THE EFFECT OF THE BANKRUPTCY OF ENRON ON THE FUNCTIONING OF ENERGY MARKETS

HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY AND AIR QUALITY

OF THE

COMMITTEE ON ENERGY AND COMMERCE

HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

FEBRUARY 13, 2002

Serial No. 107–82

Printed for the use of the Committee on Energy and Commerce

Available via the World Wide Web: http://www.access.gpo.gov/congress/house

U.S. GOVERNMENT PRINTING OFFICE

77–988CC WASHINGTON : 2002

For sale by the Superintendent of Documents, U.S. Government Printing Office
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THE EFFECT OF THE BANKRUPTCY OF ENRON ON THE FUNCTIONING OF ENERGY MARKETS

WEDNESDAY, FEBRUARY 13, 2002

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON ENERGY AND AIR QUALITY,
Washington, DC.

The subcommittee met, pursuant to notice, at 1:30 p.m., in room 2322, Rayburn House Office Building, Hon. Joe Barton (chairman) presiding.

Present: Representatives Barton, Largent, Burr, Shimkus, Pickering, Blunt, Bryant, Walden, Tauzin (ex officio), Boucher, Hall, Sawyer, Wynn, Doyle, John, Waxman, Markey, Rush, McCarthy, Strickland, Barrett, Luther, and Dingell (ex officio).

Staff present: Jason Bentley, majority counsel; Sean Cunningham, majority counsel; Andy Black, policy coordinator; Peter Kielty, legislative clerk; Sue Sheridan, minority counsel; and Rick Kessler, minority professional staff.

Mr. BARTON. The subcommittee will come to order. I think that all of our witnesses are here. If we could get our audience to find their seats, we will begin. Today the Energy and Air Quality Subcommittee is going to hold a hearing on the effect of the bankruptcy of Enron on the Functioning of Energy Markets.

The full Energy and Commerce Committee has already held a hearing on the broader issues associated with Enron, and the Oversight and Investigations Subcommittee has an ongoing series of hearings to put the facts on the table as to any criminal, or unethical conduct by those associated within the company, or monitoring the company, or consulting with the company.

Today's hearing is a little bit different. This subcommittee has jurisdiction over the energy industry in the United States, and we want to determine, if it is possible to determine in one hearing, is how did the energy markets function in general, and specifically the Enron on-line trading system as it reduced its share of the trading in energy commodities, how did that affect the broader energy market.

There have been a lot of surprises as it related to Enron; many of them have been very unpleasant surprises. We had had employees testify how they lost their jobs, their savings, and their retirement accounts.

We have had stockholders testify as to how they lost the value they had thought was in the stock that they had purchased. We have creditors who have testified and things like this.

So now we are going to see how the energy markets work, and if they work. There is some testimony on the second panel that perhaps the energy market didn't work as well as it was expected.

We want to see if there are lessons that can be learned and if there are issues that need to be addressed in our ongoing and pending markup of the Electricity Restructuring Bill, which quite frank I had hoped to be marking up beginning last week, and continuing today.

I would much rather be doing something substantive that could help the country and the President in the future, than holding a hearing on something that perhaps went wrong. But if we can discover what went wrong, perhaps we can put some amendments in on a bipartisan basis in our Electricity Bill that could prevent something like what has happened from happening in the future.

I have a full statement, but in the interest of time, I am going to put that into the record. I would just hope that our panelists testify truthfully.

I would now like to recognize the ranking member of the subcommittee, Mr. Boucher, for an opening statement.

[The prepared statement of Hon. Joe Barton follows:]

PREPARED STATEMENT OF HON. JOE BARTON, CHAIRMAN, SUBCOMMITTEE ON ENERGY AND AIR QUALITY

There have been many surprises related to Enron, most of them unpleasant. Employees lost jobs and in some cases their retirement accounts, stockholders generally lost their investment, and creditors and other companies had to unwind deals or wait in hopes of payment. I am glad that the full Committee and the Oversight Subcommittee are doing all they can to explore the many issues surrounding the fall of Enron.

Not all of the surprises have been unpleasant. We knew energy markets worked, but I think we were all surprised by the strength they showed last fall. Even at the highest point of the crisis, the lights stayed on and consumers saw no real price increases. Electricity was delivered where it needed to go, and natural gas still arrived on time. The biggest market-maker in both electricity and natural gas left the market, and the result was nary a blip on reliability and prices. That is a testament to the strength of competitive markets.

Today's hearing is about the effect of the bankruptcy on the functioning of energy markets. We will leave the autopsy of the Enron body to other subcommittees—we are here to discuss energy-related issues surrounding Enron's collapse. I welcome all of the witnesses here today, including a very distinguished first panel of Federal and State government witnesses.

I ask each of the witnesses to tell us his or her perspective of the effect Enron's bankruptcy had on energy markets. Are there lessons we can learn from those amazing days when markets overcame tough obstacles? Do we have enough market transparency and disclosure? Do we need more? Are there some types of disclosure, transparency or regulation that would actually hurt markets? What is actually happening in the markets today?

Some witnesses here today will say that energy markets actually work better today as a result of Enron's behavior before their downfall. I am glad that Chairman Wood has already said the FERC will review some of these specific allegations.

I am not here to say that energy markets work perfectly. If they did, we would not need to improve them. H.R.4, still awaiting action by the Senate, seeks to improve both the supply and conservation of energy, with an eye toward a better long-term balance in supply and demand. During our experience last year on the Western electricity crisis, we learned about the lack of adequate generation in the West and the awful disparity in takeaway capacity from interstate natural gas pipelines into California.

And since nearly everybody in town tells me that electricity markets are not operating at their maximum efficiency, we have drafted H.R.3406 to improve transmission, increase generation nationally, encourage renewable energy and conservation, and otherwise reduce barriers to wholesale competition. This Subcommittee will return to that legislation soon, after full committee Chairman Tauzin and I decide the time is right.

Despite the good news of the past few months, this is a dangerous time in the real world of energy markets. The stock markets are spooked, fearful of new problems in other companies and accounting relationships. Credit-rating agencies have rightfully taken a new look at the complexity and business strategies of companies that trade energy and match buyers and sellers. Both factors cause companies to hunker down and ride out the storm.

Our Nation needs energy companies to do more than simply show Wall Street and Congress that their house is in order. We need energy producers, energy traders, and energy utilities leading us toward a better future. We still need these capital-intensive projects to increase generation through new power plants, and we still need innovative companies promoting efficiency in the generation, marketing and consumption of energy. We got lucky in the West last summer and again this winter. Mild temperatures and economic concerns dropped demand, masking the still-present problem of demand outstripping supply.

While Enron is on the front page, the real story is inside the paper. Every time a company cancels or postpones a power plant project, the future looks scarier. Every time our confidence in energy trading decreases, we take a step backwards. But the genie of wholesale competition cannot and should not be put back in the bottle. Now is not the time to re-regulate energy markets. But now is the time to learn what we can learn from Enron and make energy markets better. We always want the furnace to turn on, the pilot light to be lit, and the bill to be affordable, no matter what happens to participants in the energy market. That is the real reason we are here today.

Mr. BOUCHER. Thank you, Mr. Chairman.

The scheduling of today's hearing is timely, and the examination of the effect of the Enron collapse on the wholesale electricity market is highly appropriate.

I believe that we have sufficient information to draw some conclusions. First, in the wake of the Enron bankruptcy filing, the wholesale electricity market functioned smoothly and effectively. It didn't miss a beat. There was no interruption in power delivery, and the lights stayed on, and electricity flowed. Even with the removal from the market of a major trading firm the market recovered immediately. Other firms quickly filled the void. The wholesale electricity market experienced the largest corporate bankruptcy in American history, and the fact that it didn't miss a beat is truly a testament to its strength.

Second, I believe that the flexibility inherent in the largely deregulated wholesale market was the key to its rapid recovery. If the market had been inflexible, and if it had been tightly regulated, the ability of other trading firms to fill the void would have been substantially reduced. Now is not the time to consider measures that would limit market flexibility.

As a third matter, the stock values of companies involved in energy trading, and in the construction of independent power plants, have fallen significantly in the wake of the Enron bankruptcy. Their ability to acquire capital for new power plant construction has been diminished. As a result, many power plant construction projects that had been announced have been delayed, and in some cases, canceled altogether. The Nation may in fact find itself without sufficient electricity as a consequence, and as the economy recovers, we may experience that reality.

The major concern, Mr. Chairman, that I have, and the subject that I suggest be the primary focus of this subcommittee's inquiry, is what steps need to be taken to restore investor confidence in the wholesale market. And in the basic business model of the merchant energy companies that supply electricity to it, I have some suggestions.

First, the point should be stressed that the wholesale market was largely unaffected by Enron's misdeeds. The drop in wholesale prices in one region of the Nation can be explained by the thin and illiquid nature of the market in that region, and by the long term downward trend in wholesale prices in that particular region of the wholesale market. In fact, a view of the long term price chart places the market decline well within the range of normal fluctuation.

Second, we should encourage the taking of steps by the FERC, which will increase transparency, predictability, and reliability in the wholesale market.

I congratulate the FERC for the steps it is now taking to stimulate the formation of large regional transmission organizations, and to require membership in the RTOs by entities that own transmission assets. I hope that the FERC will continue along this positive path which will make the market more reliable and more predictable. The same can be said for the FERC's proposed actions to establish uniform standards for interconnection. These are positive and helpful steps, and I hope that the FERC will move forward aggressively in both of these areas. I look forward to additional suggestions that today's witnesses may make for steps that can be taken at the FERC, or perhaps by this subcommittee, that will lead to greater wholesale market transparency, and to strengthen investor confidence in the companies that supply electricity to it.

This is our most important mission, and I am pleased that we have today knowledgeable witnesses who can comment on this subject. Thank you very much, Mr. Chairman.

Mr. BARTON. Thank you, Congressman Boucher, and I would associate myself with your remarks. I agree almost in totality with what you said. The gentleman from Tennessee, Mr. Bryant, is recognized for an opening statement.

Mr. BRYANT. Thank you. Mr. Chairman, I also want to thank you for holding today's hearing, and I look forward to hearing from the distinguished panel of witnesses on what effect, if any, Enron——

Mr. BARTON. Would the gentleman—if he wishes to be recorded for television posterity, he ought to come to this microphone right here.

Mr. BRYANT. That's okay.

Mr. BARTON. All right.

I just want to let you know.

Mr. BRYANT. Thank you. I do support this panel's testimony on what effect, if any, Enron's collapse has had or will have on the competitive energy markets. According to Robert J. Michaels' December 10, 2001 essay in U.S. Today, and I quote, "The most important fact about the fall of Enron hardly has been noted in the media.

"The disintegration of such a large company that has so dominated this market should bring bedlam to suppliers and customers.

Yet, power and gas prices remain low and stable. They continue to be driven by supply and demand, both where Enron traded and where it did not."

To my knowledge, Enron's collapse has had little effect on the consumer cost of electricity and natural gas. Judging from the lack of correspondence that my office has received, the Enron political scandal is not resonating outside the beltway.

The politics seem to be overhyped and media driven, as reporters continue to try to connect the dots between Enron and campaign contributions, this White House, and the immediate past White House, as well as Congress.

The media and some others appear to be obsessed with turning a despicable business scandal into a political scandal. This subcommittee should certainly fully understand the consequences of Enron's collapse before moving forward with electricity restructuring legislation.

However, if this subcommittee doesn't consider electricity restructuring legislation, it will be because the majority believe that it is in the best interests of consumers and the American economy, and not due to any outside influences.

There are certainly a lot of questions yet to be answered about the collapse of Enron, and questions about the role and responsibility of third-party auditors, the effects of Enron's collapse on pensions, and employee 401(k) investments, and current corporate financial disclosure practices.

However, despite all of these questions that need to be asked about that, the lights are still on even without Enron. Again, Mr. Chairman, thank you for calling today's hearing, and I look forward to these witnesses. Thank you.

Mr. BARTON. We thank the gentleman. The full committee ranking member, Mr. Dingell, is recognized for an opening statement.

Mr. DINGELL. Mr. Chairman, I thank you for your courtesy, and I commend you for holding this hearing. It will help us to begin to understand the impact of Enron's bankruptcy on energy matters, and most importantly upon consumers.

Today's hearing is a good start at peeling back the layers of what looks to be a rather large, and quite frankly, smelly onion. I welcome the participation of Federal Agencies today, and I note that they are responsible for protecting investors and consumers.

I am pleased that both the Securities and Exchange Commission, the SEC, and the Federal Energy Regulatory Commission, FERC, are investigating Enron's activities. There is plenty to investigate there, and I trust that these inquiries will be conducted in a careful and thorough, as well as fair, manner.

It is necessary to provide the agencies and Congress with the best information possible so that we can take whatever actions our respective responsibilities require to ensure that working people and investors are not victimized by this kind of a smelly mess again.

With this in mind, I must express reservations about the apparent tendency of both the SEC and FERC to reach premature conclusions about important public policy questions posed by the hearing today.

On the one hand, each agency has begun investigations into Enron in keeping with their statutory responsibilities. On the other hand, and this is most troubling to me, and I suspect also to the committee, both agencies already seem to have concluded that Enron's collapse raises no substantial question about regulation of the Nation's electricity suppliers.

I differ very strongly with that view. Mr. Chairman, I would like to introduce into the record a response from SEC Chairman Harvey Pitt to a letter in which my colleague, Mr. Markey, and I asked whether, in light of the Enron debacle, that the Commission was reconsidering its position with respect to the appeal of the Public Utility Holding Company Act.

Mr. BARTON. Does the gentleman have a document that he wishes to put into the record?

Mr. DINGELL. This is such a good one that I would like to read it, Mr. Chairman.

Mr. BARTON. Oh, I thought you wanted to put it in the record.

Mr. DINGELL. Since I have 5 minutes, I will just say this is an admirable statement, Mr. Chairman. I had hoped that my colleagues will read it, and enjoy it as much as I would.

Mr. BARTON. The Chair will accept it being put in the record if the gentleman would formally ask that it be put in the record. We are not trying to be extreperous. We are trying to follow the rules that you so ably enforced when you were chairman.

Mr. DINGELL. Mr. Chairman, I ask for unanimous consent that my statement be put in the record in full, and also that the Securities and Exchange Commission's response to my communication, and another communication which I am going to send them, and in which I know they are going to answer quickly, although——

Mr. BARTON. We will accept the one that has already been sent and answered to. We can't accept one that has not been sent or answered to yet.

Mr. DINGELL. Well, I want the record kept open, Mr. Chairman. I know that is within your power.

Mr. BARTON. We will do so. Without objection, it is so ordered.

Mr. DINGELL. Thank you, Mr. Chairman.

[The prepared statement of Hon. John D. Dingell follows:]

PREPARED STATEMENT OF HON. JOHN D. DINGELL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Mr. Chairman, I commend you for holding this hearing to help us begin to understand the impact of Enron's bankruptcy on energy markets and, most importantly, on consumers. Today's hearing is a good start at peeling back the layers of what looks to be a rather large and pungent onion.

I welcome the participation of the federal agencies responsible for protecting investors and consumers. I am pleased that both the Securities and Exchange Commission (SEC) and the Federal Energy Regulatory Commission (FERC) are investigating Enron's activities, and trust that these inquiries will be conducted in a careful and thorough manner. This is necessary to provide the agencies and the Congress with the best information possible, so we can take action to ensure that working people and investors are not victimized again.

With this in mind, I must express reservations about an apparent tendency of both the SEC and FERC to reach premature conclusions about the important public policy questions posed by today's hearing. On the one hand, each agency has begun investigations into Enron in keeping with their statutory responsibilities. On the other hand, and this is the troubling point, both agencies already seem to have concluded that Enron's collapse raises no substantial questions about regulation of the Nation's electricity suppliers.

Mr. Chairman, I would like to introduce into the record a response from SEC Chairman Harvey Pitt to a letter in which Representative Markey and I asked whether, in light of the Enron debacle, the Commission was reconsidering its position with respect to repeal of the Public Utility Holding Company Act (PUHCA) of 1935. The agency acknowledges that it is appropriate for Congress to await the results of various Enron investigations to address PUHCA repeal—but in the same letter reiterates its support for PUHCA repeal "*at this time.*" I am curious to understand why the regulatory agency charged with protecting the interests of utility investors has concluded there is nothing to learn from its own ongoing investigation into Enron's behavior? Had PUHCA already been repealed, Enron might have bought utilities throughout the country. In that event, legions of state regulators would likely be combing the books of thousands of subsidiaries, both domestic and foreign, to determine whether affiliate abuses had occurred and what harm befell consumers. Moreover, these utilities might have met the same fate as Portland General Electric, which currently is being sold off by a cash-strapped Enron. Is this what we want for such a fundamental industry?

Likewise, I am puzzled by FERC Chairman Wood's testimony, which concludes that Enron's collapse "has not had any substantial spillover effects" on "energy markets." Perhaps this is a matter of terminology, but I wonder how Chairman Wood reached this conclusion when FERC still is in the early stages of a fact-finding investigation into allegations that Enron may have manipulated electric and gas markets? Chairman Wood indicates that, once the Commission receives the staff report, it will decide whether to institute formal investigations under section 206 of the Federal Power Act "into long-term power contracts whose prices may have been influenced by any inappropriate Enron activities." Perhaps I fail to grasp an implicit distinction between impacts on "energy markets" and *impacts on energy consumers.* I assure you, however, such distinctions will mean little to the average consumer in the West or any other region where Enron is found to have used its market power to manipulate prices—a matter squarely within FERC's responsibility to ensure that wholesale power prices are "just and reasonable."

In conclusion, I caution both the SEC and FERC to resist the temptation to trump their own investigations and reach premature conclusions they may later have to retract. Enron's collapse is a very serious matter, and the public has no desire to shove the details aside and proceed as if nothing important has happened.

I thank Chairman Barton for holding this hearing and look forward to our continuing to work together on these important questions.

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
February 12, 2002

The Honorable JOHN D. DINGELL
Ranking Member
Committee on Commerce
U.S. House of Representatives
2322 Rayburn House Office Building
Washington, DC 20515

The Honorable EDWARD J. MARKEY
U.S. House of Representatives
2108 Rayburn House Office Building
Washington, DC 20515

DEAR CONGRESSMEN DINGELL AND MARKEY: Thank you for your January 30th letter, asking us to consider whether the Commission, in light of Enron's tragic collapse, should continue to support repeal of the Public Utility Holding Company Act of 1935. I very much appreciate, and share, your continuing interest and concern about this important policy issue. I have attempted to provide a comprehensive response to the concerns raised in your letter.

First, in the face of Enron's collapse, the Commission is reconsidering its views on all matters, including our position on PUHCA repeal. As I am sure you are aware, Commissioner Isaac Hunt testified on behalf of the Commission before the Senate Committee on Energy and Natural Resources on February 6th. Before the Commission submitted its testimony, we carefully considered our longstanding position on PUHCA repeal and whether it needed to be modified. Ultimately, as the testimony demonstrates, the Commission determined that it should continue to support conditional repeal of PUHCA. As the investigation of Enron continues and we learn from the events surrounding Enron's collapse, however, we will continue to be open-minded about this issue and will reassess our views periodically.

Second, as your letter points out the Commission's position an repeal has always been based an our conclusion that much of the regulatory structure required by PUHCA either duplicates other systems of regulation or is simply no longer necessary. As the Commission initially concluded in the early 1980s, the Commission's regulation of all issuers has been significantly enhanced since 1935. In addition, since 1935, state and federal regulators have been given additional authority and have become much more sophisticated in their regulation of utilities.

Today, as I have pointed out in both my recent article in the *Wall Street Journal* and in recent testimony, there is a compelling need to improve and modernize our corporate disclosure and financial reporting system and to establish an effective and transparent system of private regulation of the accounting profession subject to the Commission's rigorous oversight. Specifically, in my testimony last week before a subcommittee of the House Financial Services Committee, I outlined a number of critical areas in which we must improve our system of regulation in order to ensure that all investors receive financial disclosure that is meaningful and intelligible.

Nonetheless, the need to improve our regulation of corporate disclosure is not inconsistent with our longstanding view that much of the regulation required by PUHCA is duplicative and unnecessary. Needed reforms to our way of regulating corporate disclosure and accounting must be made on an across-the-board basis. Attempting to fix the system on an industry-by-industry basis is an inefficient use of resources and is potentially counterproductive. As we implement new initiatives in this area, and thereby add effectiveness to the securities laws administered by the Commission, the regulatory framework created by PUHCA in these areas will be increasingly duplicative and inefficient.

The Commission continues to believe that repeal of PUHCA should be accompanied by legislation providing the Federal Energy Regulatory Commission and state regulators with effective tools to police against the risk of abusive affiliate transactions and cross-subsidization. As we have testified, as long as electric and gas utilities continue to function as monopolies whose rates are regulated by state authorities, state and federal regulators must be able to protect consumers from potentially abusive practices. At the federal level, FERC is the proper agency to have this type of authority. Moreover, if Congress chooses not to repeal PUHCA, we believe that Congress should transfer authority for administering it to FERC.

The question whether Congress should act on PUHCA repeal now or wait until the various investigations of Enron are complete is not an easy one. It is certainly appropriate for Congress to await the results of various investigations of Enron's collapse and to apply what it learns from those investigations in a wide variety of areas, including in its consideration of reforming and modernizing the regulation of the natural gas and electricity markets.

At the Commission, although we continue to support repeal of the Act, we also recognize that repeal is the prerogative of Congress. As long as PUHCA remains law, you have my assurance that we will continue faithfully to administer its letter and spirit. However, in order to reduce unnecessary regulatory burdens on America's energy industry, we continue to support repeal of PUHCA at this time coupled with necessary consumer protections.

Almost 67 years ago, in response to the controversy surrounding PUHCA's enactment and the Commission's initial attempts to implement it, then-Chairman James Landis said, "under these circumstances the discretion of silence might well be the better part of valor. But to me, silence would be a denial of a fundamental of democratic government." The same is true today. Although Enron's collapse is a tragedy for the innocent investors and innocent employees who have been injured by it, and although it has provoked needed discussions in Congress, at the Commission and elsewhere on a number of important policy issues, we cannot allow the fury surrounding its collapse to hinder our ability to make sound policy judgments. In the Commission's view, repeal of PUHCA, coupled with necessary consumer protections, remains sound policy.

Again, I very much appreciate your continuing interest in the Commission's views on and administration of PUHCA. If you would like to discuss these matters further, I would welcome the opportunity to meet with you at your convenience. And, if you have additional questions or comments, please do not hesitate to contact me at 942-0100.

Yours truly,

HARVEY L. PITT
Chairman

cc: The Honorable W. J. "Billy" Tauzin
The Honorable Joe Barton
The Honorable Rick Boucher

Mr. BARTON. The Chair would recognize the full committee chairman, the distinguished gentleman from Louisiana, Mr. Tauzin, for an opening statement.

Chairman TAUZIN. Thank you, Chairman Barton, and I want to thank you for working to coordinate this hearing with the other subcommittee hearings on the state of the Enron collapse, and its effect on this market, as well as others.

And obviously you have all heard that tomorrow the Subcommittee on Oversight and Investigations will be continuing its work, and we will have Sherron Watkins, the Enron employee who tried to warn the President of Enron, Ken Lay, that there were questionable accounting practices going on behind these transactions.

And we will also have a Subcommittee on Commerce, Trade, and Consumer Protection, hearing that will look into the current financial accounting standards, and whether they are sufficiently informative to consumers and other investors in corporations.

So this subcommittee hearing is part of that 3-part process, the Oversight and Investigations Subcommittee taking a long look at any wrongdoing and violation of standards, and nevertheless, these two subcommittees to make sure that we understand the effect on the market, and the effect on our need to improve the laws and the rules by which people invest in markets like this one.

The hearing also I think will highlight a good story in the face of all the bad stories that we have been hearing in this investigation. Despite Enron being the largest energy trader in North America, a sudden and dramatic departure from the energy markets took place with little, if any, impact on energy prices and supplies.

That is a remarkable story, and that somehow the markets worked around the financial collapse, and still delivered energy to consumers at rational rates, and still delivered ample supplies of gas and electricity in those markets, and at a time when energy prices still remain significantly low.

And no disruptions in supplies, and no disruptions in deliveries that we know of, and I think that is a testament to the maturity and success of these competitive energy markets today, and the stability and benefits that I think they will continue to deliver to folks in this country.

We saw that in gas, and we also saw it in electricity, and hopefully, as a result of this hearing, we can get a better picture of how that happened, and how these markets are working in spite of this type of collapse, so that we might follow a very important rule when we go about trying to fix some of these problems, and that is do no harm.

And that we not harm the good features of a marketplace that does in fact work. I want to make it clear that our committee intends to follow this investigation wherever it leads, and so we endorse the FERC's examination of issues raised in the Senate.

At the same time, we also believe that in this market, as in other markets, that more disclosure, more transparencies, is probably a very good idea, and to the extent that you can shed some light on how this energy trading system can be perhaps more transparent and more informative to both consumers and investors in that market, we will be interested in hearing.

I want to welcome again the FERC Chairman, Pat Wood, to the committee. Mr. Chairman, you know that you and I don't agree on all issues, and we are debating a few right now, but I want to commend your hard work and your tenacity.

And I also want to welcome the CFTC Chairman, James Newsome. We appreciate your willingness to help us understand the role that your agency plays in these markets, and we certainly welcome Commissioner Hunt back, of course.

And we look forward to the testimony which we feel strongly the House needs to follow the Senate's lead in the repeal of the Public Utility Holding Company Act, although my friend, Mr. Dingell, has a different view on that.

But we want to hear more about it, and we also want to welcome the Acting Director of the Energy Information Agency, Ms. Mary Hutzler, back to the subcommittee for the first time with a new title, and we welcome you.

And we certainly want to welcome the Maine Public Utility Commissioner, Chairman Welch. This is going to shed light on what we hope will be an understanding of how these energy markets function in today's competitive marketplace.

I thank the chairman for the hearing.

[The prepared statement of Hon. W.J. "Billy" Tauzin follows:]

PREPARED STATEMENT OF HON. W.J. "BILLY" TAUZIN, CHAIRMAN, COMMITTEE ON ENERGY AND COMMERCE

Thank you, Chairman Barton for working to coordinate this vital hearing, which will consider the state of our Nation's energy markets following Enron's collapse. The effects of that collapse will remain in sharp focus for our Committee as we continue to investigate what happened and examine possible legislative action.

Tomorrow, the Subcommittee on Oversight and Investigations continues its multi-day hearing into the transactions that toppled this company. The witness will be Sherron Watkins, the Enron employee who tried to warn Ken Lay about questionable accounting behind the transactions. The Subcommittee on Commerce, Trade and Consumer Protection will also hold a hearing tomorrow to see whether current financial accounting standards are sufficient to protect investors.

This hearing today is especially important because it highlights a story that is not being told. Despite Enron being the largest energy trader in North America, its sudden and dramatic departure from the energy markets took place with little, if any, impact on energy prices and supplies. Energy prices generally remained low and stable around the country as parties unwound their positions with Enron. There were no disruptions in supply, and customers received their deliveries without interruption. This is a testament to the maturity and success of competitive energy markets and the stability and benefits they can deliver when structured properly.

Natural gas markets provide another example of this fact. Federal policies that regulated wellhead gas prices and allowed for the existence of gas pipeline monopolies, which shut out competing suppliers and denied producers access to consumers, resulted in serious gas shortages in the late 1970s. Schools and hospitals closed down because they couldn't get gas to heat their buildings. Beginning with the passage of the Natural Gas Act in 1978, Congress and the Federal government worked to open the market up, by requiring pipelines to transport gas for others and finally by deregulating wellhead prices. A combination of failed regulatory policies and understanding of market forces pushed us back then to adopt competition as a policy in gas—not Enron lobbying.

The same is true with electricity. Electricity markets have been maturing around the country. Beginning with the 1992 Energy Policy Act, we have increasingly opened up access to the transmission grid for competitively priced wholesale power. The result has been an overall decline in the price of wholesale power, and the advent of cleaner, more efficient generating plants.

The bottom line is that policies encouraging competitive markets have deep roots in our regulatory structure, regardless of Enron. The need for more affordable, more efficient sources of energy and power, and the benefits that customers derive from

this are what drives competitive markets and what has driven reform of regulatory policy—not the actions of a particular company.

That said, this Committee intends to follow our investigation of Enron wherever it leads. I understand that the FERC has undertaken a fact-finding investigation into allegations that came out of a Senate hearing, which is in addition to the other ongoing investigations. In our second panel, we will hear from the latest source of those allegations and one of the expert witnesses in that litigation; we will be able to discuss whether their arguments have any merit. If there indeed turns out to be a need for additional disclosure or transparency in electricity markets, this Subcommittee will be ready to address that legislatively in Chairman Barton's electricity bill.

As for our other witnesses, I would like to welcome FERC Chairman Pat Wood back to the Committee. You and I don't agree on all the issues, but I commend your hard work and your tenacity. I would also like to welcome CFTC Chairman Newsome. We appreciate your willingness to help us understand the role your agency plays. We welcome Commissioner Hunt back before us. I look forward to your testimony since I feel strongly that the House needs to follow the Senate's lead and repeal the Public Utility Holding Company Act of 1935. I also welcome Acting Director of the Energy Information Administration, Mary Hutzler, back to the Subcommittee—but for the first time with her new title. Finally, welcome to Maine Public Utility Commission Chairman Welch. Thank you for coming, and I look forward to all your testimony.

Mr. BARTON. Thank you. We now want to recognize Mr. Waxman of California, who was the first member present at the hearing today, and we welcome your opening statement.

Mr. WAXMAN. Thank you very much, Mr. Chairman. Thank you for holding this hearing. It is very timely. Yesterday, Ken Lay refused to testify about the Enron scandal, but it wasn't too long ago that Ken Lay testified before this subcommittee, and freely made a number of promises about deregulation.

And I would like to spend a few moments reviewing these promises. Let's look at the first chart. Ken Lay told us to reform the electric power system and give American consumers the equivalent of one of the largest tax cuts in American history.

Well, many States took Mr. Lay's advice and restructured their electric utilities. So how accurate was Mr. Lay's prediction? According to a recent report by the Consumer Federation of America, "Despite predictions of huge rate reductions in States that restructured electricity service, consumers there are paying higher prices, and receiving less reliable service than in those which have not restructured."

Now let's look at another prediction. Mr. Lay told us that deregulation would dramatically cut rates for consumers. He said that it is time to bring competition to the electric business, and in the process cut electricity rates by 30 to 40 percent.

Well, that sounds pretty good. Unfortunately, this prediction has not held up too well either. According to the Consumer Federation of America, "In retrospect, claims of efficiency gains and price reductions of 40 percent or more for electricity restructuring seem silly. In fact, careful analysis showed that under the best of circumstances efficiency gains in generation could only be a fraction of that, while efficiency losses and new costs are far larger. It may well be that inefficiencies introduced into what has been a reasonably well managed network have increased overall costs by over 10 percent."

Mr. Lay promised the competition would bring rates down by 30 to 40 percent, and in effect, it appears to have raised rates by over 10 percent, and things are worse in California.

The Los Angeles Times reported that the typical homeowner in Southern California, Edison territory, now pays 18 percent more each month than in 1995.

At no point during the deregulation process did residential consumers enjoy the sharply lower electricity rates prices that advocates of the policy had forecast. Now, another prediction.

Mr. Lay told us that customer choice will allow the introduction of green energy options. Well, the American people want the environment protected, and this promise has appeal to it.

Unfortunately, the reality is that air pollution has gone up as a result of wholesale electricity competition. The North American Commission for Environmental Cooperation recently conducted a study on this issue and as the chart shows, found "U.S. Energy regulators underestimated the amount of increased pollution that arose after wholesale electricity competition rules were adopted in 1996."

"Recent experience indicates that electricity competition is likely to increase air emissions from power plants. FERC underestimated by nearly 8 percent the amount of carbon dioxide and other pollutants that U.S. utilities emit under the worst case scenario."

Well, despite Mr. Lay's prediction that consumers and the environment would win under competition, these promises haven't been realized, but what about business? Let's look at the next chart.

Mr. Lay told us that "American industry will become more profitable, and become stronger competitors in an international marketplace." Well, this one may just be the biggest whopper of them all. According to the L.A. Times, "The collapse of the Enron Corporation, so far a political, legal, and investor crisis, is now imposing widespread costs on the U.S. economy according to a range of companies, energy experts, and bankers. The very decline of Enron stock from more than $90 a share to 50 cents a share in a single year has taken a massive $67 billion of shareholder wealth out of the economy. Also, other energy companies have suffered losses in the hundreds of millions of dollars because of their relationship to Enron."

And I would like to also introduce into the record an article just from today's Washington Post, entitled, "Enron-Related Fears Take Toll on Other Firms' Stocks." Mr. BARTON. Do you have an article?

Mr. WAXMAN. Yes.

Mr. BARTON. Have we seen it?

Mr. WAXMAN. Well, it is in the Washington Post, and I hope that you have seen it. We will provide it to you and you can take it under submission as to whether you will put it in the record, but I would request you do so.

Mr. BARTON. But I am sure that we will put it in the record.

[The article follows:]

[Wednesday, February 13, 2002—Washington Post]

ENRON-RELATED FEARS TAKE TOLL ON OTHER FIRMS' STOCKS

By Ben White, Washington Post Staff Writer

NEW YORK, Feb. 12—Despite a handful of light-volume bargain-hunting rallies, the markets are off to a rocky start for the year. After coming out of the blocks jazzed about an incipient economic recovery and certain of a rebound in stock prices, investors and money managers have instead pulled back. And after the spectacular

collapse of Enron Corp., companies that carry even a hint of possible accounting problems have been hit hardest.

As investigators probe whether Enron's byzantine accounting methods broke the law, investors have grown fearful that other companies may be massaging the books to inflate their stock prices or hide serious weakness. Such concerns have hurt the stock prices of big firms, such as Tyco International Ltd. and General Electric Co., as well as less well-known companies such as franchiser Cendant Corp. and Irish drugmaker Elan Corp.

Others suffering from increased worries about accounting issues include the stocks of telecom giant WorldCom Inc., energy producer Reliant Resources Inc., power producer Calpine Corp., network-equipment maker Enterasys Networks Inc., energy services firm Williams Cos. and PNC Financial Services Group.

Taken together, these companies, along with GE, Tyco and Cendant, lost $108 billion in market capitalization for the month beginning Jan. 7 (just before the Justice Department launched its criminal probe of Enron), according to Markethistory.com, a research Web site.

And the losses are by no means limited to those nine. While the pain has been widespread, no company has felt it more sharply than Bermuda-based conglomerate Tyco.

On Jan. 7, the company's stock closed at $54.38. A month later it finished at $28.05, a drop of close to half and a paper loss of $50.9 billion. The stock has recovered somewhat but closed today at $30.50, down $1.30.

Money managers said Tyco shares might have slipped regardless of Enron; there have been questions about how the company accounted for its many acquisitions for years. But without Enron, and the attendant media frenzy, many managers believe there would have been no mad dash to dump the company's stock.

"We made a decision to sell Tyco not because there was anything fundamentally wrong with their accounting," said Timothy R. Stives, portfolio manager at Ashland Management Inc., which handles $2 billion. "But now we are in a situation where Enron has created a negative psychological environment and stocks like Tyco are underperforming. And we think this situation is likely to persist, longer than many expect."

Meanwhile, General Electric has long been lauded as among the nation's best-run corporations. Yet shares in the company dropped as low as $35 on Feb. 4 before stabilizing recently. But GE is still trading well below its high of $53.50. And plenty of detractors remain who question how the conglomerate continues to produce such consistent earnings.

No one has accused GE of wrongdoing. Most of the questions center not on GE's well-known product lines, such as aircraft engines, but rather on its financing arm, GE Capital. Some analysts and investors have been putting pressure on the company to provide more information about GE Capital, which produced 40 percent of the company's $13.7 billion in earnings last year. GE has said it will consider ways to make its credit arm more transparent.

Shares of long-distance provider WorldCom, already suffering in the depressed telecommunications sector, have fallen as questions about its debt received more intense scrutiny because of Enron, analysts said. Those questions lead to speculation that the firm could wind up in bankruptcy court. WorldCom has repeatedly said it is in no such danger.

Reliant shares dropped after the company said it would delay a fourth-quarter earnings report and restate 2001 profits because of accounting mistakes. Calpine shares dropped to a 22-year low earlier this month after the firm acknowledged that the Securities and Exchange Commission was investigating whether the company improperly disclosed information to analysts. Enterasys also delayed fourth-quarter earnings over accounting issues and said it was the subject of an SEC investigation.

Energy company Williams Cos. lost ground after saying it might have to pay as much as $2.4 billion to cover debt payments for Williams Communications, which the parent company spun off last April. The company has also struggled to stave off the kind of credit downgrades that helped seal Enron's fate. And PNC shocked an already nervous Wall Street on Jan. 29, saying it would reduce 2001 net income by $155 million, or 27 percent, to address concerns raised by the Federal Reserve that the company had improperly accounted for some underperforming loans.

In a normal environment, none of these announcements would have been good, financial observers said. But their potential to damage a company's stock price has been magnified.

"Anything that comes out now is having a serious ripple effect," said Kenneth A. Bertsch, director of corporate governance at TIAA-CREF, the investment firm that handles retirement money for educators.

Bertsch cited a number of reforms necessary to restore investor confidence, including stricter accounting standards and more muscular corporate boards free from any conflict-of-interest problems. Bertsch also said among the most important ways to make corporate balance sheets more closely resemble reality, and thus more useful to investors, would be to change the accounting method used for stock options.

Currently, companies do not have to count options granted to employees against earnings. And, once the options are exercised, companies can use them to ease their tax burden. Corporations have fiercely and successfully lobbied against repeated efforts in Washington to end this practice.

But Bertsch said Enron has created a new environment that threatens to expose politicians who in the past have blocked the changes without fear of public scrutiny. "This really could have a positive impact down the road," he said, adding that the post-Enron drop in share prices could send a message to companies that the 1990s mentality that "corporate governance issues don't matter" is over.

Opinions remain mixed on Enron's potential long-term impact on the stock market. Some argue that the markets could drift slowly downward all year, reflecting a general pullback similar to what happened after the crash of 1929, when the middle class abandoned the capital markets for two decades.

"If you put it all together, I suspect this will have more of an impact on investor confidence than the fall of the Nasdaq technology stocks did," said Henry Hu, a professor of securities law at the University of Texas, noting that along with the collapse of Enron itself, investors may be scared off by the many conflict-of-interest questions raised in Enron's wake about accountants, Wall Street analysts and credit rating agencies—all of whom are supposed to provide investors with unbiased information about a company's performance.

But others believe that Enron alone, without more splashy failures, will not be enough to reverse the trend of average Americans pouring their savings into stocks in recent years. Stock prices will pick up, these people argue, once the economy does.

"What will reverse this market," said Stives of Ashland Capital Management, "is the first real evidence that the economy is turning around and corporate profits are improving. That, and when the media decides to move on to something else."

