, please also provide their titles, employer and the dates of your interaction with these individuals.

Response. To the best of Mr. Hall's recollection, below is a list of other attorneys (other than personal counsel), Enron employees and Portland General Electric employees with whom in preparation of the December 6, 2000 memorandum from Stephen Hall and Christian Yoder to Richard Sanders he may have consulted or otherwise may have discussed the contents of the memorandum:

James Fell, partner at Stoel Rives, LLP;
Gary Fergus, attorney-at-law, formerly of Brobeck, Phleger & Harrison LLP;
Richard Sanders, Vice President and Assistant General Counsel, Enron Corporation;
Marcus Wood, partner at Stoel Rives, LLP; and
Christian Yoder, Director of Legal Services, UBS Warburg Energy.

Mr. Hall continues to offer his full cooperation with the Committee's investigation into this matter. Please feel free to contact me with any questions concerning his responses.

Sincerely,

MARK J. HULKOWER,
Attorney for Mr. Stephen Hall.

RESPONSES OF GARY FERGUS TO QUESTIONS FROM SENATOR CANTWELL

Question 1. Please provide me with a comprehensive list of the traders with whom you consulted in preparation—or otherwise discussed the contents—of the memos recently released by FERC. To the extent possible, please also provide their titles, current employer and the dates of your interaction with these individuals.

Answer. These are the individuals that I recall discussing, at least in part, the facts underlying the contents of the memos:

Tim Belden, Vice President Enron North America; now at UBS Warburg
Jeff Richter, Manager Cash California Short Term Desk; now at UBS Warburg
Chris Mallory, Analyst Cash California Short Term Desk; present employment unknown
John Forney, Manager, Real Time Desk; present employment unknown
Michael Driscoll, Analyst; present employment unknown
Mike Dillingham, Title unknown; present employment unknown

Bret Huntsucker, Sr. Specialist, Cash Volume Management; present employment unknown
Kim Ward, Manager, Middle Market; present employment unknown
Chris Stokely, Sr., Specialists, Volume Management; present employment unknown
Bill Williams, Specialist, Real Time Desk

My primary interaction with these individuals was in late fall 2000 and early January 2001. I also was in communication with Mr. Belden and Mr. Richter from time to time thereafter on specific issues. There may be others that I do not recall.

Question 2. Please provide a comprehensive list of any other attorneys, Enron or Portland General Electric employees with whom you consulted in preparation—or otherwise discussed the contents—of the memos recently released by FERC. To the extent possible, please also provide their titles, employer and the dates of your interaction with these individuals.

Answer. I recall discussing the contents of the memos, at least in part, with the following attorneys:

Gibbs & Bruns—Robin Gibbs, Jean Frizzell, Barrett Reasoner
Enron—Richard Sanders, Christian Yoder, Steve Hall (during certain periods)
Stoel Rives LLP—Marcus Wood, Steve Hall (during certain periods)
Post Kirby Noonan & Sweat LLP—Michael Kirby, Dave Noonan
Goodin, MacBride, Squeri, Ritchie & Day, LLP—Michael Day
Brobeck, Phleger & Harrison LLP—Michael Molland, Kelly Wooster, Peter Meringolo, Amanda Smith
Bracewell & Patterson—Dan Watkiss
Ruby & Schofield—Allen Ruby
Cooper, Arguedas & Cassman—Chris Arguedas
Law Offices of Paul Meltzer—Paul Meltzer
Vinson & Elkins—Mark Tuohey III

There may have been other attorneys with whom I discussed the contents of the memos that I do not recall.

Enron Employees

I spoke with the individuals listed above to learn the facts.

I may also have spoken with Allan Comnes, in Enron's governmental affairs group in Portland, about some of the contents of the memos.

Portland General Electric

I had two meetings with Portland General Electric but we did not discuss the contents of the memos.

RESPONSES OF JEAN FRIZZELL TO QUESTIONS FROM SENATOR CANTWELL

The following are my responses to the questions from Senator Cantwell:

Question 1. You have asked me to provide a list of the traders with whom I consulted in preparation—or otherwise discussed the contents—of the memos recently released by FERC. I was not involved in the preparation of the memoranda authored by Stephen Hall and Christian Yoder. I recall meeting with the following traders in December of 2000 and/or January of 2001 before coauthoring the draft memorandum:

a. Tim Belden: Tim Belden was the head trader for the Portland office. I have heard that Mr. Belden currently works for UBS Warburg.

b. Jeff Richter: I do not recall Mr. Richter's specific position; however, I believe Mr. Richter was responsible for one of the trading desks. I do not have any information regarding his current employment.

c. John Forney: I do not recall Mr. Forney's specific position; however, I believe Mr. Forney was responsible for one of the trading desks. I do not have any information regarding his current employment.

d. Chris Mallory: I do not recall Mr. Mallory's specific position; however, I believe Mr. Mallory was responsible for one of the trading desks. I do not have any information regarding his current employment.

2. The attorneys, Enron or Portland General employees, with whom I consulted in preparation—or otherwise discussed the contents—of the memos recently released by the FERC are as follow:

a. Gary Fergus—Partner, Brobeck, Phleger & Harrison LLP (now Fergus, A Law Firm), 1 Market Street, 35th Floor, San Francisco, California 94105

b. Michael Kirby—Partner, David Noonan (discussed Hall/Yoder memorandum only), Partner, Post, Kirby, Noonan & Sweat, 600 West Broadway, 11th Floor San Diego, CA 92101

c. Richard Sanders—Enron In house counsel, Enron Company, 1400 Smith Street, 28th Floor Houston, Texas 77002-7361

d. Robin Gibbs—Partner, Barrett Reasoner; Partner, Brandon Allen (discussed Hall/Yoder memorandum only); Associate, Gibbs & Bruns, L.L.P., 1100 Louisiana, Suite 5300, Houston, Texas 77002

○