Mr. BRYANT. What if we don't read the Washington Post?

Mr. WAXMAN. Well, when you read the record, you will read this story if it is permitted to go in the record.

Mr. BARTON. We could get somebody to read it to you maybe.

Mr. WAXMAN. For years, we have heard the promises about deregulation, but the reality of deregulation has meant more pollution and more costs to consumers. Mr. Chairman, we have a duty to protect consumers from gouging, to protect the environment from pollution, and to protect investors from sham accounting that hides huge losses in energy markets. It is time to take a deep breath and rethink this pending legislation.

Mr. BARTON. I thank the gentleman for his statement. I would simply say that it is heartfelt, but some of those promises may yet come true once we actually do it. We have to do it first.

Mr. WAXMAN. That is a matter of faith and belief, but not reality.

Mr. BARTON. I am a very faithful person. The gentleman from Oregon, Mr. Walden, is recognized for an opening statement.

Mr. WALDEN. Mr. Chairman, I am going to keep my remarks brief. However, I just think that we are darn lucky that the Enron collapse occurred, if it was going to occur, at the time that it occurred.

Because I think that our economy is so far back on its rear end that demand is so low for energy products across the country, and the markets were not under the same pressure they were prior to that when we were having hearings a year ago.

And the more I hear about what Enron has been up to, and was up to, the more it appears to me that perhaps their goal was to cre-

ate chaos in the market so that they could then capitalize on it in trading before regulatory oversight would come to bear.

And so I am not sure how eager I am to necessarily applaud the fact that the markets have gone along fine with or without Enron, because I am not sure that I am ready to admit that without the downturn in the economy that we would not be in a lot worse shape right now.

And I think the market does have vitality to it, and I do think there is others that could fill the gap, but if it were going to happen, I think we are probably not suffering as mightily as we might have had it occurred when the markets were tighter. I don't know. We will see how that bears out.

And as we look at this whole issue of regulation, coming from Oregon, which of course is the one utility, Portland General Electric, in Oregon that Enron owned, we were fortunate that frankly our Public Utility Commission was pretty strong, in terms of putting some boundaries around what Enron could or could not take out of Portland General Electric.

One of the things that have been reported that they did, however, was take multi-millions of dollars in supposed Federal tax payments into the rate structure in Portland, and then basically bonus that up to the main company that apparently never did pay that in Federal tax.

And so the rate payers paid what they thought—what the utility commission thought was going to be tax payments to the Federal Government that may never have been paid. So I think that there are some issues here that we need to cautiously approach. Thank you, Mr. Chairman, for this hearing.

Mr. BARTON. Mr. Luther was next on the Democrat side. Is he in the annex? If not, Mr. Luther, we will go to Mr. Sawyer. All right. We will recognize Mr. Sawyer for an opening statement.

Mr. SAWYER. Well, thank you, Mr. Chairman, and thank you for holding this hearing. It is an important step in our exploration of the Enron debacle. Mr. Chairman, I know, and I share your dedication to removing as appropriate barriers that exist to healthy electricity markets that benefit customers.

But I am sure that you would agree that it is best that we evaluate the causes and consequences of Enron's astonishing fall before we move forward on a electricity bill.

Today's hearing will help advance that understanding, but I imagine that it will take more than what we can accomplish here today for us to unravel Enron's business practices, and their effects on energy markets.

I would also add that I don't think we ought to allow Enron to derail our longer standing efforts to overcome the significant impediments to workable energy markets that still exist.

We can look to California to see a cautionary tale about taking the time to get the market rules right before putting them into effect. And I would just simply add that I think we are heeding that lesson today.

And another lesson from California is that government has the responsibility to craft clear rules to undergird a market and then enforce those rules on all parties. Right now the electricity industry and their consumers are stuck in the middle of a transition to com-

petitive markets, and there is very little certainty about where those markets are heading.

So I hope that today begins a renewed effort to ensure that the rules that we use to create viable regional electricity markets are both effective and enforceable.

Just as an aside, I would add, Mr. Chairman, and repeat the interest that I have in which consumer protections and other elements in PUHCA, we must ensure and survive a possible repeal of that Act. With that, Mr. Chairman, I yield back the balance of my time.

[The prepared statement of Hon. Thomas C. Sawyer follows:]

PREPARED STATEMENT OF HON. TOM SAWYER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Thank you Mr. Chairman, and thank you for holding this hearing. It is an important step in our exploration of the Enron debacle. Mr. Chairman, I know and share your dedication to removing barriers that exist to healthy electricity markets that benefit consumers. But it is best that we evaluate the causes and consequences of Enron's astonishing fall before we can consider moving forward on an electricity bill. Today's hearing will help to advance our understanding, but I imagine that it will take a good deal more time for us to unravel Enron's business practices and their effects on the energy markets.

But I will also add that we should not allow Enron to derail our longer-standing efforts to overcome the significant impediments to workable energy markets that still exist. We can look to California and see a cautionary tale about taking the time to get the market rules right before putting them into effect. I think we are heeding that lesson today. But another lesson from California is that government has a responsibility to craft clear rules to undergird a market, and then enforce those rules on all parties.

Right now the electricity industry and their consumers are stuck in the middle of a transition to competitive markets, and there is very little certainty about where those markets are heading. We must measure twice, then cut once, but Congress cannot afford to do no cutting at all. So I hope that today begins a renewed effort to ensure that the rules that we use to create viable regional electricity markets are both effective and enforceable.

It seems to me that one lesson that is emerging from our investigation of Enron's collapse is that it is primarily the product of an arrogant corporate leadership choosing to flaunt securities rules and exploit loopholes in standard accounting practices, not the inevitable product of electricity restructuring.

I expect that we will hear testimony from today's panel about the possibility that Enron manipulated prices in the energy futures markets in which it was heavily involved. But the fundamental motivation for that behavior again goes back to accounting procedures. The "mark-to-market" accounting standard allowed Enron to take the expected value of its long-term energy contracts, and place that expected income on its current income statements. In order to exploit this standard, implemented by FASB in 1993, Enron may have worked to hike the value that it ascribed to long-term contracts in order to allow it to inflate its current year's earnings statement.

Congress must respond to the weaknesses in our regulatory system that Enron's activities have exposed. Part of that work will be trying to make energy trading markets more transparent, and ensuring that energy consumers continue to receive protection from the manipulation of prices on a product that is a necessity of modern life. I am particularly curious about which consumer protections from PUCHA we must ensure survive a possible repeal of the act.

But I suspect we will obtain the most leverage on answering the questions raised by Enron's collapse by addressing the disturbing accounting and securities issues revealed by Enron's conduct. I am particularly concerned by the seemingly arbitrary quality of mark-to-market accounting rules, as well as the standard by which Special Purpose Entities like Raptor and Chewco could have been unconsolidated with Enron as long as three percent of its assets were owned by outside equity holders. But I am especially interested in this panel's view on the continued exemption of over-the-counter energy derivatives trading from CFTC oversight. I thank the witnesses for being here, and look forward to their testimony.

Mr. BARTON. We thank the gentleman from Ohio for that statement, and seeing no one on the Republican side, next is Mr. Wynn. Did he just leave? Is he out there, because he was here. If not, then it will be Mr. Hall. We will start with Mr. Hall for an opening statement.

Mr. HALL. Mr. Chairman, thank you, and members of the committee, I of course thank you, Joe Barton, for holding this hearing today on market issues and questions that have been raised in the wake of the collapse of Enron.

I think that I would like to begin by saying that it is my most sincere wish that we take from this unfortunate event a list of improvements that we make in our energy markets so that we might not see a catastrophe like this and of this proportion again. That remains to be seen.

And while it is important that we understand fully what happened at Enron so that we might carry out our obligations to make whatever changes are needed in law and policy, we need to recognize that ultimately the courts and the regulatory agencies are going to deal with what happened there.

And I guess it is our duty to point up the facts, and I think that bears on each party that are doing their very best to do that. Evidence has come to light that energy markets may have been manipulated, especially during the Western energy crisis of 2000.

I remember that we were well on track to give aid to our most populous State that was having a lot of problems then, and a mild summer kind of came to their aid, and September 11th changed a lot of it, because it diverted money to a war that we are going to have to support and fight, and that we need desperately to help some of the States that are having difficulty.

And to work on prescription drugs, and to correct a lot of the Medicare and Medicaid. So that is a reality. We have got a young Commander-in-Chief that is doing a good job, and is working day and night, and I think it is our duty to support him.

Now, consequently, FERC investigations may nullify some of the long term contracts that States thought they were stuck with, and if this is the case, it will provide some relief for countless utility customers.

And it will also provide further testament to the instability and the malleable nature of energy markets, which all of you are very aware of. And I see Pat Wood out there, who is of my own State, and a young man for whom I have the highest respect and regard.

And I was very pleased when he was appointed and when he accepted, and when you read the papers, it sounds like Ken Lay is the only guy in the world that recommended him, but that's not true.

I know that I wrote letters and made calls, and I think many of the Texas delegation did, and others from other State delegations that knew of Pat Wood, and knew of his dedication and his knowledge.

So I think that as these facts are all uncovered, obviously there is going to be a need for more hearings of this type by this committee. The distinguished witnesses that we have before us today have a great deal to teach us based on what they have observed

thus far, and I trust that we are going to benefit greatly from their observations and their experience.

Mr. Chairman, perhaps we ought to have them back in 6 months or 4 months from now, and ask them how their views may have changed as the Enron story continues to unfold, and the markets react accordingly.

And it may in fact be much longer than that before we see the true effects of such a radical change in the market. Restating earnings has a very negative effect on the credit worthiness of a company, and we have to be realistic when assessing the future of the energy markets if the major players don't have access to the capital enabling them to proceed with generation progeny.

We are not here to ensure the future of major corporations, but it is our duty I think to ensure the future of our citizens, and in closing, Mr. Chairman, as a member from the oil patch, let me urge my colleagues, as did Mr. Sawyer, who is exactly right in his assessments, not to tar all other energy companies with an Enron brush.

There are many, many well-run energy companies that are conservatively managed, and treat their creditors, their employees, their shareholders, and those that expect to retire with a pension, treat them fairly.

Oil and natural gas, and, yes, electricity markets, are evolving, but let's be careful that we don't act hastily and undo the progress that these markets have made, and as problems are uncovered, let's correct them, but don't throw out the premise that competitive markets are innately.

At the very least, we owe it to ourselves to tread cautiously, but not falter in our commitment to utility restructuring, and I yield back my time.

Mr. BARTON. We thank the gentleman from Texas. The gentleman from Illinois, Mr. Rush, is recognized for an opening statement.

Mr. RUSH. I want to thank you, Mr. Chairman, for holding today's hearings on the effects of the Enron bankruptcy on energy markets. In the wake of the Enron collapse, several House and Senate committees have been left to take inventory of the laws and regulatory schemes that were open to abuse by Enron.

And indeed remain open to abuse by all of corporate America. At the center of that discussion lies the Public Utility Act of 1935, and enacted at a time when big business proved itself to be completely untrustworthy and dangerous to investors and consumers alike.

PUHCA assumed that the nature of big business is to grow and prosper, even when that growth and prosperity comes at the expense of the consuming public.

Thankfully that wisdom lives on through the words of officials like former Governor Bush of Texas, who stated in 1999, "The invisible hand works many miracles, but it cannot touch the human heart."

Indeed, opponents of PUHCA repeal argue that without firmer consumer protections to take its place, repeal may replace the miracle of the free market with the nightmare of market manipulation and monopoly.

Still, many, including Enron, were unconvinced; playing a tune of free and efficient markets, Enron was the pied piper of stand alone PUHCA repeal, and while many in government were not swayed by its song, there were many more in positions of power and influence who listened and marched blindly forward, following the songs of Enron.

Mr. Chairman, if there is a silver lining to the tragedy of Enron, it lies in the fact that it has forced Congress to rethink its stance on the role of the Federal Government and regulation of corporate activity in the public's interest.

Supporters of PUHCA repeal argue that the serious reconsideration of how Congress moves toward electricity restructuring is unnecessary, even in light of the Enron collapse.

Time and time again, they point out that despite the political and regulatory shock waves sent out by the collapse of Enron, energy markets barely flinched in response. This observation is well noted. However, we need only to look to the West Coast brownouts of 2001 for possible evidence of a connection between Enron's financial misdeeds and the wallet of unsuspecting consumers.

That said, I am convinced and encouraged by FERC's willingness to launch an investigation into whether Enron used its long term energy contracts to manipulate energy markets in the West.

And as that investigation continues, I will be eager to learn whether Enron, as it struggles for its own survival, attempted to save itself from going under by pushing firmly down on the shoulders of California's consumers.

If that turns out to be the case, the fact that States like New York and Pennsylvania, and Florida, and indeed my own State of Illinois, were not used as lifesavers for Enron, will ultimately serve as testament to the effectiveness of PUHCA. Thank you, Mr. Chairman, and I yield back the balance of my time.

Mr. BARTON. I thank the gentleman from Illinois, and I go to another distinguished gentleman from Illinois, Mr. Shimkus, for an opening statement.

Mr. SHIMKUS. Thank you, Mr. Chairman. I will be brief. I know that we are here today to talk about what happened to the markets after the Enron collapse, and I think that is an important thing to discuss.

A company that controlled 20 percent of the energy contracts disappeared overnight and what happened. Illinois, the last two winters ago, we experienced a shock of what happens when natural gas prices go skyrocketing.

We heard from our constituents, and that did not happen here, and I think it is worth investigating why. And in the whole guise of the energy debate issue, I look forward, and I think it is timely, Mr. Chairman, and I will just yield back my time. Thank you.

Mr. BARTON. Good. We now hear from the gentleman from Pennsylvania, who normally gives stellar and exemplary opening statements, and his is usually one of the most stellar and exemplary. And so let's see if he can match his normal standard of excellence.

Mr. SAWYER. Talk about the burden of high expectation.

Mr. DOYLE. Flattery will get you everywhere, Mr. Chairman. Mr. Chairman, thank you for convening this hearing to examine the effect of the Enron bankruptcy on the functioning of energy markets.

Like all members of this committee, I am seriously concerned about the actions of Enron and its management.

We must continue to thoroughly investigate the facts of the matter and institute appropriate remedies. The hearings in the House and Senate, in conjunction with the insight and clarity provided by the Powers report, have demonstrated that various types of reform appear to be warranted to prevent others in the marketplace from causing the level of undo harm that Enron has inflicted upon its shareholders, employees, and our financial system.

What is significantly less clear at this point is the effect of Enron's practices and subsequent bankruptcy had on the functioning of energy markets. I recognize that many of the witnesses that we will hear from today assert that there has been no noticeable disruption to the functioning of energy markets, in terms of price fluctuation, generation, or trading.

If further investigations by FERC and others confirm this initial impression, what does this tell us about the state and structure of our energy markets given the collapse of Enron, a major energy trader, whose transactions comprised an estimated 15 to 25 percent of wholesale energy trades, seemingly has had such a negligible effect.

Furthermore, I am particularly interested in looking at how these initial impressions might be skewed within the context of a falling energy price market. Obviously, we need to examine this dynamic further before reaching conclusions about the entire wholesale electricity market.

Competition, if structured and implemented appropriately, has brought benefits to electricity consumers. This is a new marketplace and deserves our scrutiny, but it is my hope that we will continue to move forward with our efforts to preserve and improve competition.

And, finally, Mr. Chairman, as a member of the committee who did not have the opportunity to weigh in on the Commodity Futures Modernization Act, I am eager to hear more about how the major changes regarding the regulation of exchanged traded futures contracts, over-the-counter derivatives, and securities futures, have fared.

I look forward to today's discussion, Mr. Chairman, and I yield back my time and thank you.

Mr. BARTON. As I said, it was a good statement, and your staffer who helped prepare it is smiling. So she thinks it is acceptable.

We now want to hear from the vice chairman of the committee, or the subcommittee, Mr. Largent. This will be his last official act as a member of this subcommittee. He is resigning from Congress tomorrow to go to the great State of Oklahoma and put his name up for election to be the Governor of Oklahoma.

We are going to miss you, and you have been a good member. You have worked extremely hard on the issue of electricity restructuring, and I had hoped to move the bill out of the subcommittee before you left so you could participate in that markup. That is not going to happen.

But as you are running for Governor, watch the press, because we still hope to move that bill, and we will have some amendments in it that will be entitled, "The Largent's Amendments," I'm sure.

So we would welcome you for an opening statement on this issue and any valedictory statements that you wish to make as a soon-to-be retired member of the subcommittee.

Mr. LARGENT. Thank you, Mr. Chairman. It has been an honor to serve on your subcommittee. You have done an outstanding job, and I was thinking about my Congressional career 7 years here in Washington, DC.

I came in and the first vote I cast was on GATT, and the last vote of the 103d Congress was my first vote, and now my last vote in Congress is going to be on campaign finance reform.

And it reminded me of Samuel Clemens, alias Mark Twain, who has said that he was born when Haley's comet passed the earth, and was visible from the earth, and then died on Haley's comet.

And that is sort of my career; it began with GATT, and end with campaign finance reform. Mr. Chairman, my only statement is that one of the real highlights for me of my time in Congress is having gotten the opportunity to serve on the Commerce Committee.

It is a great committee, and we deal with a number of really significant issues for our country, and I really believe that in the near future dealing with the electricity restructuring that we need so desperately in this country, is a very important issue, in terms of establishing a really sound national energy policy.

You know, frankly, I think that everything evil has now been attached to the word Enron, but the fact is that the markets have worked. The markets worked when it punished a bad actor in the form of Enron, and the markets have continued to work when you take a major player like Enron out of the market, and you see the electricity.

Markets have consistently and seemlessly moved forward, and I think that is something that we all should be very proud of. Free markets really do work. And I look forward to hearing the testimony of our distinguished panel, and thank you for calling this hearing, and I would yield back the balance of my time.

Chairman TAUZIN. Would the gentleman yield for a second?

Mr. BARTON. But we still have Mr. Markey to give an opening statement.

Chairman TAUZIN. I will just take a statement, because we will not have a full committee process before we see the departure of our friend, Steve Largent. I wanted to say, Steve, how much we have all appreciated your service to the committee.

Mr. Dingell, who was formerly Chair of this committee, and I both share a fierce love and devotion to the work of this committee, and the one thing we always tell people on and off this Hill, is that only the best and the brightest make it here, and you were one of the very best and brightest.

And I want to thank you for your service, not only to this committee, but to the country, and I wish you well in your new ventures in Oklahoma.

Mr. LARGENT. Thank you, Mr. Chairman.

Mr. BARTON. Mr. Doyle, who has been on the receiving end of your fastball in the Congressional baseball games, said he is not terribly disappointed that you are going to Oklahoma. Mr. Markey is recognized for an opening statement, welcomed and recognized for an opening statement.

Mr. MARKEY. I thank the chairman very much, and I will miss the gentleman from Oklahoma. Many of the amendments which he was going to make in the subcommittee markup were Largent-Markey amendments, and I am not sure that I will be able to score as frequently without Steve Largent carrying the ball.

And particularly when it comes to the Tennessee Valley Authority, which was a particularly interesting subject for the both of us, in terms of their structure inside the electricity marketplace.

Mr. BARTON. Let's not get personal now.

Mr. MARKEY. No, no, no, no, no. It is not to be facetious. I was going for the jocular vein, and not the jugular vein there. So he is a great member, and I am sure that the people of Oklahoma are very happy that he is coming home to serve them in that larger capacity.

I thank you for holding this hearing. Some have rushed to say, Mr. Chairman, after the Enron scandal broke that this has nothing to do with electricity on natural gas markets. They say this is merely a matter of accounting and securities fraud, and that Enron could have just as easily been trading widgets as natural gas or electricity.

Clearly, there has been securities fraud, and clearly there has been massive accounting fraud. Clearly, there has been shredding of documents and possible obstruction of justice. But I simply do not know how anyone can say right now that Enron's demise has absolutely no implications for the energy markets.

Last week, I asked Jeff McMann, Enron's new president and chief operating officer, how many special purpose entities Enron created, and what they were used for, and whether any of them involved other Enron insiders, and what types of financial arrangements Enron had with them.

He did not know the answer to any of those questions. The powers committee of Enron's board, which reported to us in its internal investigation, told us that it only looked at the LJM, Raptor, Jedi, and CHUCO transactions.

So right now all we know about is the tip of the iceberg. Sherron Watkins' memo mentioned market-to-market valuation problems with Enron Energy Services and other investments.

What were they? When I asked Enron officials last week, no one had looked into the concerns she raised in these areas. How many secret deals and long term contracts are still out there like ticking time bombs waiting to explode?

How big is the iceberg of fraud and deceit?

We simply do not know. The fact is that Federal regulators appearing before us today either waived oversight over Enron's activities, or had it taken away from them. The CFTC's authority to regulate Enron's energy trading was gutted by the Futures Trading Practices Act of 1992.

The exemptive rules adopted by former CFTC Chair and current Enron board member Wendy Graham, and the additional loopholes adopted by the Commodities Futures Trading Act of 1999.

The SEC's ability to restrict Enron's diversifications and limit its self-dealing practices has been constrained by the fact that it has decided to administratively repeal the Public Utilities Holding

Company Act of 1935 through a policy of non-enforcement and neglect, including application of this Act to Enron.

Press reports have also revealed that the SEC waived application of the Investment Company Act of 1940 on Enron. Of course, the SEC did have authority to review Enron's annual and quarterly filings under the Securities Act of 1933, and the Exchange Act of 1934, but apparently didn't fully do so from 1997 until it actually began its enforcement action last fall.

And finally the FERC had the authority to regulate many of Enron's trading activities, including setting accounting standards, and regulating its electricity rates, but choose not to use these authorities until the California meltdown began to force action.

Enron clearly had great success in largely avoiding any meaningful Federal oversight of its core businesses for many years. So just what was it doing in the natural gas and electricity markets? Some of the prepared testimony we have received today suggests that Enron's trading activities may have contributed to increased volatility in the natural gas and electricity markets.

And that Enron may have even manipulated prices in these markets. I have received written testimony from a witness that the majority staff declined to accept. This testimony suggests that Enron's on-line trading activities had a negative impact on electricity markets and significantly increased volatility in those markets.

I would like to ask for unanimous consent that this testimony be included in the record of this hearing. I have long been supportive of moving toward competitive energy markets, but I have repeatedly emphasized that I favor demonopolization and not deregulation.

The tragedy of what has happened in our energy markets is that the old regulatory structure of regulated monopolies is being torn down. Unfortunately, it has not yet been replaced with a new regulatory structure that serves the public interests by protecting consumers from abusive sales and trading practices, assuring fair and orderly, and transparent markets, and eliminating excessive and artificial levels of volatility.

Replacing regulated monopolies with unregulated megalopies is not competition. It is a formula for allowing a few big players like Enron to gain the markets to the detriment of both producers and consumers.

I look forward to the hearing today, and again I renew my unanimous consent——

Mr. BARTON. We took one of the witnesses the gentleman from Massachusetts recommend, and that witness is here, and that testimony. The other witness the gentleman recommended we did not accept, and we looked at the testimony and had some problems with it, and we will take another look at the testimony during the hearing.

And if we can accept it, we will. But we took one of your witnesses as you well know, and is going to add to the hearing.

Mr. MARKEY. I will do this, Mr. Chairman. I will withdraw right now and I will renew the unanimous consent request later in the hearing.

Mr. BARTON. We are going to go vote, but we want to hear from Congresswoman McCarthy, and her opening statement.

Ms. McCARTHY. I will be very brief in deference to the committee and the vote. I just want to thank you, Mr. Chairman for this hearing and also extend a special greeting to my constituent, Richard Green, who is the Chairman of UtiliCorp.

And I would encourage you to consider after his testimony that we take a trip and visit his subsidiary, Aquila, which is one of the power marketing firms that I went on the trading floor to better understand the task before us as we take a look at electric utilities and restructuring, and the future of power in this country.

So I am glad that he is here today. He is a success story that I am proud to represent, and I thank you for this hearing, and I will put the extent of my remarks in the record.

Mr. BARTON. Seeing no other members present, we will accept all opening statements into the record.

[Additional statements submitted for the record follow:]

PREPARED STATEMENT OF HON. ROY BLUNT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI

Mr. Chairman, thank you for holding this hearing today in an effort to shed light on the Enron bankruptcy and the functioning of energy markets.

I would like to introduce to the committee a witness from Missouri, Mr. Richard Green, Chairman of UtiliCorp United Inc. Mr. Green is here to testify on behalf of the Electric Power Supply Association.

Mr. Green is accompanied by: Jeff Ayers, Senior Vice President and General Counsel for Aquilla Inc.; Laurie Hamilton, Vice President of Regulatory Affairs for Aquilla; and Lynn Wilson, Issues Strategist for UtiliCorp.

I would like to welcome them all here today.

I look forward to reviewing the testimony presented here today, as well as subsequent hearings and investigation into Enron. It is the responsibility of this committee to oversee many of the energy, accounting, consumer protection and pension issues raised by Enron. The availability of timely and credible information for consumers is a key factor in the investigation conducted by this committee.

The testimony presented today will help shed light on the context within which the core business of Enron was supposed to function. Mr. Green's testimony will address the energy market's reaction to the Enron failure, the use of derivatives, and suggest actions to make the markets more transparent.

The failure of Enron is a tragedy for the families of thousands of employees and investors, and the impact is not limited to Enron. In my hometown of Strafford, Missouri, one of our largest employers went out of business because their owner had a contract and a loan with Enron, and Enron couldn't hold up their end of the bargain. Now 130 Southwest Missourians are looking for work. It's clear that we need to shine some light on corporate practices and enact, and then enforce, corporate disclosure requirements.

Let's get to the bottom of what changes need to be made and then enforce them, so that workers aren't left trading years of service for empty promises and uncertainty in their retirement years.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF HON. GEORGE RADANOVICH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. Chairman, thank you for holding this hearing today on the effect's of Enron's bankruptcy on the functioning of energy markets. As a Californian, I am very concerned about the failure of restructuring in my state, and I look forward to hearing testimony on the irregularities at Enron and if they played a significant role in the price spikes and supply disruptions my state experienced last year.

The collapse of Enron Corp. has caused the nation's electricity markets to be surrounded by many scandalous rumors. It is our job today to find out if there is any solid evidence to prove that Enron's collapse was related to rules, or the absence of rules, governing trading in energy contracts. We must also thoroughly investigate allegations that Enron may have manipulated electricity and gas markets in order to build investor confidence.

With respect to consumer confidence, I believe people can take comfort knowing our nation's energy markets have remained solid throughout the Enron debacle. Given the size of Enron's activity within the gas and electricity markets, the absence of a massive disruption in energy markets reiterates the stability of the marketplace. Supplies of gas and electricity have continued to be delivered to consumers throughout the collapse of Enron. The bottom line is that the energy delivery system has remained reliable. Since there is no proof that the growing trend toward competition caused or contributed to Enron's collapse, we must continue to support fair and effective wholesale competition in electricity and gas markets.

Thank you, Mr. Chairman, for holding this hearing today. I look forward to the witnesses' testimony.

PREPARED STATEMENT OF HON. BILL LUTHER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Thank you Mr. Chairman for holding today's hearing on the effects of the Enron bankruptcy on national energy markets. It is a very timely issue and something that should be explored as this committee and FERC continue to consider various proposals that move us further toward restructured markets.

At this point, most conclude that the Enron bankruptcy did not result in mass wholesale energy price disruptions. However, there are many aspects to the Enron debacle, as it relates to the overall state of energy transmission, selling and generation businesses, that need to be examined. Especially troubling are reports that energy prices in Western markets dropped due to Enron's absence in the region. It must also be noted that Enron, with the exception of the Oregon utility Portland General Electric, did not own generation facilities. To a certain extent this can explain why, especially in regions closed to competition at the state level, the company's collapse did not cause a reliability problem. These items must be further examined before any conclusions can be reached, and specifically I urge this committee to address the troubling reports of reduced energy prices in Western markets following the bankruptcy.

Furthermore, I don't believe we can make the argument that simply because energy markets did not collapse in the wake of the Enron debacle, this is a sign that we need to pass aggressive federal restructuring legislation. The fact remains that the root of the current Enron mess can be traced to a lack of transparency and oversight over Enron's day to day partnerships and transactions. Therefore, I would urge this committee to proceed extremely cautiously with proposals to repeal the Public Utility Holding Company Act and eliminate federal merger review authority that have the potential to decrease even further federal oversight of energy sales to our nation's energy consumers. I would also urge this committee to focus more attention on Enron's creation of numerous questionable energy-related partnerships that led to employees and investors losing significant portions of their retirement savings.

Thank you Mr. Chairman and I look forward to the testimony.

[Brief recess.]

Mr. BARTON. The subcommittee will come to order. We are going to reconvene the hearing.

We are ready to hear from our expert witnesses or panelists, but we have one more member who wishes to make an opening statement, and normally I would say no, but since he was so nice to me at the Mardi Gras party that the State of Louisiana put on 2 weeks ago, and made a point to throw me some special beads, I am going to say yes.

So if Mr. John wishes to make a very brief opening statement, then we will begin our panel.

Mr. JOHN. Thank you, Mr. Chairman. I must come clean——

Mr. BARTON. If we could have the attention of the audience so we can hear the statement.

Mr. JOHN. I must come real clean and as the chairman of the subcommittee, I appreciate the latitude to give an opening statement, and it was me that threw the moon pie that hit you in the head at the Madri Gras party. I'm sorry.

Mr. BARTON. Which I ate later actually.

Mr. JOHN. Thank you very much for allowing me to give a brief opening statement, and I appreciate the leadership that you have shown on this issue, which is very, very important.

First, I believe that there are many lessons that we can learn from the Enron's collapse that took down the seventh largest corporation in America. However, while the solutions may be broadly applied, I don't believe that it is very reasonable to conclude that the problems with Enron are universally applied to other energy companies around the country.

I think it is appropriate for this committee, regulators, and also investors, to take a closer look at the company's that engage in similar business practices. But I think we should be very, very careful, and not rush to judgment, or rush to indict all of the wholesale energy companies as being possibly the next Enron.

You know, it hasn't been very long ago—it was right at a year—that we had a lengthy debate in this committee and on full committee about the electricity crisis in the West, and the challenges that we must overcome to ensure a reliable and affordable supply of electricity.

A lot has changed over the past year, but I think the fundamental issue remains. Should the economy begin to recover, many of the problems that we faced last year will emerge again unless we continue to expand the wholesale energy markets.

I also believe that if we do not overcome some of these crises in confidence that currently exist with regards to companies engaged in wholesale power in the power markets, that consumers will be faced once again with high prices and brownouts in the next couple of years.

This hearing today, I believe, is a very positive step in setting the record straight about what we should learn from Enron and California so that we can restore what I think is so precious to the American people, and that is public confidence.

Mr. Chairman, my second observation is that I support the recommendations of my colleague from Chackbay, Louisiana, when he recently said at this subcommittee that we should be very careful in proceeding with a mark-up of electricity legislation until we really have a very good handle on the conclusion and investigations, and rendering a judgment about what we can learn from what has happened over the past few months.

The policy issues surrounding electricity restructuring are very complicated, and they are complicated enough that I don't believe that it would be constructive to allow a legitimate debate on legislation become confused with Enron's collapse.

And so, Mr. Chairman, thank you very much for allowing me to say an opening statement, and I look forward to the testimony before us.

Mr. BARTON. Thank you. The Chair would ask for unanimous consent that all members not present have the requisite number of days to submit their written statement for the record. Is there an objection? Hearing none, it is so ordered.

The Chair would also announce that he has reviewed the testimony that Congressman Markey of Massachusetts had proffered to

put into the record by a witness who was not going to be on the panel of testifiers, the second panel.

And the staff has reviewed that testimony and it appears to be sufficient and adequate in nature to be put into the record, and so the Chair would ask for unanimous consent that that testimony be put into the record at the appropriate point. Without objection, so ordered.

[The prepared statement follows:]

PREPARED STATEMENT OF DAVID J. TUDOR, PRESIDENT AND CHIEF EXECUTIVE OFFICER, ACES POWER MARKETING, LLC

My name is David J. Tudor, and I am the President and Chief Executive Officer of ACES Power Marketing, LLC ("APM"). APM is an energy risk management company headquartered in Indianapolis, Indiana. APM is owned by seven Generation and Transmission Electric Cooperatives ("G&Ts") which operate in five National Electric Reliability Council ("NERC") Regions. Because these G&Ts are themselves controlled by electric distribution cooperatives, the ultimate owners of APM are more than 2.4 million consumers located in 13 states. APM also provides services to twelve other cooperative G&T clients whose focus is on risk management related to the delivery of energy to ultimate consumers.

My entire professional career has been spent in the energy industry. I first became involved in energy trading with the deregulation of natural gas during the early 1980s, and I have remained involved with energy trading and risk management since that time. I have held numerous management positions in the energy business prior to joining APM, including Chief Operating Officer of PG&E Energy Trading, one of the largest trading and marketing companies in the industry.

APM supports open and competitive energy markets. The primary business focus of APM, unlike other energy trading and marketing companies, is managing and mitigating the price risk associated with delivery of energy to consumers. For most energy trading and marketing companies, the pricing and physical delivery of energy to consumers is only a small part of their portfolio.

Because APM is concerned with the reliability and delivered cost of energy to consumers, we also are vitally concerned that energy markets operate efficiently and competitively. This too sets APM apart from many other marketers. The legitimate business objective of energy trading and marketing companies is realizing a profit on the transactions that they undertake. It should be recognized that higher profits can be made in a market environment that is characterized by price volatility, inefficiency, and a general lack of vigorous competition. APM believes that it is not in the best interest of consumers to permit such conditions to prevail. While profitable to some market participants in the short term, over the long term, recurring price volatility will erode consumer confidence in the ultimate value of gas and electricity deregulation.

The specific question before this Subcommittee is what effect the demise of Enron will have on the future energy market. I define the term "energy market" as the environment that sets the price and reliability of energy available to consumers. Answering this question, however, requires a review of the market conditions that prevailed both prior and subsequent to the fall of Enron. There were and there continue to exist market conditions which Congress needs to address even after Enron's demise. These systemic problems need to be dealt with through legislation to assure that they will not distort or otherwise adversely affect the energy marketplace in the future.

. *All Energy Trading Exchanges Must Be Independent and Subject to Regulatory Oversight.*

Understanding the energy market requires recognition of the different physical and financial energy products that are traded on the various exchanges. A "physical" product is a contract for the purchase or sale at a defined price of a stated quantity of gas or electricity and for its delivery at a specified time and location. A "financial" product is a contract that provides for the payment of money, with the amount determined by the difference between the price specified in the financial product for a defined quantity of electricity or gas at a specified future time and location, and the actual price that prevails in the future period. A financial product does not provide for physical delivery of either gas or electricity.

The New York Mercantile Exchange ("NYMEX") is a regulated "financial" exchange. It offers market participants a venue to hedge or speculate in energy and

other commodities. A robust and transparent financial exchange can serve the valuable function of enhancing price stability and competitiveness. The attainment of affordable and stable prices for electricity and natural gas supplies is a laudable energy policy objective. This is extremely important for residential and other temperature-sensitive consumers because electricity and natural gas are essential, and their requirements to a great extent are inelastic.

The value of a regulated financial exchange can be undermined when an unregulated physical and financial derivatives exchange controls a large component of the overall energy trading market. Under these circumstances, the unregulated exchange can influence pricing on the regulated exchange.

EnronOnline, was an unregulated, private exchange created by Enron for the trading of gas, electricity, and other commodities. Ownership of this exchange allowed Enron access to significantly more market data than other participants, and this knowledge translated to enhanced market power. The combination of market information and market power gave Enron the opportunity to create self serving price volatility.

The magnitude of recent price volatility is demonstrated by the movement of natural gas prices from the 2000-2001 winter to the current 2001-2002 winter. Last winter gas prices rose to levels of $10 per Dekatherm and above, while this winter gas prices have plummeted to levels in the low $2 per Dekatherm range. Price volatility can be downward as well as upward because speculative trading results in more profit for the trading companies as the movement of prices, in either direction, becomes greater. Furthermore, price volatility in gas and electricity is significantly greater than the price volatility of other commodities.

EnronOnline provided a platform for trade speculation which contributed to price volatility. However, in sharp contrast to the NYMEX, EnronOnline was not subject to any oversight or regulation. In the future, an energy trader should not be allowed to own, operate, manage, and participate in its own electric and gas trading exchange. This is counterproductive to a fair, open access market and creates an unfair advantage in the market. It is a natural conflict of interest.

This problem does not go away with the demise of Enron. EnronOnline has been purchased by UBS Warburg, which, as of yesterday (see attached Newsday.com article) is conducting business under the name UBSWenergy.com, and will now hold the same capability to generate excessive profits through creating, in a totally unregulated setting, price volatility to the potential detriment of consumers.

Given the tremendous earnings potential of operating private, unregulated trading exchanges, it is likely that a number of other large integrated energy companies which previously operated in the tier beneath Enron, may, absent a legislative prohibition, create or expand their own private electricity and gas trading exchanges.

2. Energy Trading And Marketing Companies Should Be Precluded From Engaging In Certain Affiliate Transactions.

Energy trading and marketing companies that are affiliated with regulated public utilities should not be permitted to own contracts for firm gas transportation, firm electric transmission, and firm gas storage capacity on affiliates' electric transmission or interstate gas pipeline systems. Such contractual arrangements invite abuses whereby the unregulated trading and marketing companies are able to earn excessive returns through the rebundling of the unregulated commodity with the regulated capacity services at great cost to consumers served by these assets.

Moreover, with the significant vertical and horizontal integration and convergence between gas and electric within these major energy companies, which also own unregulated energy trading and marketing companies, anti-competitive concerns certainly are raised regarding these giant companies' activities in the marketplace when they are allowed to engage in unregulated, speculative trading supported in part with regulated assets.

In conclusion, there is a need for Congress to take action to assure that the structure and activities involved in energy trading and pricing are not permitted to create an environment where electric and gas consumers, particularly those with inelastic demands for human needs, are left unprotected. The consumer cannot protect himself, and therefore, certain safeguards must be developed to allow the energy trading and marketing industry to thrive, but not through excessive profits paid by consumers.

[Associated Press—February 12, 2002]

UBS WARBURG LAUNCHES TRADING BUSINESS

By Kristen Hays, Associated Press Writer

HOUSTON—UBS Warburg's new online energy trading platform may be named for the Swiss investment bank, but the staff is almost all Enron Corp.

Make that ex-Enron.

UBS Warburg Energy on Monday cranked up the online trading operation it acquired from the fallen energy giant and saw some action from traders buying and selling natural gas and electricity.

"We're up and running and open for business," UBS Warburg spokesman David Walker said Monday of UBSWenergy.com, staffed by about 650 former Enron traders and support staff. The operation is backed by credit from UBS Warburg parent UBS AG.

"We are excited to launch UBSWenergy.com and believe that the capabilities of UBS Warburg Energy, backed by the credit rating of UBS will provide a competitive and liquid energy market to our customers," said Lawrence G. Whalley, managing director and head of the new operation.

Several traders in Houston and elsewhere on Monday couldn't gauge trading volume on the new site because they had yet to finalize logistics to use it, such as getting their assigned passcodes.

"We haven't been able to trade," said Charlie Sanchez, energy markets manager for Gelber & Associates in Houston. "it sounds like they're putting out feelers today."

"We definitely are trading. We are doing transactions," said UBS Warburg Energy spokeswoman Jennifer Walker. "Certainly there is a process of getting in your credit information and legal approvals, and certainly a ton of that is taking place today."

Sanchez and traders with El Paso Corp., Tulsa, Okla.-based Williams Cos. and Entergy-Koch Trading in Houston said they had submitted needed paperwork and planned to trade on the new site when given the necessary approvals.

"We'll be set up to trade with them later this week," said Chuck Carlton, a natural gas trader with Williams.

U.S. Bankruptcy Judge Arthur Gonzalez, who is presiding over Enron's bankruptcy case in New York, approved UBS Warburg's offer to take over the trading business three weeks ago. The bank paid nothing but agreed to give Enron and its creditors one-third of the new venture's pretax profits.

Whalley resigned as Enron's president and chief operating officer last month to lead UBS Warburg's new venture.

Enron filed for bankruptcy Dec. 2. Its trading operation, once purported to reap most of the company's profits, traded energy as well as other commodities, such as paper, pulp, bandwidth and weather futures.

The new operation is on the fifth and sixth floors of Enron's new 40-story glass tower across the street from the former energy giant's 50-story downtown Houston headquarters.

Michael Barbis, an analyst with Fulcrum Global Partners LLC in New York, said the new organization faces a tough challenge to succeed given its association with Enron.

"No one expects them to be what they were," Barbis said. "It will be a tougher time for them to get going, is my bet"

Mr. BARTON. The Chair would now recognize the Honorable Pat Wood, the Chairman of the Federal Energy Regulatory Commission, and immediate past chairman of the Public Utilities Commission of Texas; and a proud Texas Aggie,soon to be father of another child within the next 5 weeks, to the committee.

Your statement is in the record in its entirety, and we would recognize you to elaborate on it, and we are going to set the clock at 7 minutes, but that is purely for informational purposes only. If it take a little bit longer, that would be better.

Mr. WOOD. Shorter?

Mr. BARTON. Shorter would be even more fine.

STATEMENTS OF HON. PATRICK H. WOOD III, CHAIRMAN, FEDERAL ENERGY REGULATORY COMMISSION; HON. JAMES E. NEWSOME, CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION; HON. ISAAC C. HUNT, JR., COMMISSIONER, SECURITIES AND EXCHANGE COMMISSION; MARY J. HUTZLER, ACTING DIRECTOR, ENERGY INFORMATION ADMINISTRATION, DEPARTMENT OF ENERGY; AND HON. THOMAS L. WELCH, CHAIRMAN, MAINE PUBLIC UTILITIES COMMISSION

Mr. WOOD. To cut to the chase, Mr. Chairman, and members, Mr. John met with the Sabine River flow and a little bit more to the west, you could be my Congressman from back home, and so it is a pleasure to be here with you as well.

The bankruptcy of Enron was a significant event in 2001, and the energy industry certainly had a tremendous impact on the investor community on its own employees and retirees. But the focus of your hearing today is what is the effect of that event on the Nation's energy markets.

And so looking specifically at the removal of Enron from the Nation's energy markets, it is pretty safe to conclude that there has not been any significant damage from the exit of the largest power and gas marketer in the country.

The prices in the energy markets remain stable, and importantly there have been very few disruptions in the deliveries of the actual electricity or gas to customers. There have been a few, however.

And it is important to know that it is not an absolute perfect picture. It has been helpful that it was in an down economy, or has prices were trimming downward that this happened, so that customers that had locked in higher prices with Enron were actually able to exit those contracts and go get cheaper power off the market, or cheaper gas, and that is certainly fortunate.

The resilience of these markets following the collapse is a true testimony to the robustness and efficiency of these markets, ruthless efficiency as it may be. The kind of counter-question is then did the energy markets and the growing trend toward competition in those markets cause or contribute to Enron's collapse, which is a separate question.

The answer is no. I think because of Enron's business strategies certainly being explored by your sister committee, but I think certainly from all that we have available to us at the Commission and that we reviewed, the energy market strategy that Enron had was successful in a rising price market.

But it wasn't really attuned toward a cyclical market such as we have with these sort of commodities, and it is unfortunate for them that that strategy did not work. But it has not in my mind certainly caused a questioning of whether energy markets themselves caused their collapse.

However, based on recent allegations that Enron in its better days may have manipulated electric and gas markets, the FERC Commission staff has begun a fact finding investigation.

The staff team has been given by the full Commission access to whatever resources, including subpoena power, that are necessary to investigate whether there was in fact manipulation in the electric and gas markets over the past 25 months.

And we expect that hopefully this complete picture of what has happened in the—particularly in the west, but in the energy markets in the recent past will inform broadly, and specifically both, the debates that this committee is having and that energy customers are asking questions about across the country.

And I think that we owe it to them to do that in the most professional and thorough manner possible. We will be working with our sister agencies that have expertise in areas where we don't, such as Chairman Newsome's agency, and Mr. Hunt's agency, as well as the Federal Trade Commission, to develop and get the expertise that we need to really provide a full picture of how energy markets have worked, and may have been manipulated or could have been manipulated, and in fact try to draw some conclusions as to whether they were or were not actually manipulated.

And so if there is a problem, we can fix it; and if there is a bad actor, we can punish it; and if things are doing just fine, we can report that affirmatively to the customers of America.

To prevent or mitigate Enron-like problems in the future, I would recommend that Congress continue to support and enhance fair and balanced competition in the electric/gas markets.

I think as Mr. Markey points out, that is a different concept than going straight to deregulation. You have got to have competition first, and that is certainly our goal, and will be more crisply our goal in a going forward basis.

I think the separate, but equally important, decision about whether to open retail markets to competition is one that I think is appropriate to leave to the State level, because it is really separate from whether wholesale power markets work to deliver efficiencies and innovation at the generation of power level.

Finally, I think certainly support of the committee for the Commission's efforts to encourage regional transmission organizations would be very helpful and making sure that that effort goes forward.

I was pleased in today's Commission meeting which we held earlier this morning that reports from PJM, or excuse me, the Pennsylvania-Jersey-Maryland Interconnect, and the Midwest RTO, to create a single energy market over some 26 States.

As well as a separate, but also uplifting, report from participants in a Southeast United States RTO, which would be primarily the footprint covered by Entergy, Clico, and the Southern Company, as well as a number of other public power entities, gives me a lot of hope that the Commission's approach toward voluntary compliance with regional transmission organization order of the Commission 2 years ago, will move forward and result in a good wholesale, workable market for benefits to be flowed through to customers.

A final thought about what can Congress do, because Chairman Barton asked that in the invitation letter, is on transparency. We have heard a lot about this phase, transparency. It is kind of a motherhood-apple pie shoot, but what transparency means is, is the information that is back and forth given to the public marketplace about a sale or a purchase of gas, or power, is that information out there.

And quite frankly I would say the answer today is a muddled no. The Commission in July, I am pleased to report, did put forward

in its data requirements that are proposed to the public, and that has created a significant amount of comment from the industry and from people on both sides who want to make this information public, or who don't want to make this information public.

But when we talk about transparency, it is a pretty granular issue about can we really get the information out there that a buyer and a seller knows that the deal he just did is actually in the market.

That is an important fact and it helps a lot to discipline the markets as we have seen in other entities. To close, and I have heard it from a number of members, this is an industry that—the energy industry requires a tremendous amount of capital on a daily basis to build power plants, to build power lines, to put up distribution lines, to hang meters on customers' houses.

And so to do an accurate bill to a customer every 30 days, and I think I would just ask on behalf of those customers of those industries, and those people who are trying to decide where to invest capital, because we need it in those industries.

The lull in the economy has just given us time to catch up, but we need to get back on track to continue the pace and investment on both supply and demand that were moving on pretty well in the year 2000, and that it is that we keep these issues focused on what is wrong, and not try to paint with a broad brush the industry that has served to keep the lights on very adequately over the years.

And I would just say that the energy markets in fact are what I think saved this country from the collapse of a large company. They digested Enron efficiently, and ruthlessly so, and I think it is a testimony to the efficiency of the market that Enron and so many, many others advocated over the years that it worked as it did.

Mr. BARTON. Thank you, and let the record show that the Chairman took a minute, over 7 minutes, despite the promise to speak less than 7 minutes.

[The prepared statement of Hon. Patrick H. Wood III follows:]

PREPARED STATEMENT OF HON. PAT WOOD, III, CHAIRMAN, FEDERAL ENERGY REGULATORY COMMISSION

I. INTRODUCTION AND SUMMARY

Mr. Chairman and Members of the Subcommittee: Chairman Barton has asked me to answer three questions: Did Enron's collapse shake energy markets? Conversely, did energy markets contribute to Enron's collapse? And is there anything that Congress should do, relating to energy markets, to repair or prevent such problems in the future? I thank you for the opportunity to address these questions with you today.

The bankruptcy of one of the largest energy providers in the country has stunned both the energy and investor communities, and many employees and retirees saw their savings accounts all but vanish. But the collapse of Enron has not caused significant damage to the nation's energy trading or energy supplies. In the aftermath of Enron's collapse, prices in energy markets remained stable, trading within expected trading ranges. And most important, there have been few disruptions to the deliveries of electricity and gas, except for a few isolated incidents where Enron subsidiaries have not been able to honor their delivery commitments to end use customers. The Federal Energy Regulatory Commission (Commission or FERC) has monitored the effects of Enron's collapse on energy markets and has not found any substantial spillover effects. The nation's electric and natural gas markets' resilience following the swift collapse of one of its major participants indicates a high degree of robustness and efficiency.

Did energy markets and the growing trend toward competition cause or contribute to Enron's collapse? No. Enron was trying to bring its strategy of asset-light, trading platform leverage beyond energy markets into a variety of commodities and markets, including broadband, water, and others. While Enron may have developed the strategy first in gas and then in electricity markets, it is not the fault of the energy markets that Enron's business strategy may only have been successful in markets with rising prices. Prices are cyclical in most commodity industries, and an effective strategy must be designed to work in the rain as well as the sunshine. Similarly, it appears that Enron made a number of misjudgments and misrepresentations in its financial and accounting practices which undercut investor confidence and led to its failure. Enron's actions cannot be blamed upon the energy industry.

I disagree with those who claim that the Enron collapse sounds the death knell for competition in energy markets or justifies nationwide reimposition of traditional cost-based regulation of electricity. The facts available to date indicate that Enron's failure had little or nothing to do with whether energy commodities and their delivery to customers are monopoly regulated or competitive. Rather, Enron appears to have failed because of its questionable non-core business investments and the manner in which it reported on its financial position to its owner-investors and to the broader business community. Based on the facts as they appear now, Enron's actions would have led to the same result whether its core business focused on energy, grains, metals or books.

You may be aware that members of the Senate Energy and Natural Resources Committee have asked the Commission to formally investigate allegations that Enron may have exercised inappropriate influence on the nation's electric and gas markets. A comprehensive staff fact-finding investigation has begun. The staff team has access to whatever resources they will need to conduct an independent investigation, including many of our best people and whatever consulting assistance they determine is necessary. Because the FERC's responsibility and jurisdiction lies primarily in the physical assets markets rather than in the financial assets markets where so many of Enron's activities occurred, we are also consulting with our colleagues at the CFTC, SEC, DOJ, and FTC to gain their insights into how to understand and analyze these markets. An investigation of this magnitude is neither easy nor fast, so it may take several months before staff has completed its work and presents its results to the Commission, the Congress, and American energy customers. Based on the information in the fact-finding report, the Commission will determine how to proceed on any pending or future FPA section 206 complaints, or whether to institute formal section 206 investigations on our own motion, into long-term power contracts whose prices may have been influenced by any inappropriate Enron activities.

Last, what should Congress do, related to energy markets, to ensure that a future Enron disaster is prevented or mitigated? You can support and enhance the initiatives you have already encouraged to promote fair and effective wholesale competition in the electric and gas markets, because such competition lowers costs and improves reliability for all customers. To achieve this goal, you could clarify the Commission's authority over transmission utility participation in RTOs and over greater disclosure and transparency of market information in these emerging competitive markets.

I will address all these matters in greater detail in the comments below.

II. ENRON'S IMPACT ON GAS AND ELECTRIC MARKETS

Enron's collapse had little perceptible impact on the nation's physical commodity (wholesale) electric and gas markets, which are FERC's primary regulatory responsibility. Energy markets have adjusted quickly to Enron's collapse. The Commission's monitoring of the physical energy markets indicates that there has been no immediate damage to energy trading or energy supplies. Although Enron transactions comprised 15 to 20 percent of wholesale energy trades, its demise has had negligible effects on trading. With a few exceptions, parties were generally able to rearrange the deals they had executed with Enron.

Market Monitoring and Reactions

From late October 2001, when news of a likely formal investigation of Enron and its auditors by the SEC first became known, to early December 2001, after Enron's declaration of bankruptcy, spot market data indicates that there was no change in natural gas or electric wholesale prices that could not be attributed to weather or other fundamentals. As may be expected, Enron's swift exit from trading may have increased volatility somewhat. Our staff is currently investigating this concern more thoroughly.

Following the news of a formal SEC investigation of Enron in October 2001, Commission staff contacted market participants to learn whether any supply obligations might be in jeopardy. Staff began monitoring EnronOnline more closely, particularly any changes in the margins between the bid-ask prices on EnronOnline, as a widening of these bid-ask spreads might signal less liquidity in the market; but there was no significant change in the margin between the bid and ask prices on EnronOnline.

Commission staff also contacted counterparties and received assurances from them that they were adjusting to Enron by "shortening" their positions and not entering into longer-term arrangements with Enron. In mid-November, when it appeared that the Dynegy merger with Enron might be jeopardized, staff observed no significant change in the margin between the bid and ask prices on EnronOnline; at the same time, there was a marked increase in the volume traded on other online trading platforms, such as Dynegydirect and Intercontinental Exchange (ICE). Commission staff again contacted energy traders to determine whether major supply disruptions in wholesale markets were occurring, and was informed that Enron had "flattened its books," i.e., made its portfolio of trades neither long nor short so that it could more easily "step out" of transactions and not cause disruption. As events unfolded in late November and early December, other market participants stepped into these deals. With the exception of certain lightly-traded points, it appears that Enron's competitors have filled the void left behind by Enron.

The reason for this overall calmness in commodity prices is basic. Although Enron was a significant player in electric and gas markets—as a pipeline, as a commodity trader, as a futures contract trader, and as a market maker—there were many other players in these large, established commodity markets, and a great deal of market diversity. Once it became apparent that Enron might not be a stable counterparty, its trading partners began to systematically adjust their positions and practices in the marketplace, moving to other trading platforms and partners. A similar process occurred among the counterparties to Enron's longer-term, untraded gas and electric contracts. Thus, over only a few weeks time, the gas and electric markets systematically minimized Enron's role in the marketplace and the likelihood that a company-specific failure could significantly affect the underlying commodities. I believe the calm but vigilant reaction of the CFTC, among others, during this period allowed time for this unwinding to take place.

The flexibility of today's energy markets allows a buyer losing its supply to replace the energy in real-time (at least briefly) through imbalance services offered by transportation providers. With more time, such as an hour or more before a supply will be lost, a buyer generally can arrange alternative supplies from a wide range of sources. Thus, the risk of a buyer having insufficient energy because of a seller's default appears to be manageable, as evidenced by the recent experience with Enron.

The more substantial risk in these circumstances is the loss of an advantageous contractual price for energy. Even this risk, however, depends on market conditions. When a seller defaults, market conditions for buying energy may be better or worse than when a buyer entered into its contract with the seller. If better, the buyer actually may benefit from not having to buy under the existing contract and instead being able to buy at lower prices elsewhere.

Enron's market role

Enron's role in the gas and electric markets was primarily in the trading of financial assets (commodity and futures contracts) rather than physical assets (with the exception of its natural gas pipelines, which continued operation relatively untouched by the events affecting the parent and affiliated companies). Less than 10 percent of the contracts traded in these markets involve the initial producer or final wholesale customer for the physical product, whereas well over 90 percent of commodity contracts and futures are between intermediate holders who are managing risk and facilitating connections between initial producers and ultimate customers. Adjustments in the financial asset marketplace—as to the length of a contract or the identities of the counterparties—rarely affect the flow of the physical gas and electricity underlying those contracts. Thus, while the commodity markets were shortening the length of contracts and moving more trade to non-Enron partners, gas and electric deliveries continued unaffected.

Enron controls a number of natural gas pipelines, but its financial failure has had little apparent impact on their operations. But even if it had, it is worth noting that the gas and electric markets have demonstrated their ability to react to and manage around problems that could affect their ability to deliver electricity and gas. When a pipeline breaks, a compressor station fails, a transmission line collapses, or a large power plant goes off-line, the parties in the market adjust immediately to ac-

quire other supplies and delivery routes. A sufficiently robust energy infrastructure makes this possible. In these instances, prices may well rise and, occasionally, deliveries to retail customers may be slowed but the wholesale market reacts swiftly and minimizes the impact to wholesale and retail customers alike.

In response to the Enron crisis, Moody's has raised the credit standards for generators and traders. This has forced energy concerns to rebalance their debt-to-asset ratios, forcing many to reduce debt and cut back investments in new gas processing, pipelines and power plants. During December 2001, stock prices of several energy companies hit yearly lows. Enron's problems, in combination with the recession and reports of potential overbuilding, appear to have eroded confidence, making investors more cautious about putting money into the energy industry. This slowdown in infrastructure investment could be problematic in some regions as the economy recovers and demand for energy grows. For that reason, the Commission has accelerated its efforts to complete the transition to a more competitive wholesale power market in order to provide investment certainty.

Enron and Competition

The markets' reaction to Enron's collapse demonstrates what good, working competitive markets do best: a diverse group of market participants with adequate market information about the players and commodities act individually to produce a result that works for all. The nation's wholesale electric and gas markets showed great resilience and swift reaction time, and demonstrated that they are much stronger than any individual player in the marketplace.

Some claim that Enron's demise is due to the failure of deregulation and competition in the electric industry, of which Enron was one of many supporters. I strongly disagree. Wholesale competition in the gas industry has spurred gas production, encouraged pipeline construction, driven down commodity prices for the past decade and lowered retail prices accordingly. In the electric sector, wholesale competition, although still in its infancy, has enabled the construction of thousands of megawatts of new power plant capacity across the country, producing lower commodity and retail electric prices in most regions, and in a cleaner generation fleet.

III. THE COMMISSION'S REGULATION OF ENRON SUBSIDIARIES

The Commission does not regulate the parent corporation, Enron Corporation, as it does not engage in activities which are under FERC jurisdiction. FERC does regulate a number of Enron's subsidiaries. Our authority with respect to the Enron subsidiaries subject to our jurisdiction is described below.

The Commission has jurisdiction over sales for resale of electric energy and transmission service provided by public utilities in interstate commerce. The Commission has interpreted the Federal Power Act to include energy marketers as well as traditional vertically integrated electric utilities in its definition of public utilities. The Commission must ensure that the rates, terms and conditions of wholesale energy and transmission services by public utilities are just, reasonable, and not unduly discriminatory or preferential. FERC also is responsible for reviewing proposed mergers, acquisitions and dispositions of jurisdictional facilities by public utilities, and must approve such transactions if they are consistent with the public interest. We also regulate the issuance of securities and the assumption of liabilities by public utilities not regulated by States.

The Commission also has jurisdiction over sales for resale of natural gas and transportation. However, FERC jurisdiction over sales for resale is limited to domestic gas sold by pipelines, local distribution companies, and their affiliates (including energy marketers). Consistent with Congressional intent, the Commission does not prescribe prices for these sales.

A. Energy Marketers

Competitive trading of energy by "marketers" generally began about two decades ago. Marketers do not usually own physical facilities, but take title to energy and re-sell it at market-based rates. Natural gas marketing began with the deregulation of the price of natural gas in 1978 and expanded with the Commission's 1992 open access rule for natural gas pipelines, Order No. 636. In the decade since Order No. 636, natural gas marketing has developed into a large, robust activity with many marketers. The Commission lacks jurisdiction over sales of natural gas by many gas marketers. To maximize competition we have granted "blanket authorization" for those marketers under FERC jurisdiction so they do not have to file for and obtain individual approvals to sell gas at wholesale.

In the electric arena, wholesale power marketers began selling electric energy as early as 1986. The Energy Policy Act of 1992, and the Commission's 1996 open ac-

cess rule for electric transmission owners and operators, Order No. 888, further spurred the development of competitive electric power trading.

The Enron-affiliated power marketers regulated by the Commission include: Enron Power Marketing Inc., Enron Sandhill Limited Partnership, Milford Power Limited Partnership, Enron Energy Services, Inc., and Enron Marketing Energy Corporation.

EnronOnLine

Before its collapse, Enron was the largest marketer of natural gas and electric power. Enron's Internet-based trading system, EnronOnline, was until recently the dominant Internet-based platform for both physical energy (electricity and natural gas products) and energy derivatives. (Derivatives are financial instruments based on the value of one or more underlying stocks, bonds, commodities, or other items. Derivatives involve the trading of rights or obligations based on the underlying product, but do not directly transfer property.) Although EnronOnline was the leading Internet-based trading platform for natural gas and electric power, it faced competition from other Internet-based trading platforms, such as Dynegydirect and Intercontinental Exchange (ICE).

Traditional exchanges, like the NYSE and the NYMEX, determine price by matching the buy and sell orders of many traders in a many-to-many trading format. In contrast, EnronOnline uses a one-to-many trading format, where an Enron affiliate is always on one side of each energy transaction, either as a seller or a buyer. The price of a commodity or derivative on EnronOnline is determined when a buyer or a seller accepts an offer or bid price posted by an Enron trader. In the wake of Enron's downfall, the many-to-many platforms such as ICE have helped to fill the void, and create a more robust market by reflecting the bid and offer values of myriad different energy buyers and sellers.

Market-based Rate Authorization

To sell electricity at market-based rates, public utilities (including power marketers) must file an application with the Commission. The Commission grants authorization to sell power at market-based rates if the power marketer adequately demonstrates that it and its affiliates lack or have mitigated market power in the relevant markets. FERC conditions market-based rate authority on power marketers submitting quarterly reports of their purchase and sales activities and complying with certain restrictions for the protection of captive customers against affiliate abuse. There are currently 1200 electric power marketers authorized to sell energy at market-based rates.

The Commission generally grants waiver of certain regulations to power marketers which receive market-based rate authorization. For example, these marketers do not need to submit cost-of-service filings because the rates they charge are market-based. The Commission also exempts power marketers from its accounting requirements, because those requirements are designed to collect the information used in setting cost-based rates. In addition, unless others object, FERC grants power marketers' requests for blanket approval for all future issuances of securities and assumptions of liability.

Because the Commission's reporting and accounting requirements are designed to address a limited set of concerns, and apply only to the jurisdictional subsidiary at issue, it is unlikely that requiring power marketers to comply with these requirements could prevent a future Enron-like failure. Nevertheless, in our current rulemaking proceeding on accounting rules, we have invited comments on whether the current exemptions for power marketers from such requirements remain appropriate.

B. Traditional Electric Utilities

A few years ago Enron acquired Portland General Electric (PGE), a vertically-integrated utility subsidiary of Enron that handles electricity generation, purchase, transmission, distribution and sale in eastern Oregon. PGE's retail rates and practices are under the jurisdiction of the Oregon Public Utility Commission. PGE also sells energy to wholesale customers in the western United States. FERC has granted market-based rate authorization to PGE for certain wholesale sales. Although the Commission waives some of its reporting requirements for power marketers, it requires continued reporting from franchised electric utilities such as PGE, so we can monitor whether its wholesale transactions are inappropriately favoring its affiliates or harming its captive customers. Although Enron's collapse has had tragic impacts upon PGE employees' retirement accounts, we have not yet seen any negative impacts on PGE's ability to meet its obligations to customers as a result of the Enron bankruptcy. I should also observe that the sale of PGE to Northwest Natural, an-

nounced prior to Enron's collapse, is pending before FERC and other regulatory bodies.

C. Gas Pipeline Subsidiaries

The Commission has limited jurisdiction over sales for resale of natural gas in interstate commerce. The Commission has jurisdiction to regulate only sales for resale of domestic gas by pipelines, local distribution companies (LDCs), and their affiliates. Consistent with the Congressional goal of allowing competition in natural gas markets, the Commission does not prescribe the prices for these sales.

The Commission has authority over the rates, terms and conditions for pipeline transportation in interstate commerce of natural gas and oil. The Commission-regulated natural gas pipeline affiliates of Enron include: Florida Gas Transmission, Midwestern Gas Transmission, Northern Border Pipeline Company, Transwestern Pipeline Company, and Northern Natural Gas Company.

D. Transactions and Activities Not Regulated by the Commission

The Federal Power Act does not give the Commission direct, explicit jurisdiction over purely financial transactions, such as futures contracts for electricity or natural gas. The Commission has asserted jurisdiction over such transactions only when they result in physical delivery of the energy which is the subject of the financial contract, or when such transactions or contracts affect or relate to jurisdictional services or rates (e.g., financial contracts affecting firm rights to interstate transmission capacity or the pricing of such capacity).[1] While Enron and its subsidiaries engaged in many electricity futures contracts and other energy-related derivatives, it does not appear that these transactions have played a significant role in Enron's demise.

In response to rapidly evolving energy markets, the Commission has implemented a number of new initiatives to improve its market-monitoring abilities. The Commission's new strategic plan, adopted September 26, 2001, encompasses three major areas of activity in overseeing the energy industry:

- Infrastructure—working with others to anticipate 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;
- Market rules—ensuring clear, fair market rules to govern wholesale competition that benefits all participants, and assuring non-discriminatory transmission access in the electric and natural gas industries;
- Market oversight and investigation—understanding markets and remedying market rule violations and abuse of market power.

This third strategic goal is new, and reflects the present Commission's commitment to ensuring that markets continue to work for customers. The strategic plan is available on our website at www.ferc.gov.

To give substance to this third strategic goal, the Commission is creating a new Office of Market Oversight and Investigation (MOI), which will concentrate the Commission's market-monitoring resources into one workgroup and enable the Commission to better understand and track wholesale energy markets and risk management by analyzing market data, measuring market performance, investigating compliance violations, and, where necessary, pursuing enforcement actions. MOI's work will provide an early warning system to alert the Commission of potentially negative market developments and let us act more proactively to address any problems that may arise. We are currently taking applications for the Director of this Office, who will report directly to me and the other commissioners.

In mid-2001, the Commission created the Market Observation Resource Center (MOR) to better observe market developments and to enable us to grasp quickly the significance of changes in market conditions. MOR's computer hardware, software and subscription web services give us access to historical and real-time data about energy markets.

The Commission has launched several other initiatives within the past year to ensure vigilant and fair oversight of the changing energy markets. In July 2001, the Commission proposed in a rulemaking to amend the filing requirements for public

[1] In 1996, the Commission addressed the issue of whether an electricity futures contract approved for trading by the CFTC would fall under its jurisdiction, pursuant to the FPA. New York Mercantile Exchange, 74 FERC ¶61,311 (1996). The Commission found that the CFTC possessed exclusive jurisdiction over the trading of such futures contracts, and that the Commission would assert jurisdiction, pursuant to the FPA, only if the electricity futures contract goes to delivery, the electric energy sold under the contract will be resold in interstate commerce, and the seller is a public utility. Id. at 61,986.I89iv. FERC Initiatives in Energy Markets

utilities. The proposal would require all generators, public utilities and power marketers to file electronically with the Commission and post on the Internet an index of customers with a summary of the contractual terms and conditions for market-based power sales, cost-based power sales, and transmission service. These companies would also have to report transaction information for short-term and long-term market-based power sales and cost-based power sales during the most recent calendar quarter. This proposal will give the Commission and the public more complete and accessible information on jurisdictional transactions.

In September 2001, the Commission proposed in a rulemaking to revise its restrictions on the relationships between regulated transmission providers (such as Portland General Electric) and their energy affiliates, broadening the definition of an affiliate to include newer types of affiliates, such as affiliated trading platforms (e.g., EnronOnline).

Also, in September 2001, the Commission staff began a comprehensive review of the information the Commission needs to carry out its statutory obligations in the current and evolving markets in electricity and natural gas. Presently, much of the information we require relates to the historic rate-setting functions of the agency. The review so far indicates that some of this may no longer be necessary, while other information is now more essential to provide transparency in a competitive marketplace. This is a high priority initiative.

In December 2001, the Commission proposed in a rulemaking to update the accounting and reporting requirements for jurisdictional public utilities, natural gas companies and oil pipelines. FERC proposes to establish uniform accounting requirements and related accounts for the recognition of changes in the fair value of certain security investments, items of other comprehensive incomes, derivative instruments, and hedging activities. The proposal is aimed at improving the visibility, completeness and consistency of accounting and reporting changes for these items. It invites comments on whether entities that are currently exempted from these accounting and reporting requirements, such as power marketers, should be subject to these proposed regulations.

While I have an open mind on whether the Commission should continue to exempt power marketers from its accounting requirements, our accounting requirements are not aimed at the kind of activities allegedly undertaken by Enron. Based on our historical responsibilities, FERC's accounting requirements are focused on providing useful and accurate information for determining cost-based rates. Cost-based ratemaking encourages utilities to maximize their claimed costs and minimize their expected revenues, to justify the highest possible rates. The Commission's accounting rules and auditing are designed to ensure that utilities with cost-based rates do not overstate costs or understate revenues. On January 22, 2001, the SEC proposed additional accounting-related disclosures from a broad universe of companies, including those exempt from FERC's reporting requirements. Adoption of that proposal could eliminate the need for the FERC to alter its reporting requirements in this regard.

V. ADDITIONAL STATUTORY AUTHORITY

Before we can understand how to prevent another Enron-like collapse, we must first understand what internal actions and external events caused Enron to fail. That effort is now underway by this Subcommittee and elsewhere. Then we must ask whether those actions and events can and should be prevented in the future.

Whether the Commission needs any additional statutory authority depends on the role Congress intends for the Commission. Historically, the Commission's economic regulation has focused on ensuring that energy markets deliver adequate energy at reasonable prices. The demise of Enron has had little or no effect on the supply or price of energy. Instead, Enron's collapse has primarily harmed its investors and employees. Since it appears that few of Enron's problems affected the narrow scope of wholesale energy markets, it is not clear that giving the Commission additional authority within its current scope would prevent further Enron-like problems.

To encourage greater efficiencies in the energy markets and to ensure that wholesale competition expands its ability to deliver reasonably priced, adequate energy supplies to more customers, the Commission is moving forward to complete its effort to create competitive national wholesale power markets as it did with natural gas markets in the late 1980s and early 1990s. Congress endorsed wholesale power competition in the Energy Policy Act of 1992 and further endorsement of this effort would certainly be helpful. In particular, Congress should give the Commission explicit authority to require RTOs where it finds them to be in the public interest. RTOs will broaden regional energy markets, allowing greater market efficiencies and limiting possible discrimination in grid operations. Congress should also remove

tax disincentives to transferring transmission assets to RTOs and to use of public power transmission lines.

Price Transparency

Greater price transparency will help improve the efficiency of energy markets, by providing buyers and sellers with better information about market conditions. The creation and operation of broad regional energy markets with a widely-traded set of energy products will do much to make this happen. Once RTOs over broad regional markets are established, operating under fair, clear, stable market rules, price transparency will improve significantly, even without a Congressional mandate. This has already happened to an extent in the regions now served by Independent System Operators (ISOs) in the Northeastern part of the country.

The Commission is moving forward with greater transparency, as discussed above. Without question, Congressional endorsement of this effort would be helpful. I support adoption of an appropriate transparency provision.

Creditworthiness

The responsibility for ensuring creditworthiness of participants in wholesale energy trades lies primarily with the parties involved in those trades. Creditworthiness provisions are included in some contracts or tariffs filed at the Commission to date, and the Commission is likely to include some broad creditworthiness provisions in the standard tariffs that will be developed for all transmission providers and customers (to prevent the use of individual creditworthiness terms as discriminatory measures in narrow geographic areas or against specific players). However, market participants seem best equipped to develop sophisticated risk management measures and narrow creditworthiness concerns, and those provisions may be subject to Commission review for justness and reasonableness.

To the extent creditworthiness issues are raised before the Commission, we act expeditiously. For example, shortly after Enron declared bankruptcy, the Participants Committee of the New England Power Pool (NEPOOL) sought to implement alternative payment and financial assurance arrangements with Enron Power Marketing Inc., Enron Energy Marketing Corporation, and Enron Energy Services, Inc. Within a week of the date of filing, the Commission accepted and suspended these arrangements (subject to review of the finalized agreement), to protect NEPOOL participants while enabling the Enron subsidiaries to stay in the market and continue serving their customers.

I do not think there is any need to legislatively address creditworthiness issues specific to energy markets.

VI. CONCLUSION

As always, I will be happy to provide further information or answer any questions you may have and offer the services of my colleagues and staff to the Subcommittee's efforts.

Mr. BARTON. We will now hear from the Honorable Chairman of the Commodities Futures Trading Commission, Mr. James E. Newsome. And he has already asked if he may be given a little additional time, which certainly we will agree to.

Mr. Chairman, your testimony is in the record in its entirety, and you are recognized to elaborate on it.

STATEMENT OF HON. JAMES E. NEWSOME

Mr. NEWSOME. Thank you very much, Mr. Chairman. I appreciate the opportunity to appear before you and the subcommittee to testify on behalf of the Commodity Futures Trading Commission, and I do appreciate those couple of extra minutes, since this is not a committee that we normally testify in front of.

And I think that there are some relevant comments, in terms of how we do things that are important to the committee. I would like to say first that both as a financial regulator and as a citizen, I have great sympathy for those who have been harmed, and who are harmed by incomplete and inaccurate financial information.

I share the concern of many that appropriate inquiries be made to ensure that investors, creditors, and others who rely on the accuracy and completeness of financial disclosures by publicly held companies can continue to do so with full confidence.

Today, I would like to share with you the important role that the futures markets play in our economy, and the CFTC's role in overseeing these markets, particularly with respect to energy-based contracts.

And then how our role changed under the Commodity Futures Modernization Act. I will also describe how we responded to the Enron situation last fall, and then finish with some thoughts about how the Commission might contribute as we move forward.

The CFTC perceives its mission as two-fold; to foster transparent, competitive, and financially sound markets, and to protect market users and the public against fraud, manipulation, and abusive sales practices.

While the stockmarket provides a means of capital formation, a way for new and existing businesses to raise capital, the futures markets perform a different role, that of providing producers, distributors, and users of commodities with a means to manage or to hedge their exposure to price risk.

Futures contracts based on non-agricultural physical commodities, like metals or energy products, and on financial commodities, such as interest rates, foreign currencies, and stockmarket indexes, now serve the risk-management needs of businesses in virtually every sector of our economy.

Although the primary purpose of the futures market is to facilitate the risk management efforts of hedgers, futures markets also play an important price discovery role, in which businesses and investors that are not direct participants in the futures nonetheless refer to the quoted prices of futures market transactions as a reference point, or a benchmark, for other types of transactions and/or decisions.

To fulfill its mission the commission focuses on issues of market integrity, and pursues a multi-pronged approach to market oversight. We seek to protect the economic, the financial, and the operational integrity of markets in several specific ways.

I explain our approach in greater detail in the written comments, but for the sake of brevity, will not go into detail in these oral comments. We oversee on-exchange trading of futures and options contracts based on such things as crude oil, natural gas, heating oil, propane, gasoline, and coal.

The overwhelming majority of these on exchange contracts are executed on the New York Mercantile Exchange or NYMEX. The CFTC does not regulate trading of energy products on either the spot, or rather the cash markets, or the forward markets, which are excluded from our jurisdiction by the Commodity Exchange Act.

Because Enron was a large trader on the NYMEX, its on-exchange activities have been regularly monitored by our staff. At this time, we have no indication that manipulation of any futures market was attempted by Enron.

However, the rapid financial deterioration of Enron presented a separate concern for the Commission about the economic integrity

of the markets. Could Enron's positions be closed out without unduly increasing volatility, or reducing liquidity.

In fact, Enron was but one of many significant participants in these increasingly liquid markets, and the markets proved resilient. And as Enron's positions were closed out, prices did not spike, nor did liquidity suffer.

Because we are also concerned with the financial integrity of the markets, we closely monitored with the NYMEX clearinghouse and the futures commission merchants, or the FCMs, that were carrying most of Enron's positions, to monitor and manage the close-out of those positions.

Through margin increases and other appropriate measures, the NYMEX clearinghouse was able to accomplish a very smooth landing while protecting the FCMs and their other customers.

By the time that Enron filed for bankruptcy, the risk of its positions as measured by standard margin requirements had been cut by 80 percent from just a week earlier.

By mid-December, all of its positions on the regulated futures exchanges had been closed out. I believe that this episode was an example of success for the system of financial controls in the on-exchange futures markets.

The Commodity Futures Modernization Act was signed into law by President Clinton on December 21st, 2000. It amended the Commodity Exchange Act to among other things provide legal certainty for over-the-counter derivatives markets.

With respect to contracts based on energy products, and certain other non-agricultural and non-financial commodities, the CFMA amended the Act to exempt two types of markets from much of the CFTC's oversight.

The first type is bilateral, principal-to-principal trading between two eligible contract participants, a category that includes sophisticated entities, such as regulated banks, well-capitalized companies, or individuals. For example, those with over $10 million in assets.

The second type is electronic multilateral trading among eligible commercial entities, such as the eligible contract participants that I just described, that also have an ability to either make or take delivery of the underlying commodity, or dealers that regularly provide hedging services to those entities.

Other types of bilateral energy trades are beyond the scope of our authority under the Commodity Exchange Act by virtue of the statutory exclusions of forward contracts and swap contractions.

As an oversight regulator, we have and will continue to look at how and why the markets within our jurisdiction respond the way that they do, whether well or poorly, to situations such as the failure of a significant market participant.

Separately, as a member of the President's Working Group on Financial Markets, the CFTC is working with the SEC, the Treasury, and the Federal Reserve Board, to review for the President possible improvements in accounting, auditing, and disclosure practices with respect to publicly held companies.

The Enron situation has led some to call for further responses from Congress and regulators, even for reregulation of markets that were provided legal certainty under the Commodity Futures Modernization Act.

While I agree that it is prudent for a regulator to constantly review its policies and procedures to ensure that an appropriate level of oversight is exercised, I also believe that a situation of this magnitude deserves careful consideration before a regulator seeks to take action.

Mr. Chairman, I agree with Chairman Wood and his written comments, and I believe that we as regulators should make sure that the true problem has been identified before remedies are pursued.

I supported passage of the CFMA because I sincerely believed that a one-size fits all approach to regulation was outdated, particularly in light of global competition, and important advances in technology within the financial services industry.

Rules tailored to the participant, the product, and the trading facility seem to me to be a more appropriate approach than prescriptive regulations of the past. To date, I have seen no evidence to the contrary in the CFTC's initial analysis of the Enron situation.

In closing, the CMFA was enacted after numerous hearings were conducted by our House and Senate Oversight Committees in the context of reauthorizing the Commission. Many issues relating to evolving markets received a full airing, and important changes to the law were agreed upon as a result.

I believe that any departure from the path of progress represented by this important piece of legislation should be approached with extreme caution. We will continue to monitor the markets within our jurisdiction and to utilize all authorities given to us by Congress to aggressively pursue violations of the Commodities Exchange Act.

We stand ready to work with this subcommittee, the Congress, other regulators and market participants. Mr. Chairman, I thank you for the invitation to appear before this subcommittee.

[The prepared statement of Hon. James E. Newsome follows:]

PREPARED STATEMENT OF HON. JAMES E. NEWSOME, CHAIRMAN, COMMODITY FUTURES TRADING COMMMISSION

Thank you, Chairman Barton, and members of the Subcommittee. I appreciate your having given me the opportunity to testify here today on behalf of the Commodity Futures Trading Commission. I would first like to say—both as a federal financial regulator and as a citizen—that I have great sympathy for those who are harmed by incomplete or inaccurate financial information. I also share the concern of many that appropriate action be taken to ensure that investors, creditors, commercial counterparties, and others who rely on the accuracy and completeness of financial disclosures by publicly-held companies can continue to do so with full confidence.

Today, I would like to tell you about the important role of the futures markets in our economy and the role of the CFTC in overseeing those markets—particularly with respect to energy-based contracts—and how that role has changed under the Commodity Futures Modernization Act. I will also describe how the Commission responded to the Enron situation last fall and would like to finish with some thoughts on how the Commission might make a contribution as we move forward.

Background:

The Commission was created by Congress in 1974 to oversee the nation's commodity futures and options markets. The Commission perceives its mission to be twofold: to foster transparent, competitive, and financially sound markets, and, to protect market users and the public from fraud, manipulation, and abusive practices. There are important differences between the futures markets and the stock markets. While the stock markets provide a means of capital formation, a way for new and existing businesses to raise funds, the futures markets perform a different

role, providing producers, distributors, and users of commodities with a means to manage their exposure to commodity price risk.

Historically, commodity futures and options were traded primarily on agricultural products. And while contracts based on agricultural products are traded as actively today as ever, a great many futures contracts are now based on non-agricultural physical commodities like precious metals or energy products and on financial commodities like interest rates, foreign currencies, or stock market indices. Because they serve the risk management needs of businesses in virtually every sector of the economy, the volume of trading in these financials and nonagricultural physicals is now nine times that in agricultural contracts. While farmers and ranchers continue to use futures contracts to effectively lock in the prices for their crops and herds months before they come to market, manufacturers now can also use futures contracts to plan their raw material costs and to reduce uncertainty over the prices they receive for finished products sold overseas. Mutual fund managers can use stock index futures to protect against market volatility and effectively put a floor on portfolio losses. And electric power generators can use futures contracts to secure stable pricing for their coal and natural gas needs.

These producers, distributors, and users of commodities (whether physical or financial) are called hedgers. The futures contract positions that hedgers put on are referred to as covered positions. For example, a power generator's obligation to purchase natural gas will be covered by its ability to use that natural gas in its electricity generation. There are other participants in the futures markets who take uncovered positions in the hope of making profits rather than mitigating risks. These individuals and firms are known as speculators and they contribute to the smooth operation of a futures market by increasing its liquidity. Because the needs of different hedgers for long or short positions may not always be perfectly balanced, the presence of speculators increases market effectiveness by better ensuring that hedgers will be able to put on positions they need.

Although I have described the primary purpose of futures markets as mechanisms for risk management, it should be noted that many futures markets play another important role in the economy, that of price discovery. Many businesses and investors that are not direct participants in the futures markets nonetheless refer to the quoted prices of futures market transactions as reference points or benchmarks for other types of transactions and decisions. This is particularly important in many agricultural markets where no other means of price discovery exists outside of the quoted futures prices but it is also true in other sectors, including many energy markets.

How the CFTC Performs Its Mission:

In seeking to fulfill its mission to foster transparent, competitive, and financially sound markets and to protect market users and the public from fraud, manipulation, and abusive practices, the Commission focuses on issues of *integrity.* We seek to protect the *economic integrity* of the futures markets so that they may operate free from any fraud or manipulation of prices. We seek to protect the *financial integrity* of the futures markets so that the insolvency of a single market participant does not become a systemic problem affecting other market participants or financial institutions. We seek to protect the *operational integrity* of the futures markets so that transactions are executed fairly, so that proper disclosures are made to existing and prospective customers, and so that fraudulent sales practices are not tolerated.The Commission pursues these goals through a multi-pronged approach to market oversight. We seek to protect the *economic integrity* of the markets against attempts at manipulation through direct market surveillance and through oversight of the surveillance efforts of the exchanges themselves. The heart of the Commission's direct market surveillance is a largetrader reporting system, under which clearing members of exchanges, commodity brokers (called "futures commission merchants" or "FCMs"), and foreign brokers electronically file daily reports with the Commission. These reports contain the futures and option positions of traders that hold positions above specific reporting levels set by CFTC regulations. Because a trader may carry futures positions through more than one FCM and because a customer may control more than one account, the Commission routinely collects information that enables its surveillance staff to aggregate information across FCMs and for related accounts.

Using these reports, the Commission's surveillance staff closely monitors the futures and option market activity of all traders whose positions are large enough to potentially impact the orderly operation of a market. For contracts which at expiration are settled through physical delivery, such as in the energy futures complex, staff carefully analyze the adequacy of potential deliverable supply. In addition, staff monitor futures and cash markets for unusual movements in price relation-

ships, such as cash/futures basis relationships and inter-temporal futures spread relationships, which often provide early indications of a potential problem.

The Commissioners and senior staff are kept apprised of significant market events and potential problems at weekly market surveillance meetings, and on a more frequent basis when needed. At the weekly market surveillance meetings, surveillance staff brief the Commission on broad economic and financial developments and on specific market developments in futures and option markets of particular concern. At least one energy product market is usually discussed and officials from the Energy Information Administration of the Department of Energy periodically attend such meetings.

If indications of attempted manipulation are found, the Enforcement Division investigates and prosecutes alleged violations of the Commodity Exchange Act (the "Act" or "CEA") or the Commission's regulations. Subject to such actions are all individuals that are (or should be) registered with the Commission, those who engage in trading on any domestic exchange, and those who improperly market commodity futures or option contracts. The Commission has available to it a variety of administrative sanctions against wrongdoers, including revocation or suspension of registration, prohibitions on futures trading, cease and desist orders, civil monetary penalties, and restitution orders. The Commission may seek federal court injunctions, restraining orders, asset freezes, receiver appointments, and disgorgement orders. If evidence of criminal activity is found, matters may be referred to state authorities or the Justice Department for prosecution of violations of not only the CEA but also state or federal criminal statutes, such as mail fraud, wire fraud, and conspiracy. Over the years, the Commission has brought numerous enforcement actions and imposed sanctions against firms and individual traders for attempting to manipulate prices, including the well-publicized cases against Sumitomo for alleged manipulation of copper prices and against the Hunt brothers for manipulation of the silver markets.

In protecting the *financial integrity* of the futures markets, the Commission's two main priorities are to avoid disruptions to the system for clearing and settling contract obligations and to protect the funds that customers entrust to FCMs. Clearinghouses and FCMs are the backbone of the exchange system: together, they protect against the financial difficulties of one trader from becoming a systemic problem for other traders or the market as a whole. Several aspects of the oversight framework help the Commission achieve these goals:

(1) requiring that market participants post a performance bond, referred to as "margin," to secure their ability to fulfill obligations;
(2) requiring participants on the losing side of trades to meet their obligations, in cash, through daily (and sometimes intraday) margin calls;
(3) requiring that FCMs segregate customer funds from their own funds and protect these customer funds from obligations of the FCM; and
(4) monitoring the capitalization and financial strength of intermediaries, such as FCMs and clearinghouses.

The Commission works with the exchanges and the National Futures Association (the "NFA") to closely monitor the financial condition of FCMs. The Commission, the exchanges, and the NFA receive various monthly, quarterly, and annual financial reports from FCMs. The exchanges and the NFA also conduct annual audits and daily financial surveillance of their respective member FCMs. Part of this financial surveillance involves looking at each FCM's exposure to losses from large customer positions that it carries and one way in which such positions are tracked is through the large trader reporting system. As an oversight regulator, the Commission primarily reviews the audit and financial surveillance work of the exchanges and the NFA but also monitors the health of FCMs directly, as necessary and appropriate. We also periodically reviews clearinghouse procedures for monitoring risks and protecting customer funds.

As with attempts at manipulation, the Commission's Enforcement Division investigates and prosecutes FCMs that are alleged to have violated financial and capitalization requirements or to have committed other supervisory and compliance failures in connection with the handling of customer business. Such cases can result in substantial remedial changes in the supervisory structures and systems of FCMs and can influence the way particular firms conduct business. This is an important part of the responsibility of the Commission to ensure that sound practices are followed by FCMs.

Protecting the *operational integrity* of the futures markets is also accomplished through the efforts of several divisions within the Commission. The Division of Trading and Markets promulgates requirements that mandate appropriate disclosure and customer account reporting, as well as fair sales and trading practices by registrants. Trading and Markets also seeks to maintain appropriate sales practices

by screening the fitness of industry professionals and by requiring proficiency testing, continuing education, and supervision of these persons. Extensive recordkeeping of all futures transactions is also required. Trading and Markets also monitors compliance with those requirements and supervises the work of exchanges and the NFA in enforcing the requirements.

And, as with the Commission's efforts to protect the economic and financial integrity of the futures markets, the Division of Enforcement also plays an important role in deterring behavior that could compromise the operational integrity of the markets. Enforcement investigates a variety of trade and sales practice abuses that affect customers. For example, the Commission brings actions alleging unlawful trade allocations, trading ahead of customer orders, misappropriating customer trades, and non-competitive trading. The Commission also takes actions against unscrupulous commodity professionals who engage in a wide variety of fraudulent sales practices against the public.

The CFTC's Role in the Energy Markets and Our Response to the Enron Situation:

The Commission oversees on-exchange trading of energy-related futures and options contracts based on such things as crude oil, natural gas, heating oil, propane, gasoline, and coal. Several U.S. exchanges are designated to trade energy product futures and options, but the overwhelming majority of on-exchange transactions are executed on New York Mercantile Exchange (the "NYMEX"), where contracts in each of the products I mentioned are actively traded. The CFTC does not regulate trading of energy products on spot (cash) markets or forward markets, which are excluded from our jurisdiction by the CEA.

Because Enron was a large trader of energy-based contracts traded on the NYMEX, its onexchange activity has been monitored by our market surveillance over the years. At this time, we have no indication that manipulation of any on-exchange futures market was attempted by Enron. However, the rapid financial deterioration of Enron last year presented an additional concern for the Commission: Could Enron's on-exchange futures positions be closed out without causing sudden price volatility or unduly reducing liquidity? In fact, Enron was but one of many significant participants in these large and liquid markets and the markets proved to be quite resilient. When its financial difficulties became known and Enron voluntarily closed out its positions, energy futures markets showed remarkably little reaction. The prices of energy-based futures did not spike nor did liquidity dry up.

As would the financial difficulties of any large futures customer, Enron's difficulties also raised concerns about the ability of the FCMs that carried Enron's onexchange futures positions to successfully close out those positions if Enron were to fail to meet margin calls. When Enron's financial troubles became known last fall, staff from our Division of Trading and Markets worked closely with the NYMEX clearinghouse and the affected FCMs to monitor and to manage the closing out of these positions. By appropriately adjusting margin requirements, the clearinghouse was able to ensure that adequate Enron funds remained on deposit at the FCMs, which both provided additional security for the FCMs and their customers and gave Enron a strong incentive to reduce its positions as quickly as possible.

The closing out of Enron's on-exchange positions was accomplished quickly and smoothly so that, by the time of Enron's bankruptcy filing, the risks to which FCMs were exposed, as measured by standard margin requirements, had dropped by 80% from only a week earlier. By mid-December, all of Enron's positions on the regulated exchanges had been liquidated. (Enron also owned a small subsidiary FCM, Enron Trading Services, that carried no positions for other customers and only a very small portion of Enron's own onexchange positions. At all times, ETS had regulatory capital several times the required level. Also by mid-December, ETS had transferred its customers to other FCMs.) I believe that this episode was a success for the system of financial controls in the onexchange futures markets. There were no disruptions to the system of clearance and settlement. Enron met all its obligations. No customer lost any funds entrusted to any FCM.

How the Commodity Futures Modernization Act Changed Things:

The Commodity Futures Modernization Act of 2000 (the "CFMA") was signed into law by President Clinton on December 21, 2000. It amended the Commodity Exchange Act to, among other things, provide legal certainty for overthecounter derivatives products. For contracts based on energy products and certain other non-agricultural and nonfinancial commodities, the CFMA added a new Section 2(h) to the Act that exempted two types of markets from much of the CFTC's oversight.

The first type is bilateral, principal-to-principal trading between two eligible contract participants, a category that includes sophisticated entities such as regulated banks and wellcapitalized companies or individuals (for example, those with assets

of at least $10 million), among others. The second type is electronic multilateral trading among eligible commercial entities, such as eligible contract participants that can also demonstrate an ability to either make or take delivery of the underlying commodity (called "eligible commercial entities") or dealers that regularly provide hedging services to those entities.

Suggestions on Moving Forward:

As an oversight regulator, we will continue to look at how and why the markets within our statutory jurisdiction respond the way they do, whether well or poorly, to situations such as the failure of a significant participant. Separately, as a member of the President's Working Group on Financial Markets, the CFTC is working with the SEC, the Treasury Department, and the Federal Reserve Board to review for the President possible improvements in accounting, auditing, disclosure practices with respect to publiclyheld companies. And, within the Commission, we recently proposed a reorganization plan that will consolidate our market oversight functions into one division to help improve already excellent programs in market and financial surveillance.

The Enron situation has led some to call for further responses from Congress and regulators, even for re-regulation of markets that were provided legal certainty by the Commodity Futures Modernization Act. While I agree that it is prudent for a regulator to constantly review its policies and procedures to ensure that an appropriate level of oversight is exercised, I also believe that a situation of this magnitude deserves careful consideration before a regulator seeks to take action. I believe that regulators should make sure that the true problem has been identified before remedies are pursued.

I supported passage of the CFMA because I sincerely believed that a onesizefitsall approach to regulation was outdated, particularly in light of important advances in technology within the financial services industry. Rules tailored to the participant, the product, and the trading facility seemed to me to be a more appropriate approach than the prescriptive regulations of the past. To date, I have seen no evidence to the contrary in my agency's initial analysis of the Enron situation. The CFMA was enacted after a number of hearings conducted by our House and Senate oversight committees in the context of reauthorizing the Commission. Many issues relating to evolving markets received a full airing and important changes to the law were agreed upon as a result. I believe that any departure from the path of progress represented by this important piece of legislation should be approached with extreme caution.

We will continue to monitor the markets within our jurisdiction and to utilize all authorities given to us by the Congress to aggressively pursue violations of the Commodity Exchange Act. We stand ready to work with this Subcommittee, the Congress, other regulators, and market participants. Thank you for the invitation to appear before your Committee. I will be happy to answer any questions you may have.

Mr. BARTON. We thank you, Mr. Chairman, and appreciate your testimony.

We now want to hear from the Commissioner of the Securities and Exchange Commission, the Honorable Isaac Hunt, who has appeared before our subcommittee before.

Mr. HUNT. Yes, sir.

Mr. BARTON. Glad to have you back, and your statement is in the record, and you are recognized for 7 minutes, and to elaborate on the statement.

STATEMENT OF HON. ISAAC C. HUNT, JR.

Mr. HUNT. Chairman Barton, Ranking Member Boucher, and members of the subcommittee, I am Commissioner Hunt of the U.S. Securities and Exchange Commission. I am pleased to have this opportunity to testify before you on behalf of the SEC.

As you know, for almost 20 years the SEC has consistently supported repeal of those provisions of PUHCA that either duplicate laws administered by other regulators, or that are no longer necessary.

Since I last testified on PUHCA repeal before this committee in December, the magnitude of the Enron debacle and the harm that Enron's collapse has travesty inflicted on the company's investors and employees has become clearer.

Congress and various regulatory agencies, including the SEC, are appropriately investigating what happened at Enron, why it happened, and what should be done to prevent Enron-like debacles in the future.

As we continue to investigate and learn from the events surrounding Enron's collapse, we remain open-minded and of course would reconsider our views on conditional PUHCA repeal if warranted.

Currently, however, we are not aware of anything that would cause us to conclude that there is reason to abandon our longstanding support for conditional PUHCA repeal. The Commission continues to support repeal of PUHCA as long as the repeal is accomplished in a way that gives the FERC and State regulators sufficient authority to protect utility consumers.

Specifically, FERC and State regulators should be given additional authority to monitor, police, and regulate affiliate transactions. As long as electric and gas utilities continue to function as monopolies, there will be a need to protect against cross-subsidization.

The best means of guarding against this is likely to be audits of books and records, and Federal oversight of affiliate transactions. Any move to repeal PUHCA should include provisions providing FERC and State regulators the necessary tools to engage in this type of oversight.

In addition, Congress should consider giving FERC the authority to issue rules prohibiting or limiting those types of affiliate transactions that FERC concludes are inherently abusive.

The harm that Enron's collapse has tragically inflicted on the company's investors and employees are now clear. What may not be as clear is why Enron's power marketing activities did not subject it to PUHCA, and why Enron is an exempt public utility holding company.

In 1994, Enron Power Marketing, Inc., a subsidiary of Enron, received a no-action letter from the staff in the SEC's Division of Investment Management, in which the staff agreed not to recommend enforcement action against that subsidiary if it engaged in power marketing activities without it or Enron itself registering under the Act.

In its request for no-action relief, the subsidiary argued that the contracts, books, and records, and other materials underlying its power marketing activities were not, "facilities used for the generation, transmission, or distribution of electric energy or sale."

Accordingly, Enron argued that the power marketing subsidiary was therefore not "an electric utility company" for purposes of PUHCA, and therefore Enron was not a utility holding company for purposes of PUHCA.

The staff gave the subsidiary the requested no-action relief, and since that time, the staff has given analogous no-action relief to approximately 20 other companies.

Moreover, in 1997, the Commission, after public notice and comment, adopted Rule 58 that permits registered holding companies to engage in the brokering and marketing of energy commodities as permitted non-utility activities.

In July 1997, Enron acquired Portland General Electric and claimed an exemption to PUHCA registration under Rule 2 as intrastate public utility holding company. Enron was able to claim this exemption because both Enron and Portland General were incorporated in Oregon, and all of Portland General's operations were in Oregon.

Enron recently agreed to sell Portland General to Northwest Natural Gas, a transaction that is subject to Commission approval under PUHCA. Enron's claim to an intrastate exemption was and is consistent with the Commission's historical interpretation of the intrastate exemption.

For example, as early as 1937, the Commission granted an exemption to the Southeastern Indiana Corporation. That company, which was incorporated in Indiana, owned a single public utility subsidiary, which was also incorporated in, and operated exclusively in Indiana.

The company, however, also owned a number of nonutility subsidiaries incorporated in Indiana and Ohio that provides bus and telephone service in Indiana, Ohio, and Kentucky. In granting the company's request for an exemption, the Commission stated that, "such nonpublic utility activities of the applicant do not deprive it of its intrastate character insofar as public utility aspects of its business is concerned, and that so long as all of its public utility subsidiaries are organized under the laws of Indiana and confine their public utility business to that State, it will be entitled to the exemption provided by Section 3(a)(1)," the intrastate exemption.

Again, with respect to PUHCA, as we continue to investigate and learn from events surrounding Enron's collapse, we remain open-minded and would reconsider our views on repeal if warranted. Currently, however, it appears that the tragic collapse of Enron is not as a result of its classification or lack of classification as a public utility holding company.

Rather, a number of recent events, including Enron's collapse, suggests that for several years our system of disclosure regulation has needed repair. What happened to investors of Enron should be prevented from happening to investors in any other company.

All investors, including investors in public utility holding companies, are entitled to a regulatory system that produces disclosure that is meaningful and intelligible. Today, this morning, the SEC announced its intention to propose its first set of rule changes designed to enhance and improve our current disclosure system.

These proposals would, one, require companies to timely disclose transactions by their executive officers and directors in company securities, including transactions with the company.

Two, require enhanced disclosure of other companies critical accounting polices. Three, accelerate the timetables for companies to file their quarterly and annual reports with us.

Four, expand the list of significant events required to be disclosed on Form 8K, and accelerate the following deadlines for that form; and, five, require that public companies include their 8K re-

ports on their internet websites at the same time that those reports are filed with the SEC.

These proposals will be the first of a series of Commission initiatives to enhance our disclosure and financial reporting system. Other Commission initiatives to follow will include better disclosure of trend and evaluative data, clear and informative financial statements, and enhanced related party disclosures that would provide needed sunshine to affiliated transactions.

Likewise, in order to permit our systems of accounting from being abused, whether by public utility holding companies or other types of companies, we are working to establish a better system of private regulation of the accounting profession, and to make sure that they respond expeditiously and clearly to establish needed accounting standards.

The lessons learned from the Enron tragedy cannot be limited merely to public utility holding companies. In my opinion, these teachings must be used to protect all investors, not just those who have invested in public utility holding companies.

After all, investors who have lost their life savings will find little comfort in the fact that their losses came from an investment in a computer company, as opposed to a public utility holding company. Thank you for your time, and I would be happy to answer any questions that you may have.

[The prepared statement of Hon. Isaac C. Hunt, Jr. follows:]

PREPARED STATEMENT OF HON. ISAAC C. HUNT, JR., COMMISSIONER, U.S. SECURITIES AND EXCHANGE COMMISSION

Chairman Barton, Ranking Member Boucher, and Members of the Committee:

I. INTRODUCTION

I am pleased to have this opportunity to testify before you on behalf of the Securities and Exchange Commission ("SEC") regarding the SEC's continuing support for legislation to repeal much of the Public Utility Holding Company Act of 1935 ("PUHCA," "the 1935 Act" or "the Act").[1] As you know, for almost twenty years the SEC has consistently supported repeal of those provisions of PUHCA that either duplicate laws administered by other regulators or that are no longer necessary. The SEC has always stressed, however, that, in order to protect the customers of multistate, diversified utility holding companies, it is necessary to give the Federal Energy Regulatory Commission ("FERC") and state regulators authority over the books and records of holding companies and authority to regulate their ability to engage in affiliate transactions. Since I last testified before this Subcommittee on PUHCA repeal in December, the magnitude of the Enron debacle, and the harm that Enron's collapse has tragically inflicted on the company's investors and employees, have become clearer. Congress and various regulatory agencies, including the SEC, are appropriately investigating what happened at Enron, why it happened and what should be done to prevent Enron-like fiascoes in the future. As we continue to investigate and learn from the events surrounding Enron's collapse, we remain open-minded and, of course, would reconsider our views on conditional PUHCA repeal if warranted. Currently, however, I am not aware of anything that would cause us to conclude that there is reason to abandon our longstanding support for conditional PUHCA repeal.

II. BACKGROUND

Before discussing the SEC's current views on PUHCA, it is useful to review the history of the SEC's longstanding support of repeal. PUHCA was enacted in 1935 in response to abuses that had occurred in the gas and electric industry during the

[1] As I testified before this Subcommittee in December 2001, the SEC generally supports H.R. 3406, which is pending before this Subcommittee and which would repeal much of PUHCA. But see, footnote 7 *infra*.

first quarter of the last century.[2] The abuses included misuse of the holding company structure, inadequate disclosure of the financial position and earning power of holding companies, unsound accounting practices, excessive debt issuances, and abusive affiliate transactions.

The 1935 Act addressed these problems by giving the Commission authority over various practices of holding companies, including their issuance of securities and their ability to engage in affiliate transactions. The Act also placed restrictions on the geographic scope of holding company systems and limited registered holding companies to activities related to their gas or electric businesses. Because of its role in addressing issues involving securities and financings, the SEC was charged with administering the Act. In the years following the passage of the 1935 Act, the SEC worked to reorganize and simplify existing public utility holding companies in order to eliminate abuses.

In the early 1980s, however, the SEC concluded that many aspects of 1935 Act regulation had become redundant. Specifically, state regulation had expanded and strengthened since 1935, and the SEC had enhanced its regulation of all issuers of securities, including public utility holding companies. The SEC therefore concluded that the 1935 Act had accomplished its basic purpose and that many of its remaining provisions were either duplicative or were no longer necessary to prevent the recurrence of the abuses that had led to the Act's enactment. The Commission thus unanimously recommended that Congress repeal the Act.[3]

For a number of reasons—including continuing concern about the potential for abuse through the use of a multistate holding company structure, related concerns about consumer protection, and the lack of a consensus for change—repeal legislation was not enacted during the early 1980s. Because of continuing change in the industry, however, the SEC continued to look at ways to administer the statute more flexibly.

In response to accelerating changes in the utility industry during the early 1990s, in 1994, then-Chairman Arthur Levitt directed the SEC's Division of Investment Management to undertake a study, under the guidance of then-Commissioner Richard Y. Roberts, to examine the continued vitality of the 1935 Act. The study was undertaken as a result of the developments noted above and the SEC's continuing need to respond flexibly in the administration of the 1935 Act. The purpose of the study was to identify unnecessary and duplicative regulation, and at the same time to identify those features of the statute that remain appropriate in the regulation of the contemporary electric and gas industries.[4]

The SEC staff worked with representatives of the utility industry, consumer groups, trade associations, investment banks, rating agencies, economists, state, local and federal regulators, and other interested parties during the course of the study. In June 1995, a report of the findings made during the study ("Report") was issued. The staff's Report outlined the history of the 1935 Act, described the then-current state of the utility industry as well as the changes that were taking place in the industry, and again recommended repeal of the 1935 Act. The Report also outlined and recommended that the Commission adopt a number of administrative initiatives to streamline regulation under the Act.

Since the report was published, the utility industry in the United States has continued to undergo rapid change. Congress has facilitated many of these changes. For example, as a result of various amendments to the Act, any company, including registered and exempt holding companies, is now free to own exempt wholesale generators and foreign utilities and to engage in a wide range of telecommunications ac-

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[2] *See* 1935 Act section 1(b), 15 U.S.C. § 79a(b).

[3] *See Public Utility Holding Company Act Amendments: Hearings on S. 1869, S. 1870 and S. 1871 Before the Subcomm. On Securities of the Senate Comm. On Banking, Housing, and Urban Affairs,* 97th Cong., 2d Sess. 359-421 (statement of SEC).

[4] The study focused primarily on registered holding company systems. There were, at the time of the study, 19 such systems. The 1935 Act was enacted to address problems arising from multistate operations, and reflects a general presumption that intrastate holding companies and certain other types of holding companies, which the 1935 Act exempts and which now number 119, are adequately regulated by local authorities. Despite their small number, registered holding companies account for a significant portion of the energy utility resources in this country. As of September 30, 2001, the 27 registered holding systems (which included 35 registered holding companies) owned 133 electric and gas utility subsidiaries, with operations in 44 states, and in excess of 2500 nonutility subsidiaries. In financial terms, as of September 31, 2001, the 27 registered holding company systems owned more than $417 billion of investor-owned electric and gas utility assets and received in excess of $173 billion in operating revenues. The 27 registered systems represent over 40% of the assets and revenues of the U.S. investor-owned electric utility industry and almost 50% of all electric utility customers in the United States.

tivities.[5] In addition, the SEC has implemented many of the administrative initiatives that were recommended in the Report.[6] In sum, during the past decade, while the SEC has continued to support repeal of the Act, we have also recognized that we need to administer it faithfully, while streamlining and adding flexibility to the regulatory structure where permitted by the Act.

III. REPEAL OF PUHCA

A. The Commission's Continuing Support of Repeal

As I have stated, the Commission continues to support repeal of PUHCA, as long as repeal is accomplished in a way that gives the FERC and state regulators sufficient authority to protect utility consumers.[7] Not surprisingly, however, in light of recent events, there are those who are now asking whether Enron's collapse should cause those who support PUHCA repeal to reconsider.

As I stated at the beginning of my testimony, the harm that Enron's collapse has inflicted on the company's investors and employees is now readily apparent. The SEC, various other regulatory agencies and the Congress are now all investigating what happened at Enron, why it happened and what should be done to prevent Enron-like debacles in the future. These investigations are not only appropriate, but are necessary if the implications of Enron for a broad range of policy issues are to be fully understood. Currently, however, I am aware of nothing with regard to Enron that would change our opinion on PUHCA repeal.

Enron is currently an exempt holding company under PUHCA. When Enron acquired Portland General Electric in 1998, it claimed an exemption under PUHCA rule 2[8] as an intrastate holding company.[9] Enron was able to claim this exemption because it was incorporated in Oregon; Portland General, its only utility subsidiary, was incorporated in Oregon; and Portland General's utility operations were located in Oregon.[10] For more than sixty years, the SEC has held that as long as the holding company and its utility subsidiaries are all incorporated in the same state and the utility operations are conducted primarily in that state, the holding company is entitled to an exemption. The SEC does not look to where the holding company's

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[5] Sections 32 and 33 of the Act, which were added to it by the Energy Policy Act of 1992, permit, subject to certain conditions, the ownership of exempt wholesale generators and foreign utility companies. The impact of section 32 on the electricity industry is discussed in more detail below. Section 34, which was added by the Telecommunications Act of 1996, permits holding companies to acquire and retain interests in companies engaged in a broad range of telecommunications activities.

[6] The Report recommended rule amendments to broaden exemptions for routine financings by subsidiaries of registered holding companies (see Holding Co. Act Release No. 26312 (June 20, 1995), 60 FR 33640 (June 28, 1995)) and to provide a new exemption for the acquisition of interests in companies that engage in energy-related and gas-related activities (see Holding Co. Act Release No. 26667 (Feb. 14, 1997), 62 FR 7900 (Feb. 20, 1997) (adopting Rule 58)). In addition, the Report recommended, and the SEC has implemented, changes in the administration of the Act that would permit a "shelf" approach for approval of financing transactions. For example, during calendar year 2000, all eleven of the new registered holding companies received multi-year financing authorizations that included a wide range of debt and equity securities. The Report further recommended a more liberal interpretation of the Act's integration requirements which has been carried out in our merger orders. The Report also recommended an increased focus upon auditing regulated companies and assisting state and local regulators in obtaining access to books, records, and accounts. Six state public utility commissions participated in the last three audits of the books and records of registered holding companies.

[7] We do, however, have a concern about coupling PUHCA repeal with provisions that would provide unique regulatory benefits to small groups of companies under other statutes that the Commission administers. Section 125 of H.R. 3406 raises this concern. Section 125 appears to address a unique set of circumstances that give rise to questions about the status of an issuer as an "investment company" under the Investment Company Act of 1940. The Investment Company Act already provides the Commission with significant flexibility to deal with status issues. We therefore see no reason for legislation to deal with such issues. More broadly, we are prepared to work with any utility holding companies currently relying on the exemption from the definition of "investment company" provided by section 3(c)(8) of the Investment Company Act if repeal of PUHCA leads to questions about their status under the Investment Company Act.

[8] 17 C.F.R. § 250.2.

[9] Enron recently agreed to sell Portland General to Northwest Natural Gas, a transaction that is subject to Commission approval under PUHCA.

[10] The intrastate exemption which, in part, underlies rule 2 is PUHCA § 3(a)(1), 15 U.S.C. § 79c(a)(1). In administering the intrastate exemption, the SEC has traditionally looked to three factors: the state in which the holding company is incorporated, the state(s) in which its utility subsidiaries are incorporated, and the state(s) in which the public utility subsidiaries do business.

non-utility subsidiaries are incorporated or where the non-utility subsidiaries operate.[11]

The manner in which the Commission has administered the intrastate exemption is consistent with its purpose. One of the overriding concerns of PUHCA is to give federal regulators jurisdiction over multistate public utility holding companies that no single state can effectively regulate. In particular, PUHCA is meant to ensure that if a state does not have jurisdiction over both the holding company and the utility that does business in its state—a situation that will occur if the holding company is incorporated in a state different than that in which the utility subsidiary is incorporated—a federal regulator with access to all the holding company's books and records can step in to monitor and police affiliate transactions. In general, the Commission has concluded that, where the holding company and all of its utility subsidiaries are incorporated in the same state, this concern does not arise, and an exemption from PUHCA is warranted. Indeed, Oregon's experience with Enron as an exempt company, at least anecdotally, confirms this—the Chairman of the Oregon Public Utility Commission recently testified that Oregon ratepayers were not harmed by Enron's collapse and that "this utility [Portland General] is able to function just as well as it did before."[12]

In 1994, Enron Power Marketing Inc. ("EPMI"), a subsidiary of Enron, received a no-action letter from staff in the SEC's Division of Investment Management in which the staff agreed not to recommend enforcement action against EPMI if it engaged in power marketing activities without it or Enron registering under the Act. In its request for no-action relief, EPMI argued that the contracts, books and records and other materials underlying its power marketing activities were not "facilities used for the generation, transmission, or distribution of electric energy for sale,"[13] that the power market subsidiary was therefore not an "electric utility company" for purposes of PUHCA, and that Enron was thus not a utility holding company for purposes of the Act. EPMI's request stated that, at the time, other companies were already engaged in similar power marketing activities. The staff, without necessarily concurring in EPMI's legal analysis, gave EPMI the requested no-action relief. Since 1994, the staff has given analogous no-action relief to approximately twenty companies.[14]

As Chairman Pitt recently testified before a House Subcommittee, the speed and tragic consequences of Enron's collapse demonstrate the need for a variety of reforms in our administration of the securities laws that the Chairman and others at the SEC have been discussing in recent months. All investors, including investors in public utility holding companies, are entitled to a regulatory system that produces disclosure that is meaningful and intelligible. To address flaws in the current system, we continue to consider ways to ensure that investors receive more current disclosure, better disclosure of "trend" and "evaluative" data, and clear and informative financial statements. Likewise, to prevent our system of accounting from being abused, whether by public utility holding companies or other types of companies, we are working to establish a better system of private regulation of the accounting profession and to make sure that the FASB responds expeditiously and clearly to establish needed accounting standards.

In sum, Enron is a tragedy for our entire system of disclosure regulation. What happened to investors of Enron should be prevented from happening to investors in any company. However, the tragic collapse of Enron is not a result of its classification or lack of classification as a public utility holding company.

B. Affiliate Transactions and Cross-Subsidization

Thus, we continue to believe that repeal of PUHCA will not sacrifice any needed investor protections. As we have testified in the past, however, we continue to believe that, in order to provide needed protection to utility consumers, the FERC and state regulators should be given additional authority to monitor, police, and regulate affiliate transactions.

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[11] *See, e.g., In the Matter of Southeastern Indiana Corp.*, 2 S.E.C. 156 (1937)("[S]uch non-public utility . . . activities of the applicant do not deprive it of its intrastate character so far as the public utility aspect of its business is concerned . . .").

[12] *See* Tom Detzel, "Senators Mull Enron, PGE Link," *The Oregonian* (Feb. 7, 2002) (quoting Roy Hemmingway, Chairman, Oregon Public Utility Commission).

[13] *See* PUHCA § 2(a)(3), 15 U.S.C. § 79b(a)(3) (definition of "electric utility company").

[14] The Commission has also given exempt and registered holding companies the authority necessary to engage in power marketing as a nonutility activity. For example, rule 58, 17 CFR § 250.58, which was adopted in early 1997, permits registered holding companies to engage in "[t]he brokering and marketing of energy commodities, including but not limited to electricity, natural or manufactured gas and other combustible fuels" as a permitted nonutility activity.

Specifically, although deregulation is changing the way utilities operate in some states, electric and gas utilities have historically functioned as monopolies whose rates are regulated by state authorities. Some regulators subject these rates to greater scrutiny than others. There is a continuing risk that a monopoly, if left unguarded, could charge higher rates and use the additional funds to subsidize affiliated businesses in order to boost its competitive position in other markets. Because repeal of PUHCA would eliminate existing restrictions on both the size of utility holding companies and their ability to engage in non-utility activities, this risk may be magnified if holding company systems become bigger and more complex. Thus, so long as electric and gas utilities continue to function as monopolies, the need to protect against this type of cross-subsidization will remain. The best means of guarding against cross-subsidization is likely to be audits of books and records and federal oversight of affiliate transactions. Any move to repeal PUHCA should include provisions giving the FERC and state regulators the necessary tools to engage in this type of oversight.

As we testified late last year with respect to H.R. 3406, the bill represents a form of this type of conditional repeal. In particular, H.R. 3406 would provide the FERC with the right to examine books and records of holding companies and their affiliates that are necessary to identify costs incurred by associate utility companies, in order to protect ratepayers. H.R. 3406 would also provide an interested state commission with access to such books and records (subject to protection for confidential information), if they are necessary to identify costs incurred by utility companies subject to the state commission's jurisdiction and are needed for effective discharge of the state commission's responsibilities in connection with a pending proceeding. H.R. 3406 thus gives the FERC and state regulators the ability to review affiliate transactions after-the-fact and to exclude unjustified costs arising from affiliate transactions from a utility's rate base. While this is a significant power, and one we believe that state and federal rate regulators should possess, we also believe that Congress should consider giving the FERC the authority to use its rulemaking authority to prohibit or limit on a prospective basis those types of affiliate transactions that it concludes are so abusive that they should not be allowed.

C. Market Power Issues

Repeal of PUHCA would remove barriers that now exist to consolidation within the utility industry as well as barriers that prevent diversified, non-utility companies from acquiring utilities. Removal of these restrictions may raise competitive issues related to the "market power" of utilities. PUHCA was intended to address, among other things, the concentration of control of ownership of the public-utility industry. In particular, section 10(b)(1) of the Act requires the SEC to disapprove a utility acquisition if it will tend toward concentrated control of public-utility companies in a manner detrimental to the public interest or the interest of investors or consumers.[15] Traditionally, the SEC's analysis of utility acquisitions under section 10(b)(1) includes consideration of federal antitrust policies.[16] More specifically, the anticompetitive ramifications of an acquisition have traditionally been considered in light of the fact that public utilities are regulated monopolies subject to the ratemaking authority of federal and state administrative bodies.[17]

However, the SEC is not the only agency that reviews the potential anticompetitive effects of utility acquisitions. In many instances, proposed utility acquisitions are subject to FERC and state approval. Like the SEC, the FERC must consider antitrust implications of matters before it.[18] In addition, the potential anticompetitive effects of utility acquisitions are independently reviewed by the Department of Justice or the Federal Trade Commission.

In recent years, the SEC has looked to all these regulators for their expertise in assessing operational and competitive issues, particularly in situations in which the

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[15] The SEC must also consider whether the purchase price is reasonable; whether the purchase will unduly complicate the capitalization of the resulting system; and whether the transaction will serve the public interest by tending toward the economic and efficient development of an integrated public-utility system.

[16] *Municipal Electric Association v. SEC,* 413 F.2d 1052, 1056-07 (D.C. Cir. 1969) (section 10(b)(1) analysis "must take significant content" from "the federal anti-trust policies"), cited in *City of Holyoke v. SEC,* 972 F.2d 358, 363; *Environmental Action, Inc. v. SEC,* 895 F.2d 1255, 1260 (9th Cir. 1990) ("Federal antitrust policies are to inform the SEC's interpretation of section 10(b)(1)").

[17] *Entergy Corp.,* Holding Co. Act Release No. 25952 (Dec. 17, 1993), citing *Northeast Utilities,* Holding Co. Act Release No. 25221, *request for reconsideration denied,* Holding Co. Act Release No. 26037 (Apr. 28, 1994), *remanded sub nom. Cajun Electric Power Cooperative, Inc. v. SEC,* 1994 WL 704047 (D.C. Cir. Nov. 16, 1994).

[18] *See Gulf States Utilities Co. v. FPC,* 411 U.S. 747 (1973).

combined entity resulting from a merger would have control of key transmission facilities and of surplus power. Thus, although the SEC does independently assess the transaction under the standards of PUHCA, we have generally relied upon the FERC's greater expertise regarding issues related to utility competition. The Court of Appeals for the District of Columbia Circuit has stated that "when the SEC and another regulatory agency both have jurisdiction over a particular transaction, the SEC may 'watchfully defer' to the proceedings held before—and the result reached by—that other agency." [19]

Therefore, repeal of PUHCA is unlikely to affect how market power issues are reviewed at the federal level. Other federal agencies already have significant authority in this area. While PUHCA provides an additional layer of regulatory approval for certain utility mergers, the Commission's reliance, where appropriate, on other regulators for the key market power determination makes its review of market power issues largely redundant. Nonetheless, because repeal of PUHCA may increase consolidation in the utility industry, Congress could conclude that additional clarification of the FERC's authority in this area is necessary to give the FERC sufficient authority to ensure that what consolidation does occur in the utility industry does not harm consumers.

D. Other Consumer Protection Issues

I know that Congress and others are considering other types of consumer protections in the utility area. For example, there has been discussion of whether the FERC needs additional ratemaking authority in the wholesale electricity markets. Likewise, there has been discussion of whether the FERC or the Commodity Futures Trading Commission should be given additional authority to oversee trading in energy-related derivatives to prevent market manipulation. While I recognize that it is important for Congress to consider issues of these types, the SEC does not have statutory authority to regulate utility rates under PUHCA. Likewise, PUHCA does not give the SEC authority to attempt to prevent manipulation in the energy trading markets. The SEC therefore lacks the expertise to express a view on whether reforms are needed in these areas.

E. PUHCA Repeal and National Energy Policy

Repealing the Act is not, however, a magic solution to the current problems facing the U.S. utility industry. PUHCA repeal can be viewed as part of the needed response to the current energy problems facing the country—notably, the Administration's recent report on energy policy includes a recommendation that PUHCA be repealed.[20] But repeal of the Act will not have any direct effect on the supply of electricity in the United States. The Act does not, for example, currently place significant restrictions on the construction of new generation facilities. As part of the Energy Policy Act, Congress amended the Act in 1992 to remove most restrictions on the ability of registered and exempt holding companies (as well as companies not otherwise subject to PUHCA) to build, acquire and own generating facilities anywhere in the United States. These types of facilities—exempt wholesale generators or "EWGs"—are not considered to be electric utility companies under PUHCA, and, in fact, are exempt from all provisions of PUHCA. The only limitation that remains under PUHCA is one imposed by Congress on registered holding companies' investments in EWGs—namely, that a registered company may not finance its EWG investments in a way that may "have a substantial adverse impact on the financial integrity of the registered holding company system." [21] In short, the Energy Policy

[19] *Madison Gas and Electric Company v. SEC,* 168 F.3d 1337, (D.C. Cir. 1999); *City of Holyoke v. SEC, supra* note 10, citing *Wisconsin's Environmental Decade, Inc. v. SEC,* 882 F.2d 523 (D.C. Cir. 1989).

[20] *See* National Energy Policy: Report of the National Energy Policy Development Group at 5-12 (May 2001) (recommending the reform of "outdated federal electricity laws, such as the Public Utility Holding Company Act").

[21] While no Commission approval is required for the acquisition of an EWG as a result of the Energy Policy Act, Commission approval is required, for example, before a registered holding company can issue securities to finance the acquisition of, or guarantee securities issued by, an EWG. Under the Energy Policy Act, Congress directed the SEC to adopt rules with respect to registered holding companies' EWG investments. Pursuant to these requirements, in 1993 the SEC adopted rules 53 and 54 to protect consumers and investors from any substantial adverse effect associated with investments in EWGs. Rule 53, which created a partial safe harbor for EWG financings, describes circumstances in which the issue or sale of a security for purposes of financing the acquisition of an EWG, or the guarantee of a security of an EWG, will be deemed not to have a substantial adverse impact on the financial integrity of the system. For transactions outside the Rule 53 safe harbor, a registered holding company must obtain SEC approval of the amount it wishes to invest in EWGs. The standards that the SEC uses in assessing applications of this type are laid out in Rule 53(c).

Act removed restrictions on the ability of registered and exempt holding companies to build, acquire and own generating facilities anywhere in the United States. As a result, a number of registered holding companies now have large subsidiaries that own generating facilities nationwide. Numerous other companies not subject to the Act have also entered the generation business.[22]

Instead, repeal of the Act would eliminate regulatory restrictions that prohibit utility holding companies from owning utilities in different parts of the country and that prevent nonutility businesses from acquiring regulated utilities. In particular, repeal of the restrictions on geographic scope and other businesses would remove the impediments created by the Act to capital flowing into the industry from sources outside the existing utility industry. Repeal would thus likely have the greatest impact on both the continuing consolidation of the utility business as well as the entry of new companies into the utility business.

Repeal of the Act would also eliminate any impediments that exist to other regulators' attempts to modernize regulation of the utility industry. For example, during the past year, questions have arisen about how the Act will impact the ability of the FERC to implement its plans to restructure the control of transmission facilities in the United States.[23] Specifically, in order to "ensure that electricity consumers pay the lowest price possible for reliable service," the FERC recently implemented new regulations designed to create "independent regionally operated transmission grids" that are meant to "enhance the benefits of competitive electricity markets."[24] As a result of FERC's new regulations, many utilities will cede operating control—and in some cases, actual ownership—of their transmission facilities to newly-created entities. The status of these entities, as well as the status of utility systems or other companies that invest in them, raise a number of issues under the Act. Most prominently, it has been asserted that the limits the Act places on the other businesses in which a utility holding company can engage will create obstacles for nonutility companies that may wish to invest in or operate these new transmission entities. While the SEC believes it has the necessary authority under the Act to deal with the issues created by the FERC's restructuring without impeding that restructuring, repeal of the Act would nonetheless effectively resolve these issues.

This example, however, raises the broader issue of the relationship between the FERC's and the SEC's regulation of the utility industry. The FERC is clearly the agency that Congress intended to take the lead role in regulating the utility industry. The SEC, in contrast, is primarily devoted to regulating the securities markets. Although we always attempt to work together with the FERC to ensure that, to the extent possible, our regulation of utility holding companies under PUHCA does not impede their ability to regulate the utility industry, sometimes conflict is inevitable. Given this, if Congress chooses not to repeal PUHCA, we believe that responsibility for the Act, whether in its current form or in a modified form, should be transferred from the SEC to the FERC. Given the nature of the FERC's responsibilities and its expertise in regulating the utility industry, it is simply in a better position to balance the goals of PUHCA and the other statutes it administers, and thereby regulate the utility industry in a more consistent and effective manner.

The SEC takes seriously its duties to administer faithfully the letter and spirit of the 1935 Act and is committed to promoting the fairness, liquidity, and efficiency of the United States securities markets. By supporting conditional repeal of the 1935 Act, the SEC hopes to reduce unnecessary regulatory burdens on America's energy industry while providing adequate protections for energy consumers.

Mr. BARTON. Thank you, Commissioner Hunt.

We would now like to hear from Mary Hutzler, who has testified before, and who is the Acting Director of the Energy Information Administration, to give us your view on the facts and the figures about what happened when Enron's bankruptcy became more prevalent.

And I would point out for the record that each testifier has gotten a little bit longer than the previous one, and so hopefully you can disassociate yourself from that trend.

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[22] *See, e.g.,* National Energy Policy: Report of the National Energy Policy Development Group at 5-11 (May 2001) (noting that "[m]ost new electricity generation is being built not by regulated utilities, but by independent power producers").

[23] *See* FERC Order 2000, "Regional Transmission Organizations," 65 FR 810 (Jan. 6, 2000) (codified at 18 C.F.R. § 35.34).

[24] Order 2000, 65 FR at 811.

STATEMENT OF MARY J. HUTZLER

Ms. HUTZLER. Mr. Chairman, and members of the subcommittee, I appreciate the opportunity to appear before you today to discuss current and future energy prices and supplies in the United States in light of the recent Enron situation.

The Energy Information Administration is the autonomous statistical and analytical agency within the Department of Energy. We are charged with providing objective and timely data, analysis, and projections for the use of the administration, the Congress, and the public.

Energy markets with particular emphasis on electricity and natural gas have experienced considerable turmoil over the past 2 years. These markets, however, have emerged into a period of relative calm.

Most of the volatility in electricity markets occurred on the West Coast, particularly in California, and in the Pacific Northwest. Many of the conditions that contributed to the electricity market squeeze in California are no longer present.

Unfortunately, one of the contributors to lower electricity market volatility is the significant slow-down in the U.S. economy in 2001, particularly due to the dramatic decline in industrial output, which is still pervading the economy.

Despite the volatility in some spot electricity markets, most retail electricity customers have seen only slight increases in delivered electricity costs, because at the retail level, electricity prices are still regulated in many States.

Some States, particularly California, have seen large changes in delivered electricity prices, but for most areas, retail price changes have been relatively small over the last 2 years.

Some of the pressure on the electricity prices in 2000 and early 2001 were related to fuel costs, and the availability of adequate generating capacity. Throughout 2000, natural gas spot prices were rising steadily because of strong demand and stagnant or declining productive capacity.

The economy was expanding rapidly and incremental natural gas demand requirements were outstripping the capacity to produce new supplies. Natural gas inventories fell steadily to very low levels at the beginning of the 2000 and 2001 heating seasons, setting the stage for significant increases in natural gas costs to end-use customers.

Oil prices were also well above typical levels because of the tight condition of world oil markets. The reduction in hydroelectric resources in 2000 due to weather factors served to tighten electricity markets by removing an important component of electricity supply, adding to the increased demand for natural gas generation.

In late 2000, very cold temperatures moved heating and energy use to well above normal levels. This squeeze on natural gas markets resulted in a dramatic run-up in the natural gas prices, which sent fuel costs soaring.

Since last winter the onset of the economic slowdown and relatively mild weather has reduced demand and changed the cost price environment for electricity and other energy sources.

Average U.S. natural gas spot prices are currently between one-fourth and one-fifth the level seen at the height of the run-up last winter, and oil prices are noticeably lower.

Electricity spot prices are generally between $18 and $30 per megawatt hour, compared to mid-January 2001 prices of $40 to $50 in the south and east, and $400 to $500 on the West Coast.

We have examined electricity and natural gas price data since the fourth quarter of last year and compared them to Enron's stock prices. As this chart shows, we see no correlation between spot market prices for electricity and the path of Enron's stock price.

Between October 2001 and February of 2002, wholesale electricity prices for the Middle Atlantic, New York, New England, and California, displayed relative stability at the same time that Enron's stock value was plummeting from nearly $37 a share in October, to less than $1 a share 6 weeks later.

In terms of electricity, Enron was a small contributor in 2000, accounting for less than 1 percent each of total retail electricity sales, total generating capacity, and total electricity generation.

Similarly, the Henry Hub spot natural gas price, while a little more volatile than electricity prices, showed no sign of being affected by the Enron problems during the same period. While Enron had as much as a 10 percent interest in interstate pipeline capacity, this capacity, of which the largest pipeline has been sold, is operating and is expecting to operate, regardless of future ownership.

Both electricity and natural gas markets appear to have shrugged off the Enron situation with little or no discernable market impacts. In the short term, little change is expected for electricity prices.

For 2002, an average decline in residential electricity prices of 1.6 percent is expected, and a modest increase of about a .5 percent is anticipated for 2003 as fuel costs increase moderately, and as aggregate electricity demand increases.

In the longer term the electricity prices are expected to decline about .2 percent annually from 2000 to 2020, as more competition and lower coal prices to electric generators offset somewhat higher natural gas prices.

Spot wellhead prices are currently averaging around $2 to $2.20 per million Btu, or about one-quarter of what they were in January of last year, when prices at the wellhead reached record levels.

Very mild weather during the fourth quarter of last year through January of this year has reduced heating demand considerably. The low heating demand, a weak economy, and high storage levels for natural gas, should result in natural gas wellhead prices of about $1.85 per thousand cubic feet for 2002, increasing to nearly $2.40 per thousand cubic feet in 2003, as the economy grows and world oil prices increase.

Natural gas prices at the wellhead are expected to rise from their current levels, reaching $3.26 per thousand cubic feet by 2020 in real 2000 dollars.

In summary, it appears that the factors responsible for the very volatile and high electricity prices on the West Coast, and the spike and subsequent collapse in natural gas prices nationwide stemmed from numerous economic and non-economic developments that are not obviously related to Enron's market activity. Enron, while a

large and well-known player among energy trading entities in the United States, was one among many existing and potential new players in electricity and natural gas markets.

The existing array of market participants should be able to interact effectively to ensure a normal competitive market balance. There is nothing in what has occurred in energy markets since the failure of Enron that would suggest otherwise as far as the aggregate energy market data is concerned. Thank you, Mr. Chairman, and members of the subcommittee. I will be happy to answer any questions that you may have.

[The prepared statement of Mary J. Hutzler follows:]

PREPARED STATEMENT OF MARY J. HUTZLER, ACTING ADMINISTRATOR, ENERGY INFORMATION ADMINISTRATION, DEPARTMENT OF ENERGY

Mr. Chairman and Members of the Subcommittee: I appreciate the opportunity to appear before you today to discuss current and future electricity and natural gas prices and supplies in the United States, in light of the recent Enron situation.

The Energy Information Administration (EIA) is an autonomous statistical and analytical agency within the Department of Energy. We are charged with providing objective, timely, and relevant data, analysis, and projections for the use of the Department of Energy, other Government agencies, the U.S. Congress, and the public. We do not take positions on policy issues, but we do produce data and analysis reports that are meant to help policy makers determine energy policy. Because we have an element of statutory independence with respect to the analyses that we publish, our views are strictly those of EIA. We do not speak for the Department, nor for any particular point of view with respect to energy policy, and our views should not be construed as representing those of the Department or the Administration. However, EIA's baseline projections on energy trends are widely used by Government agencies, the private sector, and academia for their own energy analyses.

The Subcommittee has requested information about current and future electricity and natural gas prices and supplies in light of the Enron situation. EIA collects and interprets data on the current energy situation, and produces both short-term and long-term energy projections. The projections in this testimony are from our *Short-Term Energy Outlook, February 2002*, and the *Annual Energy Outlook 2002*, released late last year. The *Short-Term Energy Outlook* provides quarterly projections of energy markets through 2003, while the *Annual Energy Outlook* provides projections and analysis of domestic energy consumption, supply, and prices through 2020. These projections are not meant to be exact predictions of the future, but represent a likely energy future, given technological and demographic trends, current laws and regulations, and consumer behavior as derived from known data. EIA recognizes that projections of energy markets are highly uncertain and subject to many random events that cannot be foreseen, such as weather, political disruptions, strikes, and technological breakthroughs. In addition, both short- and long-term trends in technology development, demographics, economic growth, and energy resources may evolve along a different path than assumed in the *Short-Term Energy Outlook* and the *Annual Energy Outlook.* Many of these uncertainties are explored through alternative cases with a range of assumptions concerning world oil prices and weather in the *Short-Term Energy Outlook,* and world oil prices, economic growth, and, technology in the *Annual Energy Outlook.* My testimony today will present our reference case projections, which represent current policies and trends, and are not expected to be affected by the situation surrounding the collapse of Enron Corporation.

Enron Corporation declared bankruptcy in December 2001. Our mid-term projections, which were published the same month, incorporated the most recent events in energy markets as possible, but most of our analysis was completed by the end of September 2001. At that time, the problems of Enron had not yet been made public, and were not foreseen by most energy analysts. It is our view, however, that the mid-term outlook for energy markets is not materially affected by this situation, which is essentially confined to the shareholders and employees of Enron.

THE CURRENT SITUATION AND THE SHORT-TERM OUTLOOK

Overview

Energy markets, with particular emphasis on electricity and natural gas, have experienced a great deal of volatility over the past two years. For electricity, the most

dramatic ups and downs have occurred on the West Coast, particularly in California. Natural gas market changes over that period have been broader in scope and have been felt strongly across the country, although the highest price increases were in California. In general, it appears that the factors that are responsible for the very volatile and high electricity prices on the West Coast, and the spike and subsequent collapse in natural gas prices nationwide, stemmed from numerous economic and non-economic developments (some years in the making) that are not obviously related to Enron's market activity. Furthermore, these developments appear to be resolving toward a general result that would be obtained with or without the continued existence of Enron. Enron, while a large and well-known player among energy trading entities in the United States, was one among many existing and potential new players in electricity and natural gas markets. The existing array of market participants (producers, traders, marketers, distributors, consumers) should be able to interact effectively to ensure a normal (competitive) market balance in the future. The projections in this testimony are based on that premise, and there is nothing in what has occurred in energy markets since the failure of Enron that would suggest otherwise.

Electricity

Electricity markets in the United States emerged, in mid to late 2001, from a period of significant turmoil into a period of relative calm with respect to spot electricity price movements. Most of the increased volatility in spot electric prices occurred on the West Coast of the United States, particularly in California, but also in the Pacific Northwest (Figure 1). Between May 1, 2000 and June 1 2001, the average daily percent spot price change at the California/Oregon border (COB) was 20 percent with a maximum absolute change of 140 percent. For the period August 7, 1998 to December 30, 1999, the average was 12 with a daily maximum of 126. The relative calm that has characterized the West Coast market since last winter is demonstrated by the fact that between June 1, 2001 and February 8, 2002, the average daily percent change in COB electricity spot prices has been 9.6 percent with a maximum absolute change of 84 percent. Many of the conditions that contributed to the electricity market squeeze in California in late 2000/early 2001 are no longer operative and the prospects for continued calm in electricity prices through 2003 are good. Unfortunately, one of the contributors to lower electricity market volatility is the significant slowdown in the U.S. economy in 2001, particularly as demonstrated by the dramatic decline in industrial output which is still pervading the economic environment. It should be noted that, despite the volatility in some spot electricity markets, most retail electricity customers in the United States have seen only marginal increases in delivered electricity costs, and moderate declines in 2002 are likely. This result stems from the fact that at the retail level electricity prices are still regulated in many States. Some States (particularly California) have seen large changes in delivered electricity prices, but, for most areas, retail price changes have been relatively small over the last two years.

Some of the pressure on electricity prices that emerged in 2000 and early 2001 were related to fuel costs and the availability of adequate amounts of certain kinds of generating capacity. Throughout 2000, natural gas spot prices were rising steadily because of strong demand and stagnant or declining productive capacity. The economy was expanding rapidly and incremental natural gas demand requirements were outstripping the capacity to produce new supplies. Natural gas inventories fell steadily to very low levels at the beginning of the 2000-2001 heating season, setting the stage for significant increases in natural gas costs to end-use customers, including electric power generators. At this time, oil prices were also well above typical levels because of the tight condition of world oil markets. It should be noted that a concomitant reduction in hydroelectric resources in 2000 (due of course to exogenous weather factors) only served to tighten electricity markets by, in effect, removing an important component of everyday electricity supply capacity. This was particularly true on the West Coast. In late 2000, very cold temperatures shocked energy markets by moving heating demand-related energy use to well above normal levels. The resulting squeeze on natural gas markets resulted in one of the most dramatic runups in natural gas prices ever seen in the United States, with the result that industrial and power generating companies (as well as other energy users) saw fuel costs soar. For power generators, some alternatives to natural gas alleviated some of the pressure. In fact, the 2000-2001 winter turned out to be one of the busiest winters for oil-burning power stations in many years. While oil-fired generating capacity represents only a marginal source of alternative electricity supply, this development nevertheless helped prevent gas price runups from being even worse than they actually were last winter.

Since last winter, the onset of economic recession and relatively mild weather (including unusually warm heating season temperatures beginning in November of 2001) has reduced electricity (and other energy) demand and changed the cost/price environment for electricity and other energy sources. Average U.S. natural gas spot prices are currently between one fourth and one fifth the level seen at the height of the runup last winter. Oil prices are noticeably lower now than during the winter of 2000-2001 as well. Electricity spot prices now generally between $18 and $24 per megawatt-hour compared to $40-$50 in the South and East, and $400-$500 on the West Coast during mid January 2001. Cost conditions in the near term (2002 and 2003) are expected to be such that average energy prices remain much closer to current levels than to anything resembling the high prices of late 2000 to early 2001. Moreover, current supplies (inventories) are relatively high right now for most fuels in the United States, particularly natural gas. Although some tightening in natural gas markets is anticipated for 2003, prices are likely to remain quite low on average through most of 2002.

Until the U.S. economy begins to recover in earnest and domestic fuel inventories are pared to more normal levels, the probability of sharp price runups is minimal. In addition to the demand and fuel cost factors that have reduced the level of electricity price volatility since last winter, there has been a significant number of new electric generating plants added to the U.S. inventory over the last year or so. Current estimates are that there has been about a 73,500-megawatt (9.3-percent) increase in generating capacity between the end of 1999 and the beginning of 2002. Approximately 2,000 megawatts (3.9 percent) have been added in California. Furthermore, it is generally expected that a significant recovery in hydroelectric power availability on the West Coast is likely this year. Such a development would further reduce the likelihood of renewed pressure on electricity prices in the region regardless of the specific entities engaged in trading there.

Despite a period of wide variability and sharp runups in spot electricity prices since 1999, for most retail electricity consumers, price movements have been much less dramatic. For example, between 1999 and 2001, U.S. residential electricity prices have risen an average of 1.9 percent per year. The highest monthly year-over-year increase in the last two years for average residential prices has been 4.6 percent (February 2001). For 2002, an average decline in residential electricity prices of 1.6 percent is expected. A modest increase of about 0.5 percent is anticipated for 2003 as fuel costs increase moderately and as aggregate electricity demand begins to rise. U.S. electricity demand is currently estimated to have fallen by 0.6 percent in 2001. Much of that decline is expected to be reversed in 2002 and reach a more normal annual growth rate of 2.7 percent in 2003. This projection presumes that the U.S. economy will begin to recover in 2002 and post a 4.0-percent real GDP growth rate in 2003.

Enron and Electricity Prices

Average wholesale electricity prices across the Nation have been relatively stable since October 2001 (Figure 2). Monthly average electric power prices during this period ranged from a high of about $38.00 a megawatthour to a low of about $18.00 a megawatthour in response to changing demand and supply conditions.

Enron's stock traded at $36.79 per share on October 11, 2001. Its price continued its downward spiral during the months of October and November. The stock has not recovered since then. This performance is also in sharp contrast with the stock's performance in September 2000 when its price reached a high of nearly $90.

The rate of decline accelerated as information about Enron's accounting practices emerged and Federal agencies began looking closely into Enron's affairs. Failure of a merger agreement between Enron and Dynegy also contributed to a decline in Enron's stock. Given the relative stability of wholesale electricity prices together with the collapse of Enron's stock price, it is not possible to establish any meaningful correlation between electric power prices and Enron's performance in the stock market.

A review of average retail electricity prices (calculated as average revenue per kilowatthour) in relation to Enron's stock price during January 1999 through October 2001 also fails to exhibit any correlation between average retail electricity prices and Enron's stock's performance (Figure 3). As electricity prices are still regulated by many State public utility commissions, they do not appear to be influencing or being influenced by the Enron stock price.

Natural Gas

Spot wellhead prices are currently averaging around $2.00-$2.20 per million Btu, or about one-quarter of what they were in January of last year when prices at the wellhead reached record levels (Figure 4). These prices are measured at the Henry

Hub—a major upstream trading center, the prices of which are often used as representative of U.S. natural gas markets. Very mild winter weather during the fourth quarter of last year through January of this year has lowered heating demand considerably. Heating degree-days in the fourth quarter 2001 were about 26 percent below levels from the previous fourth quarter and about 16 percent below normal, while January 2002 heating degree-days were about 14-17 percent below normal (depending on the region) and below year-ago levels. The low heating demand, a weak economy, and the ensuing excess storage levels for natural gas during the winter of 2001-2002 through the spring of 2002 should result in rather tepid natural gas prices in the near term. At the end of last November, working gas in storage was 30 percent above levels during the previous November. By the end of January, the storage level was almost 80 percent above that of the previous year and about 35 percent above a 5-year normal (Figure 5). We expect that by the end of the heating season—less than 2 months away—working gas in storage will be double the level at the end of last March. Another factor that helped to temper natural gas prices is the relatively low price for petroleum. Both crude and product prices are considerably less than they were this time last year, thus relieving any upward competitive price push on natural gas.

With the heating season nearly over (given the high storage levels and weak demand), it is perhaps surprising that natural gas prices have not fallen further. It is true that average daily spot prices at the Henry Hub have slipped below $2 per million Btu on more than one occasion since November, most recently on January 29 of this year. Yet for much of the heating season to date (mid-December through mid-February), Henry Hub spot prices have remained in the $2.30-$3.00 per million Btu range. Our current view for natural gas prices is that for much of the rest of 2002, spot wellhead prices will hover near (or perhaps slightly below) the $2.00-per-million-Btu level. A modest recovery in prices by late 2002 or early 2003 depends largely upon the speed of recovery in the U.S. economy, weather, and the net effect on gas productive capacity of the slowdown in U.S. drilling. The latest statistics from Baker Hughes show that gas-directed drilling in the United States has fallen to levels not seen since July 2000. We believe that room for some continued declines exists over the next several months because, on balance, aggregate lease revenues for oil and gas producers aren't likely to turn upward again until mid-summer. This will be particularly true if oil prices remain flat or weaken instead of increasing gradually as expected. For 2003, we project that, as economic growth accelerates and as world oil prices rise, natural gas wellhead prices will rise accordingly, gaining about 50 cents per thousand cubic feet on average compared to 2002.

Enron and Natural Gas Prices

Very little information regarding Enron's true financial status was available to natural gas markets prior to October 16, 2001. In the period from that day through February 9, 2002, natural gas spot prices have fluctuated between $2 and $3 per million Btu (MMBtu) at the Henry Hub, with only a few brief exceptions.

The price fluctuations during this period do not appear to have a clear correspondence with important dates involving Enron (Figure 6). While all daily variation is not necessarily easily explained, the price trends over weeks relate well to market conditions. Spot prices were increasing during October, which is a typical occurrence as the markets prepare for the heating season. Weather forecasts at the time were calling for a cold winter and prices reacted accordingly. As low temperatures failed to materialize, prices subsided to levels around $2. In December, as temperatures declined, once again forecasts were calling for cold winter temperatures in the near future, and natural gas prices rose in reaction.

Since the beginning of the year, weather has tended to be warmer than normal, which has kept prices from increasing greatly. Further, the generally higher-than-normal temperatures during the heating season caused operators to limit withdrawals of natural gas from storage. The exceptionally large volumes of gas remaining in storage pose a substantial supply cushion that has mitigated the impact of any demand pressures on the market.

Looking back over the past 2 years, natural gas markets have experienced a remarkable period in which prices rose from just above $2 per MMBtu in January 2000 to more than $10 by the end of the year. After beginning 2001 at these elevated levels, prices returned to below $2 by the end of September 2001 (Figure 7). EIA examined gas market conditions and prices in two studies, *U.S. Natural Gas Markets: Recent Trends and Prospects for the Future* (May 2001), and *U.S. Natural Gas Markets: Mid-Term Prospects for Natural Gas Supply* (December 2001). These reports concluded that the high natural gas prices experienced in 2000 were caused by constrained domestic productive capacity that resulted from a sustained period of relatively low oil and natural gas prices, followed by unusually high demand—

the result of strong economic growth and an unusually warm summer and cold winter—and a poor storage position heading into the winter season (November 2000 through February 2001).

EIA does not believe that the Enron situation has had a strong detrimental impact on natural gas markets. The major events involving Enron do not appear to have a correlation with natural gas markets and prices. Further, gas price patterns during the past 2 years have reasonable explanations that did not require an extraordinary role for Enron.

Enron in the Electricity and Natural Gas Industries

In many ways, Enron was deemed a very large company. Among the 33 major energy companies reporting to the Financial Reporting System (FRS) in 2000, Enron ranked second in total revenues (11 percent share), third on total assets (9 percent share), seventh on capital expenditures (4 percent share), and tenth on the basis of net income (2 percent share). However, as the table below shows, Enron accounted for less than 1 percent of total retail electricity sales, generating capacity, and electricity generation in the United States in 2000. Enron mainly operated in wholesale trading markets, without owning or operating physical assets.

Table 1. Enron in the Electricity Business, 2000

Category	Enron	U.S. Total	Enron Share (Percent)
Retail Sales (million kilowatt-hours)	9.6	3,421,414	0.0003
Capacity (megawatts)	3,389	811,625	0.4176
Generation (million kilowatt-hours)	915	3,800,000	0.2400

In the natural gas business, Enron was a major player in the interstate gas pipeline business. Overall it had interests in 10 percent of the interstate gas pipeline capacity in the United States (Table 2). However, some of this capacity has already been sold. In January 2002, the largest pipeline Enron owned was sold to Dynegy, reducing its interests to 7 percent. Enron also has interests in some gas storage and intrastate pipeline facilities. Enron operates underground storage facilities through Northern Natural in the States of Iowa and Kansas. Midwest Natural Gas Transmission operates one storage field in Indiana. The total capacity of these storage operations is approximately 2.5 percent of the total underground storage capacity for the nation. On a State basis, the fields operated by Enron entities account for more then 40 percent of the 273 billion cubic feet (Bcf) of capacity in Iowa and more then 25 percent of the 301 Bcf of capacity in Kansas. Operations in Indiana amount to less then 1 percent of the total storage capacity for the State. No storage operations are associated with either Florida Gas Transmission or Northern Border. All of these facilities are expected to continue to operate regardless of their future ownership.

Table 2. Enron Interstate Natural Gas Pipelines, 2001

Company	Ownership Share (Percent)	Capacity (Million cubic feet per day)	Miles
Northern Natural Gas Company	100	3,904	15,671
Transwestern Gas Company	100	2,836	2,532
Florida Gas Transmission Co	50	1,742	5,342
Northern Border Pipeline Co	12	3,094	1,248
Midwestern Pipeline Co	[1]	1,000	359
Total Enron Interests		12,576	25,152
Total US Interstate		128,387	214,528
Enron Interests (percent) [2]		10	12

[1] Enron owns 12.4 percent of Northern Border Partners which in turn owns 100 percent of Midwestern Pipeline.
[2] The stated percentages are the share of the industry represented by the companies in which Enron has an ownership share.

ANNUAL ENERGY OUTLOOK 2002

Reference Case

Electricity Prices—Between 2000 and 2020, the national average price of electricity in real 2000 dollars is projected to decline from 6.7 cents per kilowatt-hour to 6.5 cents per kilowatt-hour, an average reduction of 0.2 percent per year, mainly as a result of competition among electricity suppliers (Figure 8). By sector, projected

prices in 2020 are 6.4, 3.9, and 0.2 percent lower than 2000 prices for residential, commercial, and industrial customers, respectively.

The cost of producing electricity is a function of fuel costs, operating and maintenance costs, and the cost of capital. In 2000, fuel costs typically represented $22 million annually—or 76 percent of the total operational costs (fuel and variable operating and maintenance)—for a 300-megawatt coal-fired unit, and $66 million annually—or 93 percent of the total operational costs—for a natural-gas-fired combined-cycle unit of the same size. For nuclear units, fuel costs are typically a much smaller portion of total production costs. Nonfuel operations and maintenance costs are a larger component of the operating costs for nuclear power units than for plants that use fossil fuels.

The impact of rising natural gas prices in the forecast is more than offset by a combination of falling coal prices and stable nuclear fuel costs. After the price spikes of 2000 and 2001, natural gas prices to electricity suppliers are projected to rise by 2.2 percent per year in the forecast, from $2.64 per thousand cubic feet in 2002 to $3.94 in 2020 (Figure 9). The natural gas price increases after 2002, however, are offset by forecasts of declining coal prices, declining capital expenditures, and improved efficiencies for new plants.

Before 2001, 14 States, including California, instituted competition in their retail electricity markets. Both the District of Columbia and Ohio began retail competition in 2001, and Texas and Virginia are scheduled to begin in 2002. Since the beginning of 2000, however, 7 States have delayed the opening of competitive retail markets beyond the dates originally planned, and in the fall of 2001, California suspended retail competition. Specific restructuring plans differ from State to State and utility to utility, but most call for a transition period during which customer access will be phased in. The transition period reflects the time needed for the establishment of competitive market institutions and the recovery of stranded costs as permitted by regulators. It is assumed that competition will be phased in over 10 years, starting from the inception of restructuring in each region. In all the competitively priced regions, the generation price is set by the marginal cost of generation. Transmission and distribution prices are assumed to remain regulated.

It is not clear at this point to what extent the Enron situation will affect the announced plans of these States to move their electricity markets toward competitive restructuring. Clearly, the large price increases seen in California during the second half of 2000 had a chilling impact on the trend toward deregulation. There have been no recent announcements of new State-level restructuring initiatives. On the other hand, with the return to stability in the California electricity market, as well as in national natural gas markets, there have been only a few decisions to delay or reverse the announcements already made. No clear trend concerning Enron's impact on electricity prices are discernible, implying that the effects will be small at best.

Electricity Sales—The continuing saturation of electric appliances, the availability and adoption of more efficient equipment, and efficiency standards are expected to hold the growth in electricity sales to an average of 1.8 percent per year between 2000 and 2020, compared with a 3.0-percent annual growth in GDP. By 2020, electricity sales are expected to be 4916 billion kilowatt-hours, compared to 3413 billion kilowatt-hours in 2000, a 44 percent increase. During the 1960s, electricity demand grew by more than 7 percent per year, nearly twice the rate of economic growth (Figure 10). In the 1970s and 1980s, however, the ratio of electricity demand growth to economic growth declined to 1.5 and 1.0, respectively. Several factors have contributed to this trend, including increased market saturation of electric appliances, improvements in equipment efficiency and utility investments in demand-side management programs, and more stringent equipment efficiency standards. Throughout the forecast, growth in demand for office equipment and personal computers, among other equipment, is dampened by slowing growth or reductions in demand for space heating and cooling, refrigeration, water heating, and lighting.

With the number of U.S. households projected to rise by 1.0 percent per year between 2000 and 2020, residential demand for electricity is expected to grow by 1.7 percent annually, to 1672 billion kilowatt-hours (Figure 11). Electricity demand in the commercial sector is projected to grow by 2.3 percent per year between 2000 and 2020. Projected growth in commercial floorspace of 1.7 percent per year contributes to the expected increase. Electricity is projected to account for three-fourths of commercial primary energy consumption throughout the forecast. Expected efficiency gains in electric equipment are expected to be offset by the continuing penetration of new technologies and greater use of office equipment. In the industrial sector, electricity consumption is projected to grow 1.4 percent annually over the forecast period, stimulated by growth in industrial output of 2.6 percent per year. Industrial

delivered electricity use is projected to increase by 32 percent, with competition in the generation market keeping electricity prices low.

Electricity Generating Capacity—From 2000 to 2020, 355 gigawatts of new generating capacity (excluding cogenerators) is expected to be needed to meet growing demand and to replace retiring units (Figure 12), bringing total capacity to about 1060 gigawatts. Between 2000 and 2020, 10 gigawatts (10 percent) of current nuclear capacity and 37 gigawatts (7 percent) of current fossil-fueled capacity are expected to be retired, nearly all before 2010. Of the 185 gigawatts of new capacity expected by 2010, 10 percent is projected to replace retired oil- and natural-gas-fired steam capacity.

Because of their favorable economics, natural gas-fired combined-cycle units are projected to be used for most new baseload requirements. The average efficiency for combined-cycle units is expected to approach 54 percent by 2010, compared with 49 percent for coal-steam units, and the expected construction costs for combined-cycle units are about 44 percent of those for coal-steam plants. As a result, most (59 percent) of the projected combined-cycle additions are expected before 2010. As natural gas prices rise later in the forecast, new coal-fired capacity is projected to become more competitive, and 80 percent of the projected additions of new coal-fired capacity are expected to be brought on line from 2010 to 2020.

A total of 31 gigawatts of new coal-fired capacity is projected to come on line between 2000 and 2020, accounting for almost 9 percent of all the capacity expansion expected. Competition with low-cost gas-turbine-based technologies and the development of more efficient coal gasification systems have compelled vendors to standardize designs for coal-fired plants in efforts to reduce capital and operating costs in order to maintain a share of the market. Renewable technologies account for 3 percent of expected capacity expansion by 2020—primarily wind, geothermal, and municipal solid waste units. About 19 gigawatts of distributed generation capacity is projected to be added by 2020, as well as a small amount (less than 1 gigawatt) of fuel cell capacity.

In addition to building new capacity, electricity generators are expected to use other options to meet demand growth—maintenance of existing plants, power imports from Canada and Mexico, and purchases from cogenerators.

Electricity Generation—As they have since early in this century, coal-fired power plants are expected to remain the key source of electricity through 2020 (Figure 13). In 2000, coal accounted for 1,968 billion kilowatt-hours or 52 percent of total generation, including cogeneration. Although coal-fired generation is projected to increase to 2,472 billion kilowatthours in 2020, increasing gas-fired generation is expected to reduce coal's share to 46 percent. Concerns about the environmental impacts of coal plants, their relatively long construction lead times, and the availability of economical natural gas make it unlikely that many new coal plants will be built before about 2005. Nevertheless, slow growth in other generating capacity, the huge investment in existing plants, and increasing utilization of those plants are expected to keep coal in its dominant position. By 2020, it is projected that 23 gigawatts of coal-fired capacity will be retrofitted with scrubbers to meet the requirements of the Clean Air Act Amendments of 1990 (CAAA90).

In percentage terms, natural-gas-fired generation is projected to show the largest increase, from 16 percent of the total in 2000 to 32 percent in 2020. As a result, by 2004, natural gas is expected to overtake nuclear power as the Nation's second-largest source of electricity. Generation from oil-fired plants is projected to remain fairly small throughout the forecast.

Natural Gas Prices—From 1995 to 2000, the wellhead price of natural gas averaged $2.38 per thousand cubic feet (2000 dollars). Relative to that average, the price is expected to increase at an average rate of 1.6 percent per year in the reference case, reaching $3.26 in 2020 (Figure 14).

Increasing prices reflect the rising demand for natural gas; the progression of the discovery process from larger, shallower, and more profitable fields to smaller, deeper, and less profitable ones; and increasing production from higher cost sources, such as unconventional natural gas. Projected average growth in production from unconventional sources from 2000 to 2020 ranges from 3.1 to 3.6 percent per year across the cases, compared to a range of 2.0 to 2.2 percent per year for conventional sources. Technically recoverable gas resources are expected to remain more than adequate to meet the projected production increases. The price increases are expected to be tempered by technological progress in both discovering and producing natural gas.

Long-term end-use prices for natural gas are projected to be lower than the relatively high prices experienced in 2000 and 2001. Average transmission and distribution margins are generally expected to remain constant or decline through 2020, moderating the projected increase in wellhead prices. The average end-use

price is expected to increase by 35 cents per thousand cubic feet from 2005 through 2020, compared with an increase of 61 cents per thousand cubic feet in the average price of domestic and imported supply in the same period. By 2020, the average end-use price is expected to be $4.92 per thousand cubic feet.

Declining margins are particularly important in restraining the rise in both residential and commercial end-use prices (Figure 15). From 2005 through 2020, residential and commercial end-use prices are projected to increase by 12 cents per thousand cubic feet, to $7.16, and 28 cents per thousand cubic feet, to $6.02, respectively.

The industrial and electricity generation sectors have the lowest end-use prices, in part because they receive most of their natural gas directly from interstate pipelines, avoiding local distribution charges. Summer-peaking electricity generators reduce their transmission costs by using lower cost interruptible transportation rates during the summer when spare pipeline capacity is available; however, as electricity generators take an increasing share of the market, they are expected to rely on higher cost firm transportation to a greater extent. Prices of natural gas for the industrial and electricity generation sectors are projected to reach $4.01 and $3.94, respectively, by 2020. The highest end-use prices are expected for compressed natural gas vehicles, because the costs of additional infrastructure requirements are expected to be added to pipeline and distribution rates.

Natural Gas Production and Imports—Growth in domestic natural gas production of 9.4 trillion cubic feet between 2000 and 2020 is expected to come primarily from lower 48 onshore nonassociated (NA) sources (Figure 16). Conventional onshore natural gas production is projected to grow rapidly in the last 10 years of the forecast, increasing its share of total lower 48 production from 37 percent in 2000 to 39 percent in 2020. As a result of technological improvements, production from unconventional sources (tight sands, shale, and coalbed methane) is projected to increase more rapidly. Unconventional natural gas production is projected to increase from 25 percent of total lower 48 production in 2000 to 32 percent in 2020. Production of associated-dissolved (AD) natural gas from lower 48 crude oil reserves declines slightly in the projections, following the expected pattern of crude oil production. AD natural gas is projected to account for 9 percent of lower 48 natural gas production in 2020, compared with 16 percent in 2000.

Offshore production is expected to increase less rapidly, accounting for 24 percent of total lower 48 gas production in 2020. In recent years, innovative cost-saving technologies have been applied, particularly in the deep waters of the Gulf of Mexico, where significant finds are expected to continue.

Alaskan natural gas production is projected to grow by 1.7 percent per year through 2020 to meet expected State demand. Options for marketing the gas outside Alaska include transportation through a pipeline, conversion to liquefied natural gas (LNG), and conversion to synthetic petroleum products.

Imports of natural gas make up the difference between U.S. production and consumption (Figure 17). Imports are generally expected to be priced competitively with domestic sources. Imports from Canada, primarily from western Canada and the Scotian Shelf in the offshore Atlantic, are expected to make up most of the increase in U.S. imports. Because most of the producing regions in Canada are less mature than those in the United States, there is strong potential for low-cost production. Net imports from Canada are projected to provide 15 percent of total U.S. supply in 2020, about the same as in 2000.

LNG imports are expected to increase, but they are not expected to become a major source of U.S. supply through 2020. Two LNG import facilities, at Cove Point, Maryland, and Elba Island, Georgia, have been closed for many years but are expected to reopen by 2002. It is expected that those facilities, plus the other two U.S. facilities, at Everett, Massachusetts, and Lake Charles, Louisiana, will be operating at full capacity by 2010, supplying 0.8 trillion cubic feet per year through 2020.

Although Mexico has a considerable natural gas resource base, trade with Mexico has until recently consisted primarily of exports from the United States. Mexico is projected to remain a net importer of U.S. natural gas through 2020; however, U.S. exports are expected to peak in 2015 and then decline as the infrastructure is developed for Mexican natural gas to meet indigenous demand.

Natural Gas Consumption—Total natural gas consumption is projected to reach 33.8 trillion cubic feet by 2020. Increasing demand by electricity generators (excluding cogenerators) is expected to account for 55 percent of the total consumption growth by 2020 (Figure 18). Demand growth is also expected in the residential, commercial, industrial, and transportation sectors. Most new electricity generation capacity is expected to be fueled by natural gas, and natural gas consumption in the electricity sector is projected to grow rapidly throughout the forecast as electricity consumption increases.

In the reference case, natural gas consumption for electricity generation (excluding cogeneration) is projected to increase from 4.2 trillion cubic feet per year in 2000 to 10.3 trillion cubic feet per year in 2020, an average annual growth rate of 4.5 percent. At the end of the forecast period, electricity generation is expected to surpass the industrial sector as the largest consumer of natural gas. Although coal prices to the electricity generation sector are generally projected to fall throughout the forecast, natural-gas-fired electricity generators are expected to have advantages over coal-fired generators, including lower capital costs, higher fuel efficiency, shorter construction lead times, and lower emissions.

Although more than half the increase in natural gas consumption between 2000 to 2020 is expected in the East, the West—including Canadian imports and most of the Gulf Offshore—is expected to provide approximately 80 percent of the incremental lower 48 natural gas supply in the reference case. As a result, most new natural gas pipelines are expected to be built from the West to the East. The exception is expected new pipeline capacity originating in Canada and the Rocky Mountains, which will be needed to meet growth in natural gas consumption along the Pacific Coast.

CONCLUSION

The collapse of Enron Corporation, while detrimental to the employees and shareholders of the company, has not had a noticeable impact on energy markets, especially those for electricity and natural gas, to date. An examination of wholesale price data for both electricity and natural gas indicates that, during the same period that Enron stock was declining from over $37 to less than $1 a share, spot prices for electricity and natural gas were relatively stable, showing normal fluctuations related to supply and demand. It is not expected that the Enron situation will have any lasting impact on future electricity and natural gas markets, either in the short term, or through 2020. Electricity prices are expected to remain fairly stable over the next couple of years, with a slight decline through about 2010 due to the effects of competition and falling coal prices before rising again through 2020 because of rising natural gas prices. Natural gas prices, which were highly volatile during much of 2000 and 2001, are expected to be lower in 2002 before rising about $0.50 per thousand cubic feet at the wellhead in 2003. In the long term, natural gas prices are expected to increase from current levels, reaching $3.26 per thousand cubic feet (real 2000 dollars) by 2020.

Thank you, Mr. Chairman and members of the Subcommittee. I will be happy to answer any questions you may have.

Figure 1. Daily Spot Electricity Prices for Various Locations

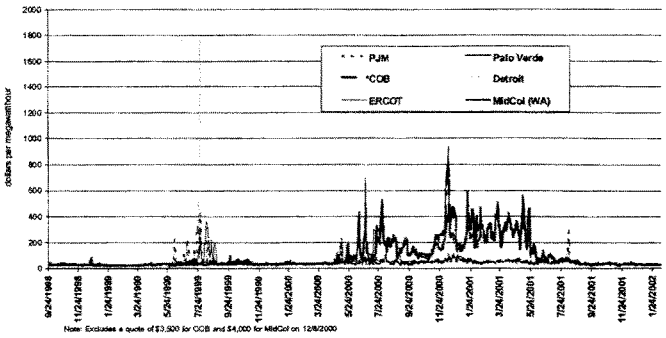


Figure 2. Average Wholesale Electricity Prices and Enron Stock Price, October 1, 2001 through February 8, 2002

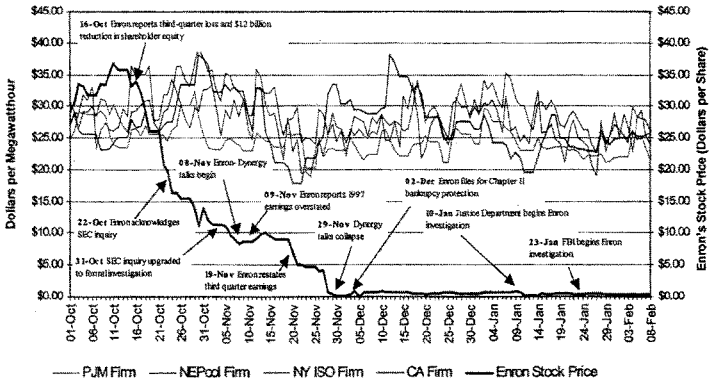
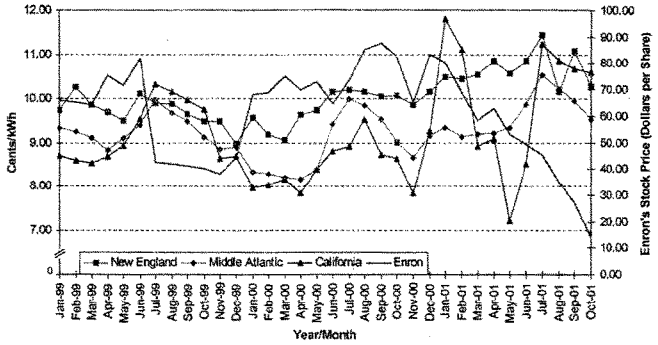


Figure 3. Electric Utility Retail Average Revenue per Kilowatthour for Selected Regions and Enron's Stock Prices, January 1999 - October 2001



Note: The monthly stock price is the closing price for the last trading day of each month.

Figure 4. Natural Gas Spot Prices (Base Case and 95% Confidence Interval)

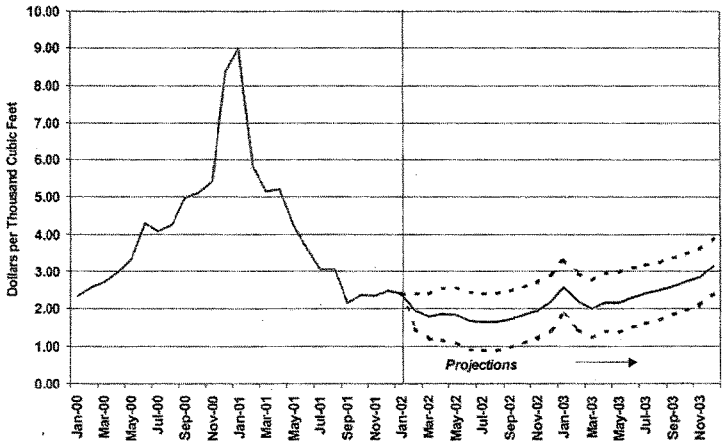


Figure 5. Working Gas in Storage
(Difference from Previous 5-Year Average)

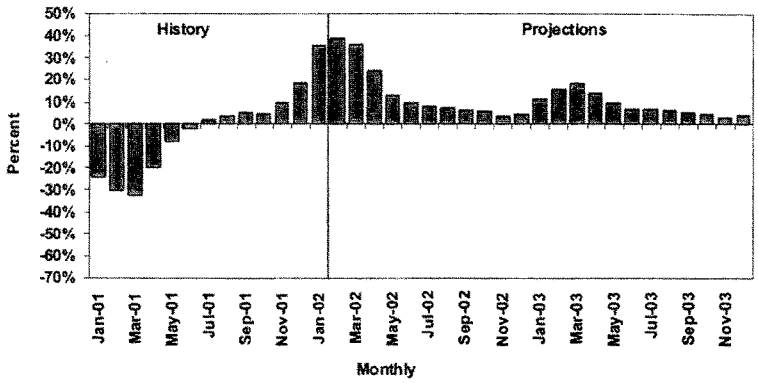


Figure 6. Henry Hub Spot Price, Enron Stock Price, and Important Dates

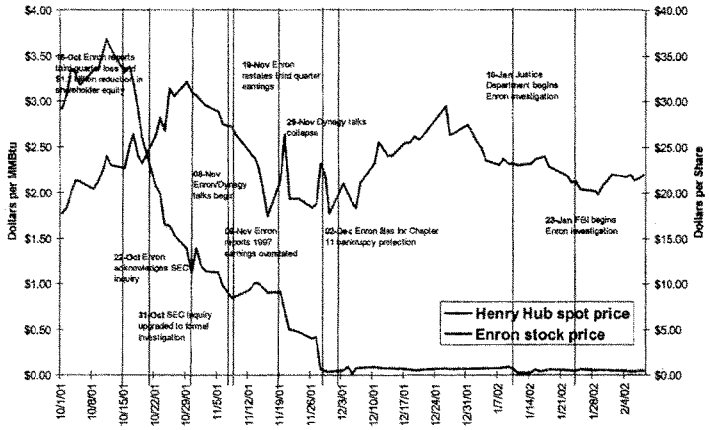


Figure 7. Natural Gas Spot Prices in Recent Years

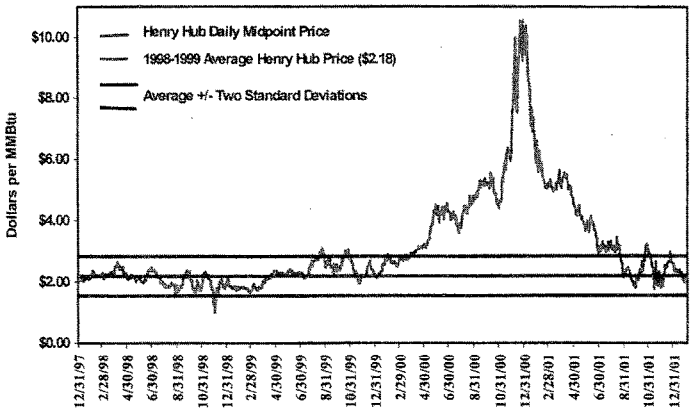


Figure 8. Average U.S. Retail Electricity Prices, 1970-2020
(2000 cents per kilowatthour)

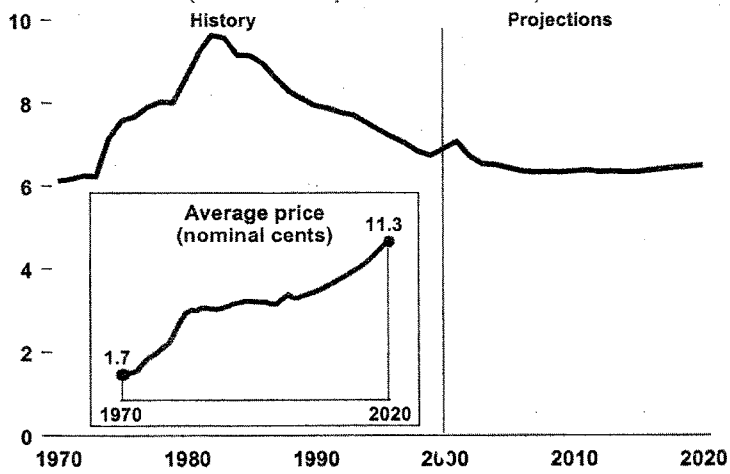


Figure 9. Fuel Prices to Electricity Generators, 1990-2020
(2000 dollars per million Btu)

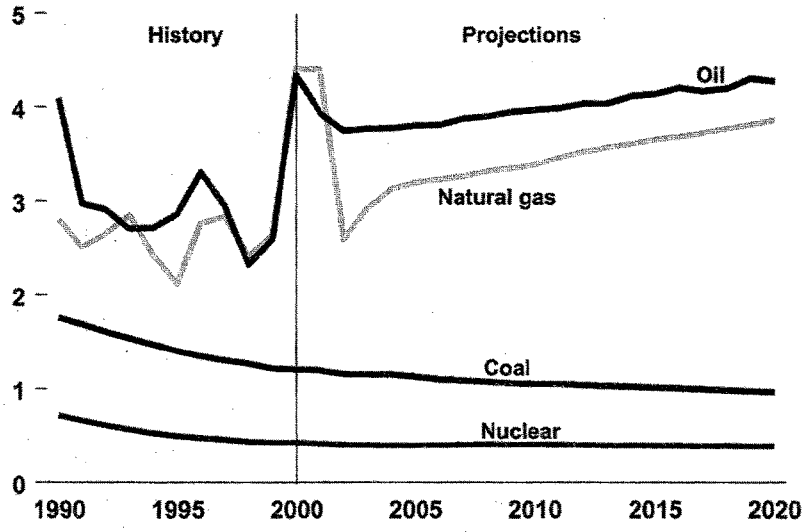


Figure 10. Population, Gross Domestic Product, and
Electricity Sales, 1965-2020
(5-year moving average annual percent growth)

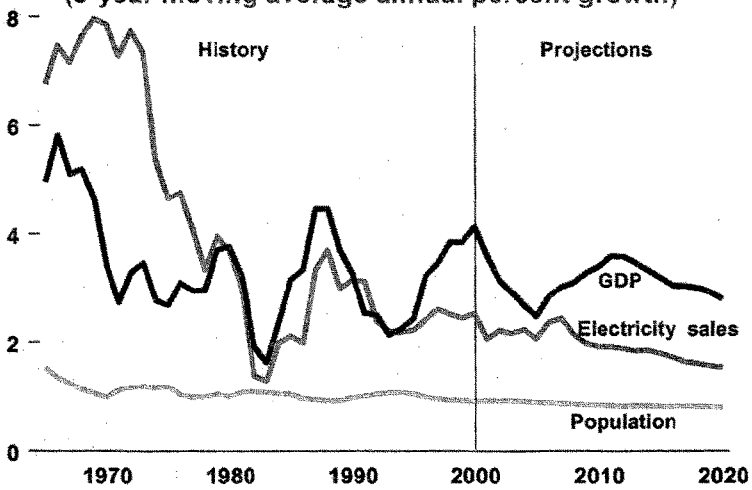


Figure 11. Annual Electricity Sales by Sector, 1970-2020 (billion kilowatthours)

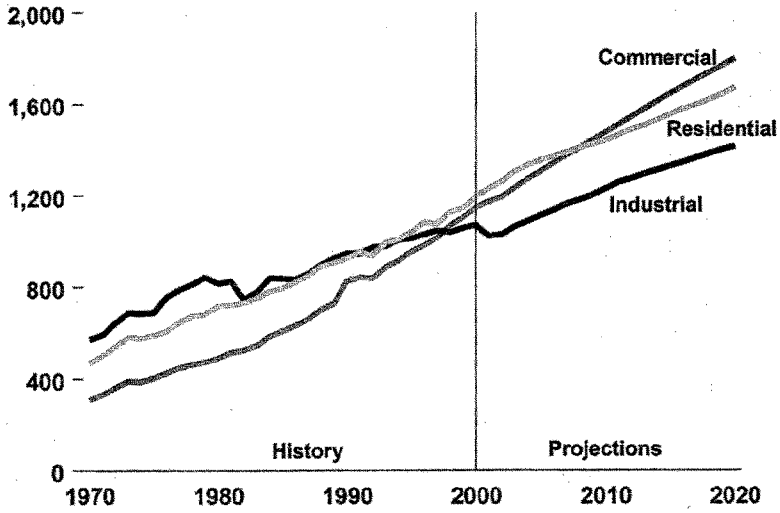


Figure 12. Projected New Generating Capacity and Retirements, 2000-2020 (gigawatts)

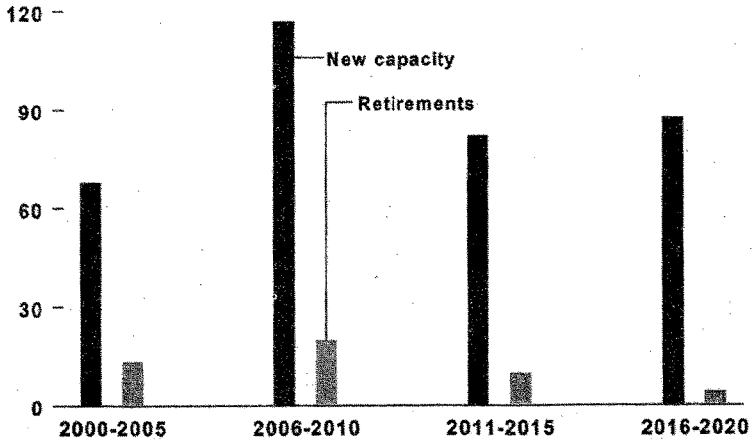


Figure 13. Projected Electricity Generation by Fuel, 2000 and 2020 (billion kilowatthours)

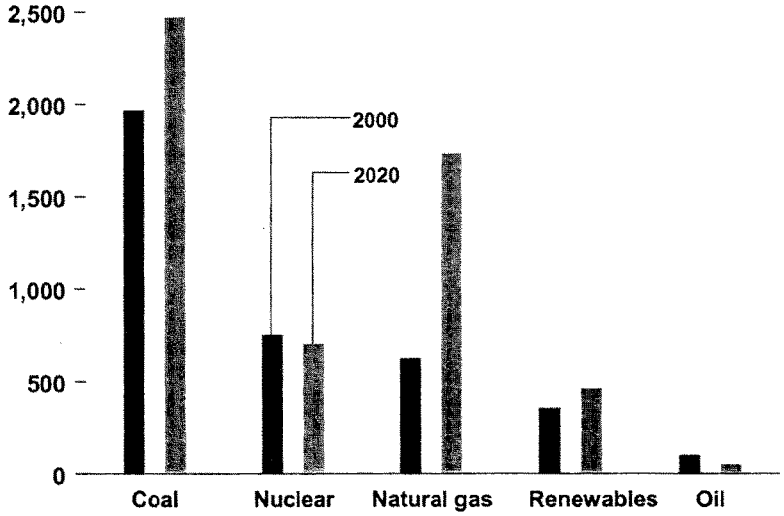


Figure 14. Lower 48 Natural Gas Wellhead Prices, 1970-2020 (2000 dollars per thousand cubic feet)

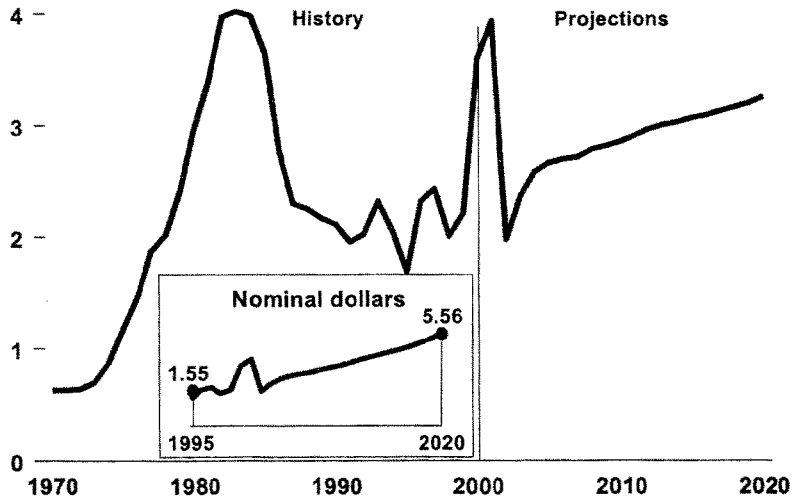


Figure 15. Natural Gas End-use Prices by Sector, 1970-2020
(2000 dollars per thousand cubic feet)

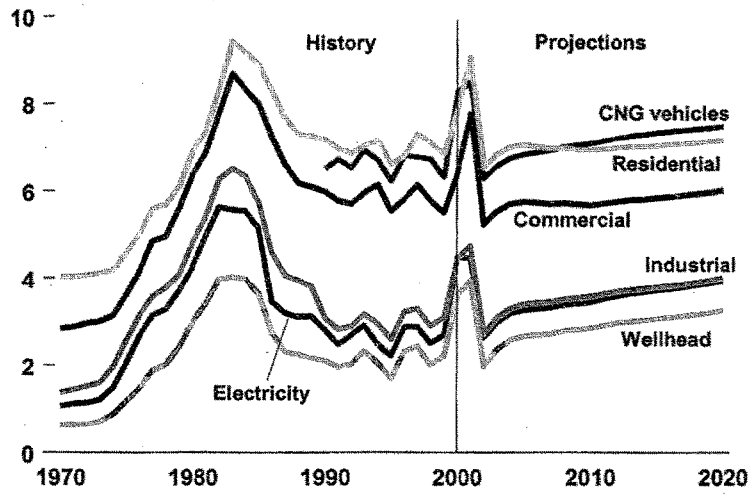


Figure 16. Natural Gas Production by Source, 1990-2020
(trillion cubic feet)

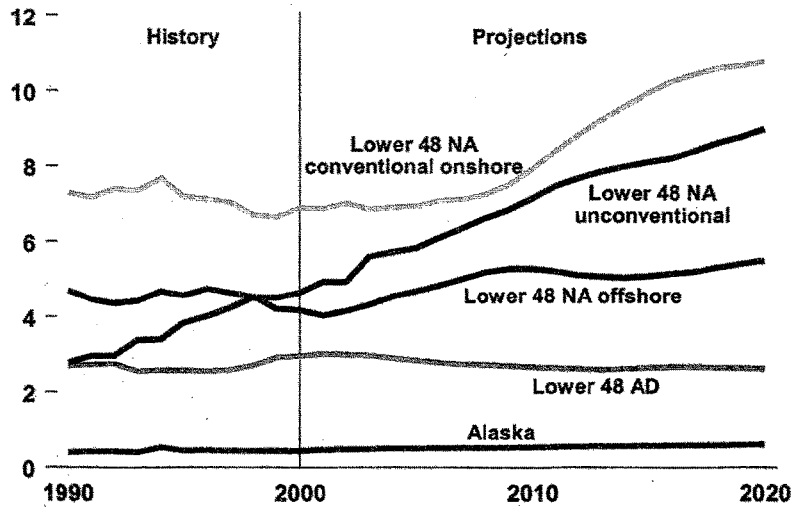


Figure 17. Net U.S. Imports of Natural Gas, 1970-2020
(trillion cubic feet)

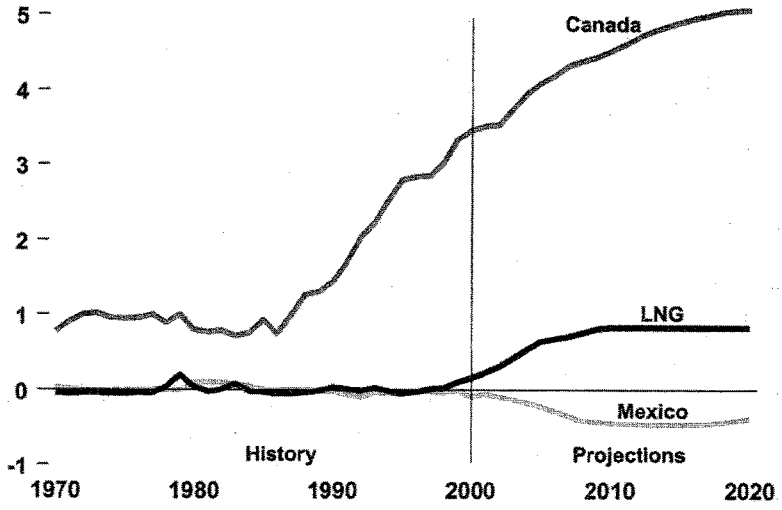
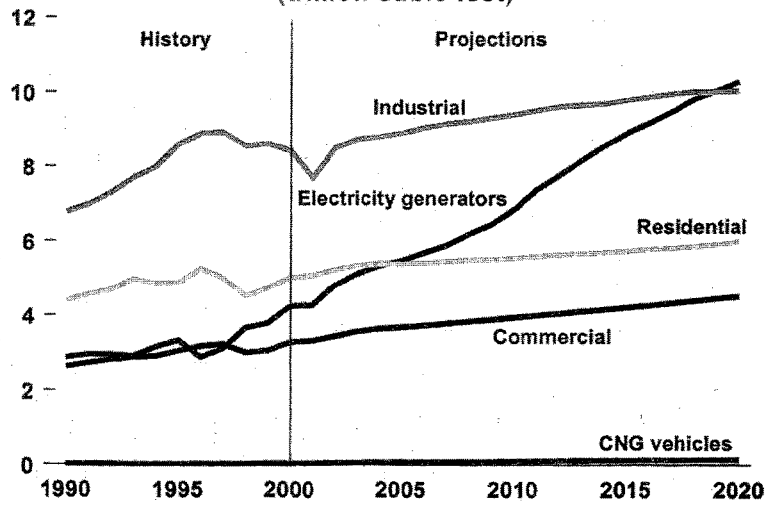


Figure 18. Natural Gas Consumption by Sector, 1990-2020
(trillion cubic feet)



Mr. BARTON. Thank you. And you are the first one to be under time, which we appreciate.

I might say before we go to Mr. Welch that some of this very dry recitation of facts and figures does tend to be a little drowsing inducing to the chairman, but it is very important.

I mean, it is important to put that into the record that those are the facts, and that is not rhetoric, but that is what is really happening in the energy market, and I appreciate you being here to put that into the record.

We now would like to hear from the Chairman of the Public Utility Commission of the great State of Maine, which is a State that I have not had the honor to visit, but it is a State that I hear great things about.

And I have got several friends from Maine who just brag, brag, brag, about what a great place it is. I hope, some day, to get up there. Your statement is in the record, and we welcome you to elaborate on it for such time that you may consume.

STATEMENT OF HON. THOMAS L. WELCH

Mr. WELCH. Thank you very much, Mr. Chairman, and members of the subcommittee. If you do plan to visit, August is a better time than February.

Mr. BARTON. In most States, by the way.

Mr. WELCH. I speak here today only for the Maine Commission, but I think since our market is as open to competition as any market in the country, our experience may nevertheless provide a useful view.

And I also want to say right away that it is a pleasure to be able to confirm, from our State's perspective, many of the observations of my friend and colleague, Pat Wood. Frankly, many of us in the States think he is exactly the right person to be in the job at the moment.

No State has a greater interest in the success of competitive electricity markets than Maine. In the 2 years since we opened our retail markets to competition, Maine's consumers have been directly and often immediately affected by changes in the wholesale prices in New England.

This dependence has its roots in two critical principles of Maine's law. First, Maine cut the regulatory link between electricity supply and delivery by requiring our utilities to divest themselves completely of generation.

We did so because we believe that competition in the electricity markets is likely to be fairest and most robust when the transmission and distribution utility has no reason to favor any one competitor over any other.

Second, Maine decided to forego artificial price controlling devices, such as price caps or low term fixed supply contracts, that insulate consumers from the prices revealed in the wholesale markets.

Even Maine's standard offer, the product for people who do not contract directly with energy suppliers, is priced by competitive bid rather than regulatory or legislative directive.

The effect of Maine's approach to restructuring has been dramatic. Forty-four percent of the total electric load in Maine is

served through bilateral contracts between retail customers and suppliers.

Incidentally, Enron, by our best estimates, served about one-quarter of Maine's total load, serving both part of the standard offer, and many retail customers as well. Maine's aggressive adoption of the competitive model, however, has vastly increased the vulnerability of Maine's consumers to distortions in the wholesale market.

Accordingly, we have worked hard to ensure that the wholesale market reflects the economics of supply and demand, and does not provide either inadequate incentives for efficient investment, or opportunities for gaming and the exercises of market power.

Thus, it is with considerable personal and professional relief that I can report that both Maine and New England have apparently avoided significant injury from Enron's recent collapse.

The greatest dangers we saw, as the collapse became evident, were threats to the reliability of supply, and to the prices paid by Enron's customers. Neither of these threats materialized to any substantial degree.

Supply continued without discernible disruption, and because of very careful management, particularly by the New England independent system operator, and participants in the New England power pool, we saw little instability in the trading market.

Enron's collapse did not cause a reliability problem because Enron does not own generation in New England. The generation owners' interest remains unchanged, to run their generators and sell the output. Customers continue to buy that output.

Loads did not change, and the generating plants did not go anywhere. Moreover, there was enough trading capacity available to ensure that purchasing and selling could proceed on a scale sufficient to absorb the volume abandoned by Enron.

Indeed, the stressed and ultimately bankrupt Enron continued, and continues to this day to meet its contractual supply obligations. These contracts remain valuable assets of the bankrupt entity because most, if not all, of these contracts are profitable for Enron in today's electricity market.

Virtually all of the contracts were signed at the time of higher electricity prices in the region, and required customers to pay a higher price than the current market price.

I'm sorry to report, however, that the ability of Maine and New England to escape largely unscathed has little to do with our own foresight or cleverness. We escaped for the simple reason that when Enron fell, energy supplies were high and energy prices low.

Had Enron collapsed in a period of rising energy prices, customers would have been exposed to enormous market risks. For example, had Enron's implosion occurred in a higher priced market, like the one we had just a year ago, and Enron had defaulted on its obligations, Maine's customers would have had to pay at least a $100 million more to secure the same supply.

The losses for all of New England could have been 10 times that amount. Our fundamental concern is that the risks in the energy market are asymmetrical. If a customer signs a contract with an energy supplier and market prices fall, the customer is stuck with paying the now higher than market price for its energy.

This remains true even if the supplier goes bankrupt. The contract is a valuable asset of the bankrupt company, and one that the bankruptcy court will likely seek to enforce. On the other hand, if a customer has a contract with an energy supplier and market prices rise, and the supplier, for whatever reason, defaults on the contract, the customer must buy new supply in the high priced energy market, and take their place in line with all of the other creditors, with frankly little hope that the protections that the customer negotiated in the supply contract will provide sufficient relief.

Maine tries to minimize such risks that the States standard offers electricity customers, by requiring licensed suppliers to provide evidence of their financial soundness, either by posting a substantial bond or providing us a corporate guarantee that the supplier will meet its obligations.

The Enron experience suggests, however, that Maine's own efforts along these lines are likely to be insufficient. A corporate guarantee from Enron, frankly which we would have accepted last year, would obviously not have saved our consumers.

Surety bonds, as we have discovered in our own experience in another matter, are difficult to enforce, and in many cases likely to become significantly more expensive due in no small part to the Enron related losses themselves.

I remain convinced that a well-structured and genuinely competitive electricity market, can bring substantial benefits to consumers and investors alike. That market will be destroyed in its infancy, however, unless market rules require all players to compete fairly based on the underlying economics of what they bring to the market.

Just as important is public confidence in the solvency and integrity of the players. Absent the latter, customers will be justifiably reluctant to enter the market. Competition and larger regional electricity markets are increasingly recognized as superior to traditional regulation as a way of creating incentives for investment, disciplining prices, and ensuring a robust and secure infrastructure.

But the political and regulatory consensus needed to achieve those broad competitive markets may whither away if consumers are perceived to be vulnerable to unethical or irresponsible behavior by market participants.

Energy providers, consumers, and investors, very much need national reforms that will restore confidence in markets, and by themselves, States cannot protect against incompetence or purposeful cheating by a major national player.

Apart from the costs and limited effectiveness of requiring corporate guarantees or surety bonds, unscrupulous players can avoid State design and State-enforced consumer protections by doing business only in States with fewer or less effective protections.

The reforms enacted to restore such confidence must thus be national in scope. I do not have specific legislative proposals to recommend this afternoon. I urge, however, that you give favorable consideration to national standards, whether done through new accounting and reporting rules, or greater FERC oversight authority over market participants.

And thus will minimize the possibility of consumers in Maine and elsewhere will be exposed to the financial consequences of events like the sudden collapse of a major market player that customers had no reason to expect based on the information available to them.

Customers in electricity markets should of course be subject to the normal competitive risks of price fluctuations due to changes in supply and demand. They should not also be subjected to risks created by deceptive financial reporting or inadequate regulatory tools. Thank you for your time.

[The prepared statement of Hon. Thomas L. Welch follows:]

PREPARED STATEMENT OF HON. THOMAS L. WELCH, CHAIRMAN, MAINE PUBLIC UTILITIES COMMISSION

Good morning, Mr. Chairman, members of the Subcommittee.

Thank you for this opportunity to report to the Subcommittee on the effects of the Enron Corporation's recent decline on the electricity market in Maine and New England. I am Thomas L. Welch, Chairman of the Maine Public Utilities Commission (MPUC).

To aid the Subcommittee's work on restructuring the electricity industry, I have brought copies of the Maine Commission's very recent Report on Restructuring in our state. This document can also be found on the MPUC website at: www.state.me.us/mpuc/2002legislation/2002legreports.htm.

No state has a greater interest in the success of the wholesale electricity markets than Maine. In the two years since we opened our retail markets to competition, Maine's consumers have been directly and often immediately affected by changes in the wholesale prices in New England. As much as any jurisdiction, Maine cut the regulatory tie between electricity supply and delivery by requiring its utilities to completely divest themselves of generation. We did so because we believe that competition in electricity markets is likely to be fairest and most robust when the transmission and distribution utility, the T&D utility, has no reason to favor any one competitor over any other. Apparently energy companies agree; currently 14 of them have competed and won customers in Maine, including Enron, which—by our best estimates—serves fully one quarter (an estimated 450 megawatts) of Maine's load—or at least it did so prior to its recent troubles.

Maine's interest in the success of the wholesale electricity markets is further rooted in our decision to forego artificial price-controlling devices such as price caps or long term fixed supply contracts that insulate consumers from the prices revealed in the wholesale markets; even Maine's Standard Offer (default or provider of last resort) supply is provided at prices that are set by competitive bid. The effect of Maine's approach to restructuring has been dramatic:

- the incumbent investor-owned utilities no-longer supply generation service;
- virtually all of Maine's generation is supplied by competitive suppliers, and
- 44 percent of the total electric load in Maine has departed the standard offer (the provider of last resort) and is served by retail suppliers.

Maine's aggressive adoption of the competitive model, however, comes at a price. The prices paid by Maine's consumers are—perhaps as much as any in the country—sensitive to the vagaries of the wholesale market. Accordingly, we have worked hard to ensure that the wholesale market reflects the economics of supply and demand, and does not provide either inadequate incentives for efficient investment or opportunities for gaming and the exercise of market power. We have tried to avoid or minimize the impact of any events which will impair competition or unfairly injure consumers—residential or business.

And, thus far, I am relieved to report, both Maine and New England have apparently avoided significant injury from Enron's recent financial collapse. Most feared were threats to the reliability of supply and to the prices paid by Enron's customers. Supply continued without discernible disruption. And, because of very careful management, particularly by the ISO-New England and participants in the New England Power Pool (NEPOOL), there was little instability in the markets and apparently no major financial losses.

Enron's collapse did not cause a reliability problem because Enron does not own the generators. The generation owners' interest remained unchanged: run their gen-

erators and sell the output. Customers continued to want that output. Loads did not change. Generators did not go anywhere. So reliability was unaffected.

And in this environment the stressed and ultimately bankrupt Enron continued—and continues—to meet its contractual supply obligations, most—if not all—of which were profitable in today's energy market. Those contracts required customers to pay a higher price than the current market price.

Nevertheless, companies who owned the generators, fearing that Enron might not pay for its power purchases, opted out of contracts when possible and instead sold into the spot market.

NEPOOL's old financial assurance policies allowed the organization to rescind membership in the Pool, but did not allow NEPOOL to cut off a company from trading in the energy markets in response to a situation like that posed by Enron. NEPOOL and ISO-New England's new policy will automatically restrict a company's trading in the pool if its credit rating falls below a certain level.

The sudden Enron disintegration impaired its ability to arrange bilateral contracts with generators. In response, Enron bought more and more from the Pool each day. When Enron declared bankruptcy, it was carrying a large, negative financial balance with the Pool (pre-bankruptcy-petition debt). There are two possible remedies for this pre-petition debt. The bonds that Enron was required to post to establish credit with the pool may cover the debt; and if not, NEPOOL has filed a claim in the bankruptcy proceeding.

Enron fought to avoid giving up its trading activities. In lieu of the 30-day settlement process accorded healthy energy trading companies, Enron negotiated a new 3-day-rolling-average payment arrangement with the Pool (administered by the ISO). Enron now maintains a 3-day cash balancing account with the ISO. At the end of each day, the ISO withdraws enough money to cover the transactions that occurred three days previously. Enron has agreed to wire-transfer to the ISO—by the end of the next day—enough money to replenish the account. In December this arrangement and term sheet were submitted to the FERC for emergency approval. The FERC promptly approved it.

There was further concern in the New England market that, because parties with bilateral contracts to supply Enron could terminate those contracts because of the bankruptcy but Enron could keep buying what it needed in the spot market, Enron's resort to the spot market could produce over-reliance on it (similar to what happened in California), sharply increasing spot-market prices. While that did not happen in this instance, it remains at least a theoretical possibility in the event of the financial collapse of another big player.

Outcomes like the one Maine and New England just experienced frequently leads to the oft-used phrase "we dodged the bullet." True, the bullet did not hit us. But it was not because we were smart enough or nimble enough to escape its blow. We were simply and profoundly lucky.

We are, and have been for many months, in a falling energy-price market, one in which suppliers with a fixed price can profit from declining prices. Had the same set of events occurred against a backdrop of rising energy prices, suppliers would have had an extraordinary incentive to escape their obligations. (Maine has had direct experience with such circumstances.)

Had Enron's implosion occurred in a rising market, Maine's ratepayers could have taken a "hit" in excess of $50 million, perhaps $100 million. And, remember, Maine is a state of fewer than 1.3 million people. If Enron has captured as much of the market across New England as it has in Maine and if we were in a rising-energy-price market, the comparable "hit" for ratepayers across New England could have approached $1 billion.

For ratepayers, there is a certain "heads you win, tails I lose" aspect to the energy market. If a customer signs a contract with an energy supplier and market prices fall, the customer is stuck with paying the now higher-than-market price for its energy. This remains true even if the supplier—as has Enron—goes bankrupt; the contract is a valuable asset of the bankrupt, one which the Bankruptcy Court will seek to use on behalf of other creditors.

But if a customer has a contract with an energy supplier, market prices rise, and the supplier (for whatever reason) goes bankrupt and defaults on the contract, the customer must buy new supply in the high-priced energy market and take its place in line with all the other creditors with little hope that the protections the customer negotiated in its supply contract will provide sufficient relief.

Maine tries to minimize such risk to the state's Standard Offer electricity customers by requiring licensed suppliers to provide evidence of their financial soundness, either by posting a substantial bond or (in the case of companies whose guaranteeing parent has a minimum credit rating of BBB+ or equivalent) by providing us a corporate guarantee that the supplier will meet its obligations.

But even if we had required and Enron had provided a bond to protect Maine's Standard Offer customers, we would have had little meaningful protection—at least sooner than the conclusion of very protracted litigation. Reportedly Enron had purchased surety bonds to guarantee billions of dollars of natural gas and crude oil to two offshore companies. Enron declared bankruptcy in November, ostensibly leaving its guarantors with the bill.

Enron's failure (perhaps amplified by large claims associated with Kmart's failure) supposedly represents one of the largest payouts ever for the surety industry, about $2 billion, according to experts. Reportedly, it is comparable to the effect of the September 11th terrorist attacks on the property and casualty insurance industry, and the magnitude of these losses may force some bonding companies out of the surety-bond business.

As a result, bond companies likely will raise prices, require collateral, tighten underwriting standards, and cancel some policies. Thus, it could be more difficult for some companies to obtain bonds, thereby reducing the number of competitive providers and making competition less vigorous. Energy market prices may reflect these additional cost burdens.

In conclusion, well-structured, well functioning energy markets can bring substantial benefits to consumers and opportunity to ethical, well run businesses, and strengthen the U. S. economy. Benefits will be realized regardless of whether a state or states open their markets to retail competition.

The keys to a well structured, well functioning market are rules that allow all players to compete fairly, based on the underlying economics of what they bring to the competition, and on the integrity of the players. Absent the latter, competitive energy providers will not enjoy the confidence of investors (hence their financial support) or other players in the market (making it harder for them to bring valuable products to the market).

Energy providers, consumers, and investors very much need reforms that will restore confidence in markets. By themselves, states cannot protect against a incompetence or purposeful cheating by a major national company. Apart from the costs and limited effectiveness of the protections mentioned earlier (e.g., surety bonds, corporate guarantee), unscrupulous players can avoid state-designed and -enforced protections by doing business only in states with the least restrictive protections. The specific reforms of this nature must be national in scope and carefully designed to balance the price of that protection—both financial and regulatory—against the value of the additional assurances received.

Mr. BARTON. Thank you for that excellent testimony.

The Chair would now recognize himself for the first series of questions, and will set the clock at 5 minutes.

There has been quite a bit of discussion about need, either need for more transparency, or additional transparency in some of these markets. It is my understanding that the Enron trading system, Enron on-line, was not a market created like the New York Stock Exchange, where the New York Stock Exchange creates a trading entity, a trading area, and then independent brokers actually create markets in the specific stocks and bonds that are traded on the New York Stock Exchange.

It is my understanding that Enron was actually a participant in each trade; that they could either purchase the commodity, or sell the commodity, but they were actually on one side of each trade.

So my first question, and I am going to ask it to Mr. Wood, and then to Mr. Newsome, but if Mr. Hunt wants to answer, he is certainly welcome to. The Enron on-line trading system, is it something that we should have separate regulations for at the Federal level?

Mr. WOOD. Actually, in September, before Enron ever came up, this issue was raised at the Commission, and we put out in the context of a broader rulemaking that we have now pending, whether the codes of conduct that applied to corporate affiliates, such as between Enron Pipeline and Enron, the gas trading company, whether that same type of reporting requirement and those prohi-

bitions that we have, should apply also to Enron on-line, which is in effect an extension, a marketing extension so to speak, of Enron's competitive sales activities.

But, yes, it is an issue that we are looking at. We gave asked for comment on, and I expect that the comments may look a little different in light of Enron's departure, but I think it is within current statutory authority to go ahead and do that if it is needed to be done.

Certainly any guidance from Congress would be welcomed, but we are looking at that also in our investigation as to the role of Enron on-line, and look deeper into just what it could have done or not have done.

Mr. BARTON. Mr. Newsome.

Mr. NEWSOME. Thank you, Mr. Chairman. As I said in my testimony, I think it is extremely important to define the problem before we look toward the solution. And at this point, at least in our opinion, as tragic as the Enron situation has been, we have yet to find any problems with the Enron on-line trading system, at least as it relates to our markets.

So it appears that there was no apparent breakdown in the trading system itself. I think when we look at their Enron on-line as a trading system, we would look at it in terms of the bilateral trading exemption that I discussed earlier.

And when we look at those bilateral systems, and I think as Congress looked at it, and made the determination to exempt from the Commodity Exchange Act, at least from the CFTC, I think it looked at a system in which you had two very large sophisticated players doing business with each other, and in which the price was negotiated at that level between those two sophisticated parties.

And recognized that that bidding was not openly competitive, and it was only between those two parties, and I think the reason that Congress did not require transparency at that point is that because you were dealing between two large sophisticated parties, who may be dealing in a very large amount of a product, that it could actually distort a competitive market price if that was in fact transparent.

Mr. BARTON. Mr. Hunt.

Mr. HUNT. I don't have anything to add, Mr. Chairman. The stockmarket is different from the energy market, and as you characterized, the trades on the exchange are between individual members of that exchange typically and the exchange itself is not a party to those trades. It is just a trading area.

Mr. BARTON. Well, would it be good for the public to know that in the Enron trading system, where Enron itself is making the market in several—it is buying on one side, and selling on another side—it is buying from one person and selling it to another person.

And if you are going to make that market, should you at the end of the day or the end of the week, the end of the month, do a net balance sheet analysis to the FERC or the CFTC, so that we know whether you are long or short in aggregate in your aggregate trading positions? Is that something that we should look at or not look at?

Mr. NORLANDER. I think Congress made the determination at the time of the CFMA that there was something that did not need to be looked at. We are continuing——

Mr. BARTON. Well, Congress changes its mind on occasion.

Mr. NEWSOME. Well, that is an area that we are continuing to look at, Mr. Chairman. We are cooperating with other agencies as well in looking at the transparency issues, and I think that as we come up with a determination, surely we will share that information and our thoughts with this subcommittee.

Mr. BARTON. My last question is did Enron actually default on any of its energy contractual obligations that it entered into under its trades with Enron on-line?

Mr. WOOD. We can check into that. I know that it has defaulted on some trades, but I am not sure if those are the ones that were entered into on Enron on-line or not.

[The following was received for the record:]

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, DC 20426

OFFICE OF MARKETS, TARIFFS AND RATES

February 15, 2002

BY FACSIMILE

Sam Behrends, IV, Esq.
Catherine P. McCarthy, Esq.
LeBoeuf Lamb Greene & MacRae, LLP
1875 Connecticut Ave., NW
Suite 1200
Washington, DC 20009-5728

Dear Mr. Behrends and Ms. McCarthy:

On February 13, 2002, the Commission issued an order stating that it intended to gather information on whether any entity, including any Enron Corporation (through any of its affiliates or subsidiaries) manipulated short-term prices for electric energy or natural gas in the West or otherwise exercised undue influence over wholesale electric prices in the West since January 1, 2000, resulting in potentially unjust and unreasonable rates in long-term power sales contracts subsequently entered into by sellers in the West.

Pursuant to that order, I hereby request that you make available copies of, and provide information regarding (specified below), all contracts for (1) wholesale electric energy and/or capacity and/or ancillary sales and purchases, and (2) retail sales of electricity, to which any Enron affiliate or subsidiary ("Enron company") is a party and:

- on which any Enron company has defaulted or has sent or received a notice of default (either as supplier or purchaser); and/or
- which has been canceled, wound down, cashed out, or otherwise terminated early, either pursuant to a specific provision of the contract (such as a credit provision) or otherwise, by the Enron company and/or a counterparty to the contract.

Your response is to include contracts from January 1, 2000 to the present. The scope of this data request is *not* limited to contracts for power sales or purchases within the State of California, but includes contracts for power sales and purchases throughout the United States, and it encompasses contracts for retail sales of electricity *and* contracts for wholesale sales and/or purchases of energy, capacity, and/or ancillary services by *any* Enron affiliate or subsidiary. Copies of all service agreements, amendments, and supplements must be included with the contracts.

In addition to making available copies of the contacts, you are to provide, in tabular form, the following information with respect to each individual contract that is responsive to this request, which table clearly identifies (through the use of a unique letter or number for each contract) the specific contract being described:

- the full legal name(s) of the Enron company or companies that is (are) party(ies) to the contract;
- the names and addresses of the counterparty(ies) to the contract, including at least one contact person for each counterparty and a telephone number for each contact person;
- the term of the contract, the execution date of the contract, the dates of delivery, and the points of delivery;
- the product(s) being sold and/or purchased under the contract, including information with respect to the firmness and availability of the product(s);
- whether each Enron company that is a party to the contract is a supplier or purchaser under the contract, with respect to each individual product being sold or purchased under the contract;
- the amounts of electricity or energy and/or capacity and/or ancillary services being sold or purchased under the contract;
- prices for all products sold or purchased under the contract;
- the article numbers or section numbers of contractual provisions that address default, breach (including anticipatory breach), early termination, cancellation, cashing out, credit or creditworthiness, or any other similar provisions; and
- a narrative description of the event, whether default, cancellation, winding down, cashing, or early termination, that makes the contract responsive to this data request. This description must include the date when such event occurred and whether it was pursuant to a specific contractual provision (which must be referenced) or otherwise. Please make available copies of any correspondence sent by the parties to the contract with respect to such event. Please provide the amount of any form of consideration (including liquidated damages, punitive or compensatory damages, or cash-out amount) paid with respect to such event.

In order to facilitate the formation of any follow-up data requests, please provide the name(s) and telephone numbers of Enron technical personnel who are familiar with the terms of the contracts that are provided with your response.

You are to provide your response to me by no later than March 1, 2002. Thank you.

Very truly yours,

Donald J. Gelinas
Associate Director
Office of Markets, Tariffs and Rates

cc: The Hon. Joe Barton
2264 Rayburn House Office Building
Washington, DC 20515

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March 1, 2002

Donald J. Gelinas
Associate Director
Office of Markets, Tariffs and Rates
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20428

Dear Mr. Gelinas:

On February 15, 2002, we received a letter from you requesting copies of, and information regarding, certain contracts for the sale of electric energy, capacity and ancillary services, including retail agreements, regarding Enron Corp. and its subsidiaries and affiliates. Enclosed with this letter are contracts in hard copy, other contracts on a compact disc ("CD") in PDF format, and lists of other contracts which fall within the scope of the February 15th request. These documents are described in detail below.

The February 15th data request was limited to contracts which were terminated early since January 1, 2000. In addition, the Commission requested that each contract be analyzed and recorded in tabular form. Unfortunately, fully responding to the request may involve the production of more than 100,000 such contracts and, if the request is

read broadly, perhaps as many as a quarter million such agreements. Enron has been unable to produce all such agreements, or to analyze those agreements, in the fourteen days since the request was issued.

Nonetheless, Enron is fully committed to providing the information which the Commission seeks, in the form which the Commission determines is most useful to its investigation. Rather than seek an extension of time, we are providing the Commission today with a portion of those documents, and with a comprehensive (but not complete) list of others which will be provided in the future. Due to the apparent focus of the Commission's investigation, we have concentrated first on those agreements which were terminated recently as a result of Enron's financial condition, and we have concentrated first on agreements affecting the western United States.

We realize that this response constitutes only partial compliance. The Commission is aware of the numerous investigations pertaining to Enron, and of the limited resources (both human and financial) which are available to Enron to comply with these investigations. Enron is aware of the Commission's need for information to be provided in a timely manner, and is continuing to work diligently to meet that need. Our goal is to produce documents on a continuing basis until the Commission possesses all relevant information. To help ensure the efficient use of scarce resources, we respectfully request a meeting with the Commission staff at your earliest convenience, so that the responses to this request (and to future requests) can be structured and timed so as to meet the Commissions most urgent needs.

The documents submitted today are described below.

Portland General Electric Company

Portland General Electric Company has no transactions that are responsive to the February 15 Letter. However, Attachment 1 are materials describing a Demand Buy Back Program. There are certain contracts under the Buy Back program that have been amended in a manner that the Commission could deem to be early termination. If you would like further details of which customers participated in that Program, we will supply them.

Enron Power Marketing Inc.

The attached CD includes images of 132 EPMI base or master contracts terminated early as a result of Enron's financial condition as well as supplements and amendments to these 132 agreements. Attachment 2 hereto is an index to the documents included on the CD. Attachment 3 hereto identifies the counterparty for each of the EPMI contracts terminated early included on the CD.

This portion of the response does not include the confirmation agreements affected by termination of the EPMI contracts. Our estimate is that approximately a hundred thousand such agreements could be affected by the request. Enron is working diligently to locate each of those documents and respond further to the request, focusing first on the roughly 20,000 confirmation agreements which were terminated recently as a result of Enron's financial condition.

Enron Energy Services, Inc. and Enron Energy Marketing Corp.

We have also enclosed, in hard copy, approximately 280 retail electricity contracts entered into by Enron Energy Services ("EES") and Enron Energy Marketing Corp. ("EEM"), and terminated prior to the anticipated termination date. Unlike the Master Agreement contained on the CD, these documents contain precise terms for each transaction.

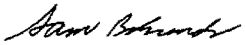
The contracts referred to above involve transactions terminated early in the western United States, as a result of Enron's financial condition. The volume of EES and EEM contracts terminated early in the East is significantly larger than the number of such contracts for the West.

In the East, EES transacted business largely through form contracts. Rather than ask the Commission to review thousands of nearly identical contracts, we have provided a list of the relevant contracts in the East. To the extent that the Commission wants any or all of those contracts, Enron will work diligently to produce them. We have also, of course, included copies of the form contracts. The lists of the submitted EES contracts terminated early in the East are included herewith as Attachments 4 through 16. Attachment 17 hereto includes EES form contracts.

The final attachment is an agreement between EES and International Business Machines Corporation, recently terminated early, and transaction agreements thereunder. It is being submitted separately because it provides for service in the East and in the West.

As stated above, we remain committed to providing the Commission with all information sought in the investigation, and to working with the Commission so that the most important information is produced on the most timely basis. Should you have any questions or comments regarding this response, please feel free to contact us.

Sincerely,



Sam Behrends
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1875 Connecticut Avenue, N.W.
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Commrs..
cc: Pat Wood
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February 14, 2002

VIA E-MAIL & FACSIMILE

Cynthia Marlette
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Re: Proposed Procedure for Handling Certain Enron Power Marketing, Inc. West Desk Power Trading Data and Documents

Counsel and Senator Dunn:

Enron Power Marketing, Inc. ("EPMI"), as the subsidiary directly involved in wholesale electrical power trading in the western United States, has received a number of requests to preserve data and documents, as well as subpoenas to produce documents and data to various committees and agencies. EPMI has also been served with an order requiring it to preserve data and documents related to its participation in the wholesale electricity market in California. In addition, EPMI is involved in a number of proceedings before the Federal Energy Regulatory Commission ("FERC") concerning its investigation into the wholesale electricity market in the western United States. As you are aware, EPMI is being operated in bankruptcy and has limits on its resources. I have been appointed by the bankruptcy court to represent EPMI in connection with the FERC proceedings and investigations ("FERC Matters"). Since many of the same documents and data are relevant for the FERC Matters as well as the other investigations, I have been asked to summarize the steps EPMI is taking to comply with these competing requests so that all agencies and committees are fully aware of these steps and have an opportunity to object or coordinate with other investigations.

A. Overview of EPMI Data Organization

I have been informed by EPMI that it has electronic data relating to its wholesale power trading operations physically existing in two locations: Portland, Oregon and Houston, Texas. I discuss each separately below:

1. Portland, Oregon

EPMI has told me that there are file servers in Portland, Oregon that were used for a time for a portion of its trading business activities. Those servers still exist and have data on them that dates back for some time. My understanding is that the approximate size of these data files is in the range of 170 gigabytes. EPMI is in the process of backing up separately the privileged and non-privileged portions of the most recent snapshot of those data file servers to make those backups available to investigating agencies and committees. EPMI has told me that these copies will be available during the week beginning February 18, 20002. In addition, those servers were backed up daily from some point in the fall of 2000. The backups contain both privileged and non-privileged data. My understanding from EPMI is that the logistics of the process for reviewing backup tapes for privilege are still being investigated.

EPMI also has a database of emails that exists in Portland. Under a previous understanding with the Attorney General of the State of California, EPMI instituted a business practice whereby employees were instructed to keep business related email for at least 24 hours. The email database was backed up daily from some point in the fall of 2000. After 24 hours, employees were permitted under this policy to follow normal business procedures with respect to the business email. My understanding from EPMI is that the logistics of the process for reviewing backup tapes of email for privilege are still being investigated.

EPMI also has a SQL server database that contains certain extracts of trading transactions from the western United States during limited periods. This database is a copy of data that exists on other EPMI databases.

EPMI has proprietary software digital tapes of publicly disclosed recordings of telephone conversations with traders. Some of these tapes are located in Portland, Oregon while other tapes are located in Houston, Texas. These tapes were kept from a period starting in the fall of 2000. EPMI has indicated to me that these tapes can be safely used only on proprietary equipment of the vendor who supplied the system. Any other use may result in the loss of data. EPMI has told me that these data tapes are available for inspection in Portland during the week of February 18, 2002.

EPMI also has a collection of hard drives that were formerly installed in the desktop computers of employees in Portland, Oregon. The computers themselves (without the hard drives) are being transferred to the purchaser of EPMI's trading operations. The data on these hard drives is being backed up to file servers in Portland, Oregon. To date, I am informed that this consists of data in the range of 200 gigabytes. EPMI has told me that it will make copies of this data it has collected so far available during the week beginning February 18, 2002. When this process is completed there will be approximately 100-120 such hard drives.

2. Houston, Texas

My understanding is that there are file servers physically located in Houston, Texas that also contain EPMI business records pertaining to its wholesale power market activities. My understanding is that there are five different EPMI uses of file servers in Houston. Most of these databases are available online and contain data that spans some period of time:

- Risk Management Price Curves
- Settlement Data Base known as "CAPS" (Many Access Databases)

- Scheduling Data
- Enpower Oracle Database of Trading Transactions
- Imaging System (known to be used for contracts)

These file servers have been backed up weekly for a significant period of time. In addition, at the request of the Attorney General of the State of California, a snap shot was taken during the winter of 2000 and has been maintained. These backup tapes will have some attorney client privileged materials on them. My understanding from EPMI is that the logistics of the process for reviewing backup tapes of email for privilege are still being investigated.

EPMI is in the process of identifying the size of the above described databases. EPMI is in the process of making copies of the data files containing risk management curves, the CAPS settlement data, and the scheduling data that exists on the Houston file servers. EPMI believes the most efficient way to make the data available from the Oracle database is to provide investigators with user identification passwords for read-only access for use on premises in Houston, Texas.

B. Overview of EPMI Documents

EPMI has documents located in Portland, Oregon and Houston, Texas. Here is the summary with respect to those locations:

1. Portland, Oregon

In Portland, EPMI has been storing documents that in the ordinary course of business would have been discarded. In addition, EPMI has a number of boxes related to its operations in Portland's offsite data storage. Some of these documents will be protected by the attorney-client privilege. EPMI has been told by the offsite storage facility that there are in excess of 590 boxes in storage. EPMI proposes to make these documents available for inspection and copying at the offsite storage facility (can accommodate 10 people reviewing documents simultaneously). EPMI proposes to make arrangements with each entity reviewing documents to cover the possibility of inadvertent disclosure of documents protected by the attorney-client privilege. EPMI will make these available for inspection and copying in Portland, Oregon during the week of February 18, 2002.

2. Houston, Texas

EPMI is in the process of assembling and reviewing documents that may be located in Houston, Texas. EPMI informs me that it will make arrangements with reviewing agencies and investigators to review those documents as soon as more information is available.

C. **Proprietary and Commercial Information**

It is my understanding that contained within the above described data and documents there remain certain information that has on-going proprietary commercial value to the estate and others. EPMI has indicated that it would like to work with the respective committees and agencies to produce the data and documents in a manner that preserves the value of the bankruptcy estate.

If you have questions or concerns about this procedure, please let me know immediately and I will convey those concerns to EPMI.

Sincerely,

Gary S. Fergus /jf.

Gary S. Fergus

Mr. BARTON. Well, specifically, energy related contracts. Did they actually default or were they able—one of the testifiers was that because of the great work of various other markets, they were able to offset, download, hedge, so that there was really none of that.

So the committee would be very interested if there were examples of actual defaulted obligations. My time has expired, and we would recognize the gentleman from Virginia for 5 minutes.

Mr. BOUCHER. Thank you, Mr. Chairman. Ms. Hutzler, let me inquire of you concerning a number of matters. In the wake of the Enron bankruptcy, there was a marked diminished ability on the part of companies that built merchant energy plants to attract capital. And I wonder, as a first matter, whether your agency has done an inventory of the projects for construction of new power plants that were either delayed, or canceled, in the wake of the Enron Bankruptcy? Do you have any information about that?

Ms. HUTZLER. We actually have not done an inventory on that, but I will note, as I noted in my testimony, that over the past 2 years we have built 74 gigawatts of capacity and brought them online, which in 2001 was probably close to a record at 49 gigawatts of capacity.

In a time when demand is high, and the economy is thriving, obviously there are a lot of announced capacity additions. But the amount of announced capacity additions would probably be far more than the demand that is needed.

In our forecast over the next 20 years, we show at a 1.8 percent growth in electricity demand, the need for about 375 gigawatts of capacity. So that would be about 20 on average a year.

Now, obviously the economy is different each year, and the weather is different in each year, and so the amount that you need does fluctuate by year. But we have certainly seen a record amount coming on recently.

Mr. BOUCHER. Well, let me focus your attention just on the most recent event, which was the Enron bankruptcy. I would like to have your opinion, and if you aren't prepared to give it today, then we would be happy to receive it in written form on a subsequent day, about the effect of the Enron bankruptcy and the subsequent lack of ability on the part of many of the merchant energy companies to attract the capital to build the new plants that they had announced that they were going to build.

And the effect that that is going to have on the energy supply for the Nation as the economy recovers. I have heard many people express a concern that these plant cancellations and delays may result in there being an insufficient amount of electricity available.

Let me just ask you if you share that concern, and if you would like to provide an answer that is more extensive in a supplement, that would be fine as well.

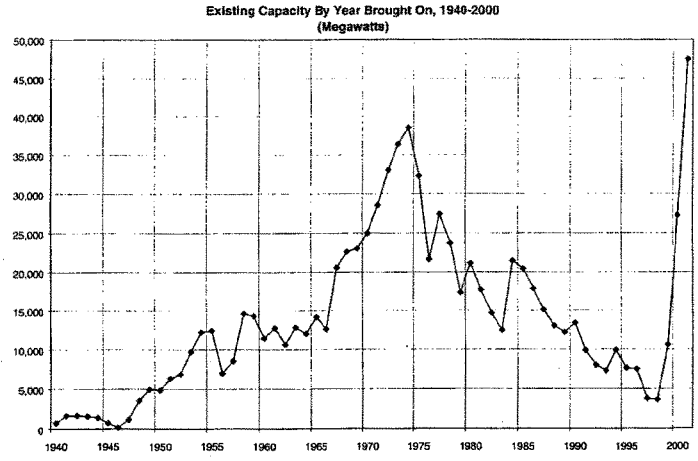
Ms. HUTZLER. Well, I would prefer to provide it for the record. As I did mention though, with the lower economy and the lower demand, you would expect cancellations at some of these plants, but I can't go into any more detail than that now.

[The following was received for the record:]

The amount of capacity under construction and planned needs to be compared to the amount of capacity needed to maintain a reliable supply of electricity. EIA's most recent data show that over 27,000 megawatts of capacity came on line in 2000

and an estimated 48,000 megawatts of capacity came online in 2001.[1] In addition, over the 2002 to 2005 period, electric power generation companies reported to EIA that about 278,700 megawatts are in earlier stages of planning. If all of that capacity were to come on line as planned between 2001 and 2005, it would mean that roughly 326,000 megawatts of capacity would be added which would amount to a 40 percent increase in total U.S. capacity from the 2000 level.

Comparing the amount of capacity added annually in 2000 and 2001 to history shows that it far exceeds the amount added annually over the past 20 years and rivals the expansion that occurred in the mid-1970s when the demand for electricity was growing much more rapidly than it is today (see figure below). Further, if all of the 326,000 megawatts called for were to come on line, it would imply annual capacity additions of 65,200 megawatts over the 2001 to 2005 period—a sustained expansion level that has never been seen in U.S. history even when the demand for electricity was growing much more rapidly, such as between 1965 and 1975 when it grew 6 percent per year. From a historical perspective, the amount of capacity additions announced in recent years far exceeds what would appear to be needed to maintain a reliable supply of electricity. It is not surprising that some companies—including construction and financing companies—are now beginning to reassess their plans and cancel some of their projects. Whether their reassessments were prompted by the problems at Enron or their continuous efforts to monitor market conditions is unknown.



Comparing the reported capacity expansion plans to projections of needed capacity also illustrates that there appears to be more capacity planned than is reasonably needed and cancellations are not surprising. With expected annual growth in the demand for electricity of 2.1 percent, the Reference Case in the Annual Energy Outlook 2002 (AEO) calls for 73,000 megawatts of new capacity to be added over the 2001 to 2005 time period—nearly two thirds of which appears to have been added in 2001 alone. Even with a higher growth rate—2.8 percent per year—the High Demand Case in the AEO 2002 calls for 88 gigawatts of new capacity between 2001 and 2005; still far below the announced capacity expansion plans of power supply companies. Regarding future growth in the demand for electricity or the amount of existing capacity that is going to be retired, the amount of capacity that has been announced to come on line over the next few years would seem to far exceed the amount of capacity that is needed.

Similar results can be seen by looking at industry data. The Table below summarizes information from the North American Electric Reliability Council's (NERC) 2001-2010 Reliability Assessment. As shown, NERC's estimates show peak demand (net internal demand) growing from 68 1,000 megawatts in 2001 to 742,000 megawatts in 2005—a change of approximately 61,000 megawatts. Essentially

[1] EIA is still working to check the status of 5,000 megawatts of capacity that had reported plans to come on at the end of 2001, but for which confirmation has not been received. As a result, the actual amount of capacity added in 2001 could vary between 43,000 megawatts and 48,000 megawatts.

NERC show's a roughly 61,000 megawatt increase in peak demand over the period. Thus, to maintain existing reserve margins about 72,000 megawatts (6 1,000 times 1. 18) would be needed. This is consistent with the AEO 2002 projections that show 73,000 megawatts of new capacity through 2005.

Year	Net Internal Demand (MW)	Planned Capacity Resources (MW)	Reserve Margin (% of Net Internal Demand)
2001	680,941	801,990	17.8
2005	741,623	934,090	26.0
Change	60,682	132,100	8.3

Source: Reliability Assessment 2001-2010, The Reliability of Bulk Electric Systems in North America, October 16, 2001, Table 1, page 14.

NERC's planned capacity resources far exceed what is needed to maintain existing reserve margins. NERC shows planned capacity resources increasing by 132,000 megawatts between 2001 and 2005—nearly double what would be needed to maintain existing reserve margins. The NERC values are much lower than the reported plans to EIA because they only include plans that they believe are reasonably firm. Because the planned resources exceed the amount needed to maintain current reserve margins, the U.S. reserve margin is projected to increase dramatically, from 17.8 percent in 2001 to 26.0 percent in 2005. For some regions the increase in reserve margin is even larger. For example, the reserve margin for the Mid-Atlantic Area Council (MAAC) region would increase from 18.1 percent in 2001 to 52.3 percent in 2005 if all of the capacity NERC is treating as firm were to come on as planned. As a result, if the entire 132,000 megawatts of planned capacity resources reported to NERC were to come on line, many areas of the country are likely to have a significant amount of excess capacity.

In summary, it is EIA's belief that the power plant project cancellations that have occurred recently primarily result from power supply companies' and finance companies, reassessments of market conditions rather than a direct response to the Enron bankruptcy. It is certainly possible that the problems at Enron prompted some of the reassessments. However, unless the number of cancellations expand dramatically, the amount of capacity still scheduled to come,on in the next few years appears more than sufficient. It is certainly possible that some local problems could occur from time to time, but they are not expected to be widespread given the amount of capacity that is still being developed.

Mr. BOUCHER. Well, the cancellations, the economy had been diminishing for the better part of a year, and these announcements of delays and cancellations came very rapidly after the Enron bankruptcy.

So most people, I think, see some correlation. This isn't simply a question of the economy having declined. So, take a look at it if you would, and enlighten us, Mr. Wood. Let me ask you a couple of questions.

What actions, in your opinion, can be taken at your agency, and what actions would be necessary for us to take legislatively, in the effort to restore investor confidence in the condition of the wholesale market, and in the companies that supply electricity into that market?

And feel free to comment, in providing this answer, if you would like, about the progress that you are making, and adopting rules with regard to regional transmission organizations, and also uniform interconnection standards, and other matters?

Mr. WOOD. Thank you, Mr. Boucher. I wrote those down as you mentioned them in your opening statement, and I would add and say that those three with certainty, and I would add two more that the Commission has also done in the past 6 months.

The transparency initiative, which I discussed to get more standardized disclosure, and make it web friendly, and make it more contemporaneous. That is a work in progress.

The RTO initiative which the Commission began with the rulemaking in 1999, at this stage we are implementing that rule. I don't envision that that substantive approach needs to change.

We will be flushing out the details of what RTOs should do, and so there is some certainty about—you know, even though this RTO may be 5 years behind that RTO, ultimately this is where it is all going so there can be some uniformity in the market and a reduction of transaction costs.

And which depending on the market, the suppliers tend to eat those transaction costs. And that is not always so, but that certainly is a thing that we can do to add certainty. Uniform generation and interconnection, and make it easy to build a power plant.

And to basically take the haggling with the local utility out of the picture, and it is hard enough to get the financing lined up, and the water rights, and the pollution issues dealt with by the local regulators.

And then to have to run the gauntlet past the utility for 6 or 10 months to negotiate a contract is to me time not well spent. We have also set up an Office of Market Oversight Investigation at the Commission.

And I think having an active referee in the market, and not a coach, and not a re-regulator, but a referee watching the market to make sure that some of the things that we worry about, or have talked about at this hearing so far, don't kind of replicate themselves through energy markets, is important.

And the last thing that I would add would be an integration of standards of conduct that we have with gas and utility companies, and electric utilities, there are standards out there that are separate. And putting those under one umbrella seems to make a lot of sense, and something that would give some certainty to how the world going forward will look.

Mr. BOUCHER. Can you take all of these steps with current authority, or do you need additional authority from this Congress?

Mr. WOOD. I mentioned in my statement, and certainly as I have before this committee before, that although in light of what I heard today maybe RTOs won't be challenged in court either, but RTOs and transparency are initiatives that I think certainly within the broad reading of the Federal Power Act, there is authority, but I also know that things go through courts at a pretty glacial pace.

And certainty from the Congress on RTOs and transparency of information are certainly—would be helpful in shaving probably 3 to 5 years off that court run.

Mr. BOUCHER. Mr. Wood, thank you, and Ms. Hutzler, thank you. And thank you, Mr. Chairman.

Mr. BARTON. We have a vote on the floor on the Shay substitute to the Campaign Finance Reform. We are going to take a short recess, and reconvene at approximately 4 p.m.

Normally, I would let this panel go, but I know Mr. Sawyer wants to ask questions, and Mr. Largent, and Mr. Shimkus, and I want to ask one more round myself. So I hate to inconvenience you, but if you all will wait another 10 minutes, we should be back and reconvene the hearing. We are in recess until approximately 4 p.m.

[Brief recess.]

Mr. BARTON. The subcommittee will come to order. We have got a number of members who wish to question this first panel, and they are not back yet. In the interest of time, I am going to ask a few questions, and then hopefully by then Mr. Sawyer, Mr. Largent, or Mr. Shimkus, or Mr. Pickering, or Mr. Wynn, will be back in attendance, and they will be recognized.

In my first round of questions, I asked the question about transparency, and whether we needed additional legislation to set some additional standards for transparency.

In this second round, I am going to ask the question a little bit differently. If you were me, chairman of the subcommittee, and jurisdiction over energy markets, what would you change or reform in current statutory authority?

I will ask that one question, and then I will recognize Mr. Sawyer, since he is now back in attendance. So what would you change, Mr. Wood, or reform, if you were the chairman with legislative authority at a markup of a pending electricity bill before your subcommittee.

Mr. WOOD. Gosh, I would like to give you an actual language, but conceptually I think the main thing that is close to the line now is the extent to which we can require a certain type of information being disclosed.

Mr. BARTON. A little additional authority for information gathering?

Mr. WOOD. Because there are a lot of cries for confidentiality. This is sensitive business information, et cetera, and while that may be true, on an open exchange such as Jim and them oversee, that information is available on an aggregate basis, and is available on trade basis, and you get a lot of information in an open exchange market that informs markets that you don't necessarily get on bilateral markets, where a lot of the energy trades actually happen.

So if you want transparency, I think it is really just kind of focused on that issue, and I would be glad to work on anything with you all.

Mr. BARTON. Good. Mr. Newsome.

Mr. NEWSOME. Mr. Chairman, I wouldn't have anything specific to add at this point. We may later as we continue reviewing what happened and how it happened. But I think as it relates to transparency, I would try to get down to the bottom end question of what is in the public good.

And certainly if a market provides a price discovery function, then it is in the public good for that market to be transparent. And trying to learn more, I guess, and make a determination about is in the public good, and what is not in the public good, would be a great place to start.

Mr. BARTON. Okay. Mr. Hunt.

Mr. HUNT. Sir, you know what I would do. I would repeal PUHCA.

Mr. BARTON. I love that answer, but you need Mr. Dingell and Mr. Markey, and Mr. Waxman here to hear it.

Mr. HUNT. Well, I made sure that they were out of the room when I said it. And give the additional protections of books and

records to FERC, and transfer authority over that amended act to FERC, because they are the energy experts. We're not.

And they could be consistent in administering all of the Federal Energy Acts together. You know, we try to avoid conflicts with them in administering PUHCA, but sometimes it is inevitable.

But we would like to see whatever comes out of this committee and the Congress as a whole in the public utility area, to transfer it to FERC.

Mr. BARTON. Okay. Ms. Hutzler, was there any additional authority your authority would like to have?

Ms. HUTZLER. Well, generally, the more markets can have information, the better they function. So that would be my only recommendation.

Mr. BARTON. And Mr. Welch, who is implementing some of these, or overseeing some of these, at the State level.

Mr. WELCH. I think with respect to FERC authority, I think what Chairman Wood indicated is probably the best thing. Getting enough information to enough people in time for them to act upon it in their own interests is really critical to these markets. And right now that flow is not where it needs to be.

Mr. BARTON. The Chair would recognize Mr. Sawyer for questions for 5 minutes.

Mr. SAWYER. Thank you, Mr. Chairman. Let me get to a question that I raised in my opening statement. Commissioner Hunt, is there any evidence or reason to suspect that Enron avoided acquiring multiple utilities in order to avoid coming under PUHCA?

Mr. HUNT. I don't know that we have any hard evidence of that. They certainly knew, Mr. Congressman, that if they acquired another utility that they would be under PUHCA if it was not a farm utility, or an EWG, or a utility from another State.

And that might have restricted their other areas of operation, because to be so registered, as opposed to exempt holding companies, PUHCA has a lot to say about what other nonutility activities unregistered holding companies can engage in.

Mr. SAWYER. So if they had come under PUHCA, there would have been tools that would have been useful in——

Mr. HUNT. If they were under PUHCA, we certainly could have examined their books and records. We are now trying to get to a 5-year cycle of closely examining the books and records of the 27 registered holding utility system.

So there is a possibility that we would have given a look at them under the Public Utility Act. But we also have the authority, Mr. Sawyer, to look at their books and records, and their annual reports under the 33 Act, but we don't have enough people to look at every large company every year. And so we put them on a 4 or 5 year cycle.

Mr. SAWYER. Are there tools within PUHCA that if or when PUHCA is repealed, we ought to take special care to assure that it remains in the law in the interest of the kinds of things that you are talking about.

Mr. HUNT. From our perspective, we think that the most important thing is how to inspect the books and records, and to look at affiliate transactions primarily. There is no cross-subsidization, and

to give PERC the power to rule, or order, prohibit affiliate transactions that are inherently unfair.

Mr. SAWYER. Chairman Newsome, are there similar oversight tools that are found in PUHCA that would be available to regulators if energy derivatives were to return to the Commodity Exchange Act?

Mr. NEWSOME. Congressman, I am just not that familiar with PUHCA. I mean, we absolutely have no responsibility or jurisdiction in that area. So it would be very difficult for me to respond from that standpoint. I just am not familiar with it.

Mr. SAWYER. Chairman Wood, are there tools which would be important to FERC as responsibilities under PUHCA went away?

Mr. WOOD. Yes, sir. Certainly the discussions, and I think Commissioner Hunt represents those pretty well in this written and oil testimony so far, that giving access to books and records of all members of a holding company system, to FERC and to State and regulatory Commissions, is important to make sure that electric and gas customers don't subsidize through regulated rates the other activities of a corporate empire.

And that role actually is to me in a lot of the discussions over the past several years, there seems to have been an important kind of tradeoff of any sort of reform to PUHCA. There are other aspects, but that it is the ability to get to the books and records.

Now, that is no easy task, as one who has lived through the rate sending saddle in the State level, it is a jungle. I mean, to go through all the costs, and make sure that they are not being unfairly allocated on top of the rate pair in your own State. And that is certainly difficult.

Mr. SAWYER. Commissioner Welch, would you agree that where you work is a jungle?

Mr. WOOD. I lived in one, too. So I think the increased access, and also I think it was mentioned in Mr. Hunt's testimony about market power reviews in PUHCA that would go to FERC, and certainly that would offset the absence of PUHCA being there.

Mr. SAWYER. Let me just say by way of observation, Mr. Chairman, that the whole question of capital formation seems to me to be critical in the industry right now. And if it is fragile in generation, then it is even more fragile in transmission, which has never been seen as a traditional earning center.

Putting transmission in a position to do precisely that I think is one of the great challenges in forming effective regional markets, and I would look forward to discussing that with you in the future. Thank you, Mr. Chairman.

Mr. BARTON. Thank you. The Chair would recognize the distinguished gentleman from California, Mr. Waxman, for 5 minutes for questions.

Mr. WAXMAN. Thank you very much, Mr. Chairman. Mr. Wood, you testified that energy markets and the growing trend toward competition did not cause or contribute to Enron's collapse.

That might be a true statement and it might not be. I think I will associate myself with the remarks of Mr. Dingell, who accurately states that we really don't fully understand Enron's collapse yet.

But, Mr. Wood, let's for a moment assume that you are right, and energy markets and competition did not cause or contribute to Enron's collapse. In your view, Mr. Wood, do we fully understand the impacts of Enron's collapse?

Mr. WOOD. For the limited purpose of the physical markets that we regulate, I think we do know certainly what has happened in the recent past was not a significant disruption of those markets. So to that extent, yes, sir, Mr. Waxman.

Mr. WAXMAN. I want to introduce into the record a letter from the Northern California Power Agency. Several of the agency's members entered into long term agreements with an Enron subsidiary for electricity, and the letter explains the serious situation these California municipalities are now in.

[The letter follows:]

NORTHERN CALIFORNIA POWER AGENCY
ROSEVILLE, CA 95678
February 12, 2002

The Honorable HENRY A. WAXMAN
United States House of Representatives
2204 Rayburn House Office Building
Washington, DC 20515

DEAR CONGRESSMAN WAXMAN: Over the past couple of years, the California energy markets have weathered several significant crises. Moreover, it appears that no group or class of consumers or market participants have been insulated from the impacts of the crisis, even those once blamed as primary instigators. The Northern California Power Agency[1] (NCPA) member cities are no exception. For example, many NCPA members have been forced to significantly raise their retail rates, some for the first time in over a decade, due to high prices, enhanced market risk, and skyrocketing litigation costs.

The Enron debacle is only one story, albeit significant, in a long list of casualties involved in the western energy market crisis. For many market participants, including several NCPA members with remaining long-term contractual relationships with Enron, there is an ongoing risk. This "ongoing risk" is discussed in more detail below.

Enron Corporation filed for Bankruptcy on December 2, 2001, the same day that Enron subsidiary, Enron Power Marketing Inc. (EPMI), stopped delivering power to NCPA and several of its member cities. Although EPMI resumed deliveries again on December 21, on a day-to-day basis, to date they provide no long-term assurances of continued deliveries to their customers. Thus, the possibility remains, given the Enron financial collapse, those deliveries will once again cease. This risk is greatly enhanced if we reenter a period of electric price volatility. Why is this significant?

Several NCPA members have been placed in a serious dilemma resulting from the Enron collapse, due to the structure and form of long-term agreements with its subsidiary, EPMI. For example, NCPA's contract with EPMI is pursuant to the Western Systems Power Pool (WSPP) agreement,[2] which is widely used throughout industry. Under this agreement, the sole remedy for the non-defaulting party (in this case NCPA) is to terminate the contract. Upon termination, however, the non-defaulting party must calculate the present value of the contract, positive or negative, and pay, or receive, a termination payment within three business days. In the case of an above-market contract (i.e., the terms under the contract are higher than what can be purchased in the market), the non-defaulting party must remit what amounts to

[1] NCPA is a nonprofit California join powers agency established in 1968 to generate, transmit, and distribute electric power to and on behalf of its fourteen **members**: cities of Alameda, Biggs, Gridley, Healdsburg, Lodi, Lompoc, Palo Alto, Redding, Roseville, Santa Clara, Ukiah, the Port of Oakland, the Truckee Donner Public Utility District, and the Turlock Irrigation District; and seven **associate members**: cites of Davis, Santa Barbara, ABAG Power, Bay Area Rapid Transit District, Lassen Municipal Utility District, Placer County Water Agency, and the Plumas-Sierra Rural Electric Cooperative serving nearly 700,000 consumers in central and northern California.

[2] The WSPP agreement is not unique in its termination provisions. Some individual NCPA members used the Edison Electric Institute (EEI) contract, with nearly identical provisions. Many view the EEI contract, in fact, as even more draconian due to onerous collateral posting requirements.

a windfall to the defaulting party (in this case EPMI). Practically speaking, the non-defaulting party cannot terminate the contract because the termination payment, in the millions of dollars, is prohibitive. As a consequence, the defaulting party is vested with all of the benefits of the contract and all of the risks are shifted to the non-defaulting party.

Should the market at some time in the future revert back to high spot prices and extreme volatility and EPMI again ceases deliveries, NCPA or its members will have missed their opportunity to replace these contracts at low rates. Moreover, it can be assumed that EPMI would be unable to make our members whole through a positive termination payment because they are insolvent.

Fortunately for NCPA and others, because the EPMI contracts are above current market rates, we can cover the EPMI contracts during the periods of non-delivery resulted in savings. Had these contracts been below market, however, it is easy to imagine that innocent parties might have been driven into their own financial crises. Thus, without the ability to terminate the contracts during a period of low prices, NCPA and other parties remain at risk should market prices again rise and if EPMI can no longer deliver.

NCPA and its members have similar contracts with other suppliers as well. They serve as an example that standards and practices applied in commodity and other free market transactions do not always translate well to utility markets. Often this is not discovered, however, until after the crisis occurs.

Overall, the Enron calamity has resulted in enhanced consumer risks, undermined consumer confidence, increased transactional costs (hidden/inflationary) to consumers due to risk premiums, and slowed the developing market. It is now incumbent upon policy makers to provide careful, nonpartisan analysis of the roots and causes of the Enron crisis, with a focus on resolving the underlying flaws in our assumptions regarding deregulated electricity markets and regulatory deficiencies in the oversight process.

If you have any questions regarding this letter, please do not hesitate to contact me at (916) 781-4200.

Sincerely,

GEORGE FRASER
General Manager

Mr. WAXMAN. Upon announcing Enron's bankruptcy the Enron subsidiary stopped delivering electricity for almost 3 weeks. Now, the Enron subsidiary delivers electricity on a day-to-day basis, providing no long term assurances.

So the Northern California Power Association Agency members are in a quandary. If they terminate their contracts, they owe Enron a huge amount of money, and if they don't terminate their contract, they have uncertain service for potentially years to come. Mr. Wood, are you aware of this situation?

Mr. WOOD. I am not specifically aware of that one, Mr. Waxman.

Mr. WAXMAN. Does FERC know how many entities hold Enron contracts who are also in a situation like this?

Mr. WOOD. We do not specifically know. We have only heard from those that actually want to invoke some authority from the FERC.

Mr. BARTON. Would the gentleman yield?

Mr. WAXMAN. Yes.

Mr. BARTON. We asked before the gentleman came a similar question. The Chair asked a similar question if there was information about contractual obligations that Enron had defaulted on. So we are with you in trying to get that information.

Mr. WAXMAN. I guess the other question, and I will ask it, and maybe we can get an answer for the record, is how many Enron contracts has FERC evaluated to determine the effect of the Enron collapse? Do you know, Mr. Wood?

Mr. WOOD. To date, not any that I am aware of. That's why we opened our investigation to look into potential manipulation in the

gas and power markets by Enron and its affiliates, and any other entity.

Mr. WAXMAN. I have one last question for all of the witnesses. The letter from the NCPA concludes by stating that it is now incumbent upon policymakers to provide careful non-partisan analysis of the roots and causes of the Enron crisis with a focus on resolving the underlying flaws in our assumptions regarding deregulated electricity markets, and regulatory deficiencies in the oversight process.

I want to ask everyone at the table if each one agrees or disagrees with this recommendation, or whether they think that Congress should immediately press forward to pass legislation to deregulate the electricity industry? Mr. Wood, why don't we start with you.

Mr. WOOD. Well, first of all, I have not viewed the efforts of this committee or any others to deregulate the industry. I think adding more competition to the wholesale power markets is quite a different thing from deregulating.

But with that caveat, I think certainly understanding what happened to Enron is important, and if in fact that causes us to change our assumptions about a lot of things, I am willing to do that.

But I also want to be informed, and as I think Mr. Newsome mentioned in his statement, by what we have learned, and by what your committee learns, and your sister committee learned, and by what we found out through courts that happened in this Enron deal.

But I do think it is the best part of good policy to learn first and then react to that after we learn.

Mr. WAXMAN. Mr. Newsome.

Mr. NEWSOME. Yes, sir?

Mr. WAXMAN. Should we learn first or should we legislate first?

Mr. NEWSOME. Well, I think when you talk about energy deregulation, it refers more to the cash markets and the forward markets, of which we have absolutely no jurisdiction over. So I wouldn't even begin to try and comment from that standpoint.

I would say that in the markets that we do have regulatory oversight that we are continuing to do our due diligence, and we are looking under every rock, and looking at all areas.

We are cooperating with other financial regulators to provide whatever expertise we might have to look at in our area of jurisdiction. But under the cash markets, we would have none.

Mr. HUNT. Mr. Waxman——

Mr. BARTON. Use one of the microphones.

Mr. HUNT. Yes, I'm sorry. We have, I think, seen some areas in the laws that we administer primarily, and in accounting regulations, that didn't work in the Enron case clearly.

My preliminary view is a part of that was lack over oversight by the board of the company, and certainly a lack of oversight by the audit committee of the board, and certainly a fairly poor job done by the outside auditors.

And in terms of the disclosure statutes that we administer, certainly the word impenetrable has been used to describe Enron's financial statements, and textual statements, in terms of describing the many off the book entities that were affiliated with Enron.

So we think we already know enough to know that we have a lot of work to do to make out disclosure laws and our regulation of the accounting profession both stronger and clearer.

Mr. WAXMAN. Let me just put the question on the table for the last two people. The recommendations from this organization in Northern California was that we don't—that we resolve the underlying flaws in our assumptions regarding deregulated electricity markets and regulatory deficiencies in the oversight process before we legislate. Do you have any views on that subject? Ms. Hutzler.

Ms. HUTZLER. It is always generally good to understand what has happened in the past and how that is going to affect future issues. The real question is how much do you need to study it, and how much detail do you need to study it.

One can continually study issues and not move forward on anything else. So you have to realize what the data will allow you to study and how far you can get answers to those questions.

Mr. WAXMAN. Mr. Welch.

Mr. WELCH. Well, thank you. We actually deregulated our market several years before Enron, and so I am not sure that we can go back. Nothing about what has happened in Enron in particular has thus far caused me to lose confidence in the basic structure of moving from a sort of command and control integrated resource planning model, which we had for many years, to a model which relies much more on market style and resources.

And having said that, we continuously review whether or not what we are doing is exactly the right thing, and obviously Enron has some lessons, and I am not sure exactly what they are. But I don't think at least for us they have thus far caused us to doubt that the particular direction in which we are moving is the right one.

Mr. WAXMAN. Thank you. Thank you, Mr. Chairman.

Mr. BARTON. The gentleman's time has expired. The gentleman from Massachusetts is recognized for 5 minutes.

Mr. MARKEY. Thank you, Mr. Chairman, very much. Chairman Wood, good job, huh? It's interesting, you know. I would like to turn to Enron's status under the Federal Power Act.

Under Sections 203 and 204 of the Federal Power Act, FERC has claimed legal authority to regulate Enron's energy marketing affiliates, such as Enron Power Marketing, as a public utility.

Now, under Section 204 of the Federal Power Act it requires prior FERC approval of issuances of securities and assumptions of liability by any public utility like Enron Power Marketing. Isn't that right?

Mr. WOOD. Yes, sir.

Mr. MARKEY. Did the FERC ever require Enron Power Marketing to obtain prior FERC approval before it issues securities, or assumed liabilities?

Mr. WOOD. The FERC has had a practice since I believe the mid-1990's or early 1990's, Mr. Markey, of granting blanket preapproval authority to power market applicants unless there is a protest.

Mr. MARKEY. So in issuing blanket prior authorization for such security issuances and liability assumptions, Enron did not have to seek FERC approval for its specific obligations or security issuances; is that correct?

Mr. WOOD. That's correct.

Mr. MARKEY. Now, Section 204 says that FERC shall approve issuances of securities or assumptions of liabilities by public utilities, quote, if it finds that such issue or assumption, (a) is for some lawful object within the corporate purposes of the applicant, and compatible with the public interest which is necessary, and/or appropriate for or consistent with the proper performance by the applicant of service as a public utility, and which will not impair its ability to perform that service. And (b) is reasonably necessary or appropriate for such purposes.

Had the FERC been reviewing and approving Enron's issuances of securities or transfers of liabilities to the LJM, CHUCO, Jedi, and Raptor Partnerships, do you think you would have approved them under that standard?

Mr. WOOD. I think it is fair to say that it would be—well, assuming that we could understand the nature of LJM, CHUCO, Jedi, and the others, and it is difficult even with the Wall Street Journal dubbing it down for us what it is.

I think it is a fair question that those would have had trouble getting past the standard.

Mr. MARKEY. So it probably would not have passed mustard given the tests that they would have had to pass if they had not already received prior blanket approval?

Mr. WOOD. Again, I am not prejudging that if we had to deal with it, but I have to say that if we had reviewed those under the lawful and necessary, the (a) and (b), standard of 204(a) and (b) in advance, we might have had a different outcome.

Mr. MARKEY. So even if you started regulating power marketers as public utilities under Section 204, you still wouldn't have authority over their holding companies would you?

Mr. WOOD. No. I believe that again is a PUHCA issue.

Mr. MARKEY. So you couldn't stop an operating utility from simply dividing up their profits and sending it up to the parents, and the parents issuing whatever securities, notes, papers, et cetera?

Mr. WOOD. Correct. It is just the marketer that is, quote, the public utility under the Act, yes.

Mr. MARKEY. So you would not have any control over that?

Mr. WOOD. No.

Mr. MARKEY. So let me go to you then, Commissioner Hunt, over at the SEC, and now you have got the ball in your court. Not withstanding the fact that the FERC has long said that a contract for the delivery of electricity constituted a public utility facility under the Federal Power Act, the SEC in 1994 issued a no action letter, deciding to tell Enron Power Marketing that it would not consider such contracts public utility facilities under PUHCA.

And reversing a longstanding 1974 SEC staff interpretation to the contrary. Isn't it true that the SEC's decision in this matter was contrary to what the law requires, and contrary to established precedent, and contrary to what the SEC staff had previously said on the matter?

Mr. HUNT. We did give an Enron subsidiary in 1994—the staff agreed not to recommend enforcement action against that subsidiary if it engaged in power marketing activities without that

subsidiary or Enron itself registering under the Public—under the 1935 Act.

We did not think and do not think that power marketing and what the tools of power marketing are, quote, facilities used for the generation and transmission, or distribution of electric energy for sale.

So we don't think that subsidiary was an electric utility company for purposes of PUHCA, and that therefore that ENRON itself was not a utility holding company for purposes of PUHCA.

We think that FERC reached a different conclusion under the Federal Power Act, because the Federal Power Act serves very different purposes.

Mr. MARKEY. Okay. Now in 1974 the SEC said just the opposite, and I would bring that to your attention, Commissioner. So obviously a big decision was made in 1994 (sic) by the SEC and we can see this regulatory black hole opening here between the FERC and the SEC.

And into which Enron and its shenanigans would be able to move. Can I ask for unanimous consent to continue for 2 additional minutes, Mr. Chairman?

Mr. BARTON. Well, you are 1 minute over. Could you have one more really penetrating question that they can answer very quickly?

Mr. MARKEY. I will try hard. Commissioner Hunt, you had previously testified that Enron got an exemption from PUHCA for owning Portland Gas and Electric because Enron reincorporated in Oregon, where PG&E was operating.

The reason of course was that Enron didn't want to be a registered holding company. So it reincorporated in Oregon because of PUHCA. Isn't that right?

Mr. HUNT. I don't know the reasons for their reincorporation. It certainly is plausible, Congressman, that their reincorporation in Oregon was to avoid the strictures of PUHCA, but I have not talked to Mr. Lay lately, and so I don't know if that is correct or not.

Mr. MARKEY. Well, isn't it true—well, let's talk about the effect of it then. Isn't it true that that allowed the Oregon——

Mr. HUNT. Yes, that is certainly true.

Mr. MARKEY. —PUHCA to place certain protections on the holding company of its Oregon operating utility as PUHCA was designed to do?

Mr. HUNT. Well, I have testified with the Chairman of the Oregon Public Utility Commission before the other body last week, and he thought that Enron's activities had nothing to do with the good functioning of the utility in Oregon.

Mr. MARKEY. All right. Now, if PUHCA is repealed, except for books and records, isn't it true that there will be no reason at all for holding companies to be incorporated in the same State where they own utilities?

Mr. HUNT. There certainly would be no PUHCA reason.

Mr. MARKEY. Okay. Thank you. I understand that the SEC——

Mr. BARTON. That's three questions after the one question. Do you have a bottom line question there?

Mr. MARKEY. If I can just get——

Mr. BARTON. Why don't you go to the bottom line question?

Mr. MARKEY. Let me get one more yes.

One more yes, and then I get the big conclusion. I understand that the SEC staff didn't fully review Enron's filings from 1997 until it initiated its enforcement inquiry late last year; is that true?

Mr. HUNT. Because of a lack of resources as you probably know, we only review a limited number of publicly held companies every years, and we had on schedule to review Enron in 2001, but some new derivatives came on line, and so we put it off for one more year.

Now, if you give us more staff and more money, we will review every publicly held company every year.

Mr. MARKEY. Well, this is the seventh largest company in the United States. If you aren't reviewing Enron's books and records, and Enron apparently could not understand its own books and records, and Wall Street analysts couldn't understand them, and their accountants couldn't understand them, how do you expect a State PUC, with limited jurisdiction, to be able to figure out what they are up to?

Mr. BARTON. This has to be your last question, because we have three other members, and you have doubled the time.

Mr. MARKEY. I will finish up by asking hasn't PUHCA kept the registered holding companies out of the junk bond scandals and indeed from what we can tell out of the Enron mess, except where they can find these regulatory black holes?

Mr. HUNT. Well, we hope that we have done a decent job administering the Act, Mr. Congressman, and that we have kept the registered holding companies out of the morass that Enron now finds itself in.

Mr. MARKEY. Thank you, Mr. Chairman. I appreciate your patience.

Mr. BARTON. Those are all good questions by the way. I am not opposed to the content of the question, but just the time that it takes to ask them. Mr. Shimkus for 5 minutes.

Mr. SHIMKUS. Thank you, Mr. Chairman. Mr. Welch, because of the Enron crisis have you all made any changes to help the individual citizens of the State of Maine so that they can uphold to the old cliche of let the buyer beware?

I mean, what changes are going on in the State to help?

Mr. WELCH. We have not done anything specific, except that we are currently reviewing what kind of security we are going to require from market participants who are selling particularly to residential consumers, residential small business.

We view the larger consumers as having sufficient wherewithal to make their own judgments about with whom they are dealing. But for the smaller consumers, we do think some form of security is important as my written remarks indicated.

We are trying to beef that up in a way that we won't be surprised in the future.

Mr. SHIMKUS. And correct me if I am wrong, but in your opening statement and in your written testimony you maintain that because in essence we are in a slow economy that we are not seeing the natural gas price spikes that we had two winters ago, and the demand was not as great.

And that that limited the effect of the Enron trading, and 20 percent leaving the market, and diluted that. And that is correct, that is what you made in your opening statement; is that correct?

Mr. WELCH. Yes, it is.

Mr. SHIMKUS. Now, I will ask the other panelists. Do you all agree with that? And if we could start with Mr. Wood, and then just go down to the others.

Mr. WOOD. Let me just clarify. Tom, what you had said yes to was the——

Mr. WOOD. I'm sorry. The particular point I was making was that because Enron typically was in the market with contracts to supply customers of prices that were above the now current market price, we were not too worried if Enron defaulted on those contracts, because in effect they had not defaulted on those contracts, and if they did default, people would be able to replace the power less expensively.

Mr. SHIMKUS. But there would have been another crisis had we been in a more restricted high demand market, with higher prices?

Mr. WOOD. Yes. Had the market price been above the Enron contract price, then it would have been a serious problem for our consumers.

Mr. SHIMKUS. Does anyone disagree with that? So we are lucky that Enron collapsed now, versus when we had the natural gas price spikes of a year-and-a-half ago, or whenever that was? Probably a year ago last winter?

I mean, is everybody shaking their head yes? Is that what it means?

Mr. WOOD. Yes, on that narrow fact, yes, sir. But I would wonder if Enron would not have collapsed had they been in that market. I mean, I mentioned in my testimony that they kind of had a one-way strategy that seemed to work.

Mr. SHIMKUS. Well, we had the accounting hearing last week, and there was a lot of—they had a lot of shady financial dealings. Chairman Wood, let me ask, has the Commission significantly altered—it is kind of similar to the question that I asked the public utility of Maine.

Have you significantly altered any of your positions with respect to the development of competitive energy markets as a result of Enron?

Mr. WOOD. I think the specific results of Enron have been that we have published one further question, but quite frankly the seminal event for us in our agency's development was what happened in Mr. Waxman's home State, and the changes that we have made to respond to what happened in California, were really the seminal events for our agency.

And in adding a market oversight division, and enhancing our ability to get transparent data as I discussed earlier, and in changing the codes of conduct for affiliate review, and looking at how market powers analyze.

So a lot of things that Enron could represent in-part were represented in the totality about what happened in California. So I would say, yes, but recognize that a big part of the yes was already under way.

Mr. SHIMKUS. Does anyone else want to have any changes or plans of changes based on what we have perceived? Obviously members of the legislative branch are looking at ways to address legislation that might affect it.

Mr. Newsome or Mr. Hunt, do you have any—are you planning on any changes?

Mr. HUNT. Yes, sir. I said in my oral testimony that today the SEC had announced five additional things that we are going to look to, to enhance disclosure of publicly held companies.

This will be the first of a series of commission initiatives to enhance our Federal disclosure and financial reporting system. Clearly, the Enron case has shown—and it is not clear whether this was all legal or not.

But that in some instances our disclosure and financial reporting systems simply did not work in that instance, and we need to make some changes in it.

Mr. SHIMKUS. In the auditing hearing that we had last week, I asked a question on pro forma statements, and that is kind of what I am addressing. Are they helpful or are they harmful?

Mr. HUNT. They can be either.

Mr. SHIMKUS. And that is kind of the answer that I got last week.

Mr. HUNT. Some people have misused them. They can sometimes help explain fairly complicated financial structures, but we issued a recent public statement that they can be misused, and warned companies to not misuse them and make their results look better than what they were.

Mr. SHIMKUS. Thank you, and Mr. Chairman, I yield back my time.

Mr. BLUNT [presiding]. I thank the gentleman. I know my fellow Missourian, Ms. McCarthy, has already welcomed our friends from Kansas City; Rick Green, from UtiliCorp, and his associates from UtiliCorp and Aquila. So I am not going to do that.

I will file a statement to the record and recognize Ms. McCarthy for 5 minutes.

And if you want to go ahead and do your 5 minutes of questioning now, or—we just had a vote call, but I would think we could do your questions if you would like.

Ms. MCCARTHY. I just have a brief question actually for Mr. Wood and anybody else who wants to discuss it with us briefly, but that is about getting greater price transparency, which was mentioned in your testimony that that would really help improve the efficiency of the markets.

And I know that transparency is something that we have been talking about here in the Congress. So could you elaborate, or if anyone else on the panel wants to talk about how is that best approached?

Is that through the regulatory agencies calling for it, or is it something that might require legislation, or is it something within the industry and can they bring that forward? I would just like for you to expand on that notion?

Mr. WOOD. Let me put two things out there and then answer your question after that. We have proposed for more price transparency in kind of a modest way quite frankly last July.

And that required standard disclosure, and internet based, et cetera, and two areas have been pushed back, and one of them mentioned a moment ago on confidentiality business information, which is traditional with the tussle that there is between opacity and transparency.

But the second one, which of course took a lot more relief after 9/11 is an argument that this much information in the market is actually a security issue now. So we are kind of—you know, you don't want to be wrong on that count, but on the other hand, you don't want that to be kind of a generic excuse not to have transparent data.

So certainly, yes, Madam, our job would be to make the best cut we can at the regulatory agency, and make that the rule. And it is kind of detailed probably that in general you all do want to delegate to an agency to figure out.

But if there is any guidance that Congress has on particularly how that ought to be balanced with security, then it would be welcomed. And certainly the corporate—you know, the private business information, and we can do that.

But any guidance on that certainly is welcomed as well. but those are the two kind of flash points that it would give us some guidance, and perhaps save us from litigating reporting form for the next several years.

Ms. MCCARTHY. Would anyone else like to comment before we go vote on the transparency issue and guidance from Congress, or other thoughts? Then thank you, Mr. Chairman, and I appreciate your——

Mr. WAXMAN. Would you yield to me?

Ms. MCCARTHY. Of course.

Mr. WAXMAN. If you have completed your questions.

Mr. MCCARTHY. Yes.

Mr. WAXMAN. Because I wanted to maybe use your time to sort of ask a question and get a response on the record. Mr. Wood, last year, the Wall Street Journal reported that Ken Lay played an influential role in the appointment of FERC Commissioners, and that you were supported by Ken Lay.

And there have also been reports that Mr. Lay supported your appointment to the Texas Public Utilities Commission. I have asked other officials for a listing of their contacts with Enron.

I would like to have you provide for the committee a list of your contacts with Mr. Lay and other Enron officials during your service as a FERC Commissioner, and while you served on the Texas PUC. And I would request that the list of contacts provide the date of contact, as well as the subject matter of the contact.

Mr. WOOD. I would be happy to provide that, sir.

[The information referred to follows:]

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, DC 20426

OFFICE OF THE CHAIRMAN

February 28, 2002

The Honorable Joe Barton, Chairman
Subcommittee on Energy and Air Quality
U. S. House of Representatives
Washington, D. C. 20515

Dear Chairman Barton:

This is in response to Congressman Waxman's request for information asked at your subcommittee hearing on February 13, 2002. He asked me to provide a list of my contacts with Enron officials during my terms as a commissioner at the Federal Energy Regulatory Commission (FERC) and at the Public Utility Commission of Texas (PUCT).

As the enclosed chronology details, I first met Ken Lay on May 29, 1996, when I was invited to present an update on Texas telecommunications and electric utility regulation to the members of the Governor's Business Council, an advisory group of Texas business executives that Mr. Lay had chaired since then-Governor Ann Richards formed the council in the early 1990's.

The enclosed chronology reflects my best recollection of all contacts I had with Enron officials based in part on calendars I have maintained since January 1996. I do not have any records prior to January 1996. I have not maintained phone logs during this period. Despite this, I believe that the contacts in the enclosed chronology represent all contacts with Mr. Lay and other officials, with the exception of Steve Kean, with whom I may have talked by phone two or three times over the seven-year period. From my records, the first occurrence of a meeting with Steve Kean is in 1998, but I feel certain we had been introduced sometime prior to that date.

In addition, the enclosed chronology does not list any meetings with non-executive Enron staff or outside attorneys, nor does it reflect contacts I may have had at legislative hearings, PUC Open Meetings, public conferences or public speeches. The enclosed chronology does not reflect several meetings I had with former Enron de Mexico President Max Yzaguirre in Texas during May, 2001 to discuss the duties of a PUCT Commissioner.

Finally, as you prefaced your oral request with a reference to letters Mr. Lay was ported to have written endorsing my nomination to both my current and prior positions, e letter that actually played a role in getting me an interview with then Governor Bush early 1995 has not been in the public record. In 1991-1993 I worked as a legal counsel FERC Commissioner Jerry J. Langdon, a Democrat from Midland, Texas who had ıown Governor Bush for many years. Martin L. Allday, also from Midland, was hairman of FERC under President George H. W. Bush, including during the time I orked for Commissioner Langdon. Shortly after the 1994 Texas gubernatorial election, ese two men wrote a letter recommending me to Governor-elect Bush for the open JCT position. After his inauguration, Governor Bush called me in for an interview for e position on January 27, 1995. During my interview, I observed the enclosed letter om Chairman Allday and Commissioner Langdon on his desk. He offered me the ›sition after our interview. I accepted it, and following my confirmation by the Texas enate on February 22, 1995, was sworn in by Governor Bush and joined the PUCT the ›llowing day.

I trust this information satisfies the request. Please contact me if I can provide any ırther information.

Best regards,

Pat Wood, III
Chairman

Enclosures

c: The Honorable Rick Boucher

CONTACTS Between Pat Wood, III and Enron Officials during Wood's terms at Texas PUC and FERC (February 23, 1995 to date)

DATE	Enron Official	Contact Type	Subject Matter of Content
5/29/96	Ken Lay	Wood's presentation at Governor's Business Council (100+ Texas business leaders; chaired by Lay)	Wood updated Council on telecom and electric utility regulation
3/3/97	Jeff Skilling	Wood presentation at DOE-sponsored fact-finding trip for German utility officials held at Enron's offices	Wood presentation to Germans on Texas regulation. Visit to "trading floor"
~3/97	Ken Lay	Wood phone call to Lay	Wood seeking Enron support for Gov.'s utility restructuring bill (unsuccessful)
1/15/98	Steve Kean	Kean visit to Wood office	(No specific notes of visit. Based on date, I expect discussion related to upcoming activities of Legislative study committee on electric restructuring)
11/29/99	Ken Lay	Wood's presentation at Governor's Business Council	Wood updated Council on telecom and electric utility regulation
1/24/01	Ken Lay	Wood phone call to Lay	Wood's concern about erratic shift of Enron policy on key Texas market design issue. Lay's congratulations on Wood's rumored FCC appointment (no response from Wood since Wood's 10/6/00 and 1/16/01 conversations with Clay Johnson regarding FERC position were not public).
~5/2/01	Steve Kean	Meeting in Washington DC	Update on Congressional activity relating to electric restructuring
9/20/01	Stan Horton Mark Frevert Steve Kean	Visit to Wood office with Jerry Halvorsen of INGAA and other pipeline company officials	Pipeline industry preparations following 9/11 attacks. (Thank you note from Frevert received on 9/26/01).
10/3-4/01	Ken Lay	Wood presentation at US Energy Policy conference in Arlington, VA	Wood at speakers' table with Lay, Barton, Bingaman and Schlesinger on 10/3; Wood presentation to conference on 10/4
11/8/01	Ken Lay	Lay phone call to Wood (not reached)	From Email of phone message, it appears to have been a call to inform of proposed merger with Dynegy

November 18, 1994

Mr. George Bush
5950 Berkshire, Suite 990
Dallas, Texas 75225

Re: Public Utility Commission
Pat Wood

Dear ~~George~~: Governor:

We know you are besieged with requests from many sides by various individuals and/or interests for appointments to the many areas of government that you will be overseeing as Governor of our state.

Yesterday the undersigned were visiting about a lawyer named Pat Wood who is currently the legal assistant to Barry Williamson at the Railroad Commission. Pat Wood was a legal assistant in Langdon's office, who, as you know, served with Allday on the Federal Energy Regulatory Commission in Washington during the time your dad was President. He is a Port Arthur native and an Aggie (that's OK) who subsequently got his law degree from Harvard University.

We both understand that there are appointments made for political reasons, but there are also appointments that need to be made based on expertise and ability. A Public Utility Commissioner is one of the latter. It is a critical appointment to the well-being of Texas. Experience in fair regulation, with no ax to grind, and protection of the consumer, coupled with a need to encourage the regulated industries, is truly needed at this vital Commission.

Because we both have seen first-hand (in spades) the ability, integrity, energy and dedication to service that Pat Wood exemplifies, we recommend that you consider appointing him to the above Commission. You simply could not do much better from our way of thinking.

We understand that Barry Williamson is aware of Pat Wood's interest in the indicated position. We both know from personal experience that when you lose a trusted helper it hurts, but in fairness you must let that helper progress when the opportunity arises. We believe Barry would hurt, but be willing.

Enclosed you will find a resume. If you want to discuss Pat Wood with either or both of us, feel free to call.

Yours truly,

Martin L. Allday

Martin L. Allday
600 Congress Avenue, Suite 1500
Austin, Texas 78701
512/495-6354

Jerry J. Langdon
700 Milam Street, 13th Floor
Houston, Texas 77002
713/546-3765

Mr. WAXMAN. Thank you. Thank you, Mr. Chair.

Mr. BLUNT. If you will provide that for the record.

Every member of the committee has a requisite number of days to submit questions and may want to do that. If we are done with this panel, we will recess for 15 minutes and start the second panel at 5 o'clock.

[Brief recess.]

Mr. BARTON [continuing]. To elaborate on it, and Houston, Texas; and Mr. Gerald Norlander, who is the Executive Director for Public Utility Law Project, in Albany, New York, and Mr. Robert McCullough, who is the Managing Partner for McCullough Research, in Portland, Oregon. We will start with you, Mr. Green. Your testimony is in the record. We will recognize you for 7 minutes to elaborate on it.

STATEMENTS OF RICHARD C. GREEN, CHAIRMAN, UTILICORP UNITED, INCORPORATED; DAVID K. OWENS, ON BEHALF OF THE EDISON ELECTRIC INSTITUTE; RAYMOND PLANK, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, APACHE CORPORATION; GERALD A. NORLANDER, EXECUTIVE DIRECTOR, PUBLIC UTILITY LAW PROJECT OF NEW YORK, INCORPORATED; AND ROBERT MCCULLOUGH, MCCULLOUGH RESEARCH, PORTLAND, OREGON

Mr. GREEN. Good. Thank you, Chairman Barton, and other members of the subcommittee. As Chairman of UtiliCorp, I appreciate this opportunity to testify on behalf of the Electric Power Supply Association. EPSA is a national trade association that represents the competitive power suppliers, producers, and marketers.

And UtiliCorp is an international energy and services company based in Kansas City. Our Aquila subsidiary is one of the largest wholesalers of electricity and natural gas. We also are one of the leading providers of risk management services in North America, and the United Kingdom, and continental Europe.

Mr. Chairman, we are here today because of the Enron bankruptcy. It has made governments suspicious and investors leery, and employees nervous. The tragedy visited on Enron's employees and its shareholders, and the communities they served should never happen again.

Recent events have raised questions about the trading of energy, the security of pensions, corporate ethics, and financial disclosure. These issues are separate and must be addressed individually.

I am here today to talk about the questions that are unique to the energy industry. Based on my understanding of the reports today, it appears that Enron failed due to questionable non-core business investments, and inadequate financial reporting practices.

Enron did not fail because it was in the energy business. It failed because of the way that it did business. Despite the shock of the Enron bankruptcy, and the loss of the largest industry player, the energy markets did not panic. This market continued to deliver power and gas to our customers.

There were no significant swings in prices and there were no interruptions. In fact, because of the transparency in the marketplace of credit, trading, and operations, the market knew way in

advance that Enron was in trouble and market participants were prepared and found it easy to replace Enron.

Mr. Chairman, these markets did work, but there is still work to be done. The further refinement of the market can do nothing but continue to deliver benefit to customers. While I understand the need to study the reasons for the Enron collapse, and how the market responded, these legitimate inquiries should not slow down the continued development of more efficient energy markets, or cause a retreat to historical forms of regulation.

Questions have been raised about the use of derivatives, and accounting disclosures of derivatives. In simplest terms, a derivative is a contract where one party pays another when a certain event occurs.

Many businesses have used derivatives over the years to manage risk. A good example of the benefits of a customized derivative is our contract with the Sacramento Municipal Utility, which provides them power or cash to purchase power when there is insufficient rainfall for their hydroelectric generation to operate.

This allows the Sacramento Utility to protect its customers from rate increases to cover the costs of purchasing last minute power at high prices on the open market.

Congress and FERC must continue their effort to restructure the energy industry. The progress to date has allowed this market to work so that the benefit to customers can continue. Do not stop now.

This will send a strong signal to the capital markets to invest in the critical infrastructure for our future energy supply and delivery. It is important to move forward to make this market more efficient.

I urge you to move forward on broad regional transmission organizations to provide more transparency, and adopt standardized interconnection rules to allow clear and timely access to the power grid for new generation supply, and repeal PERPA prospectively, and remove outdated restrictions on the ownership of QFs, which will encourage capital investment.

In closing, Mr. Chairman, I want to again emphasize the energy markets worked, and there was no panic, and energy customers were served. The modern energy market did not cause the Enron bankruptcy.

I trust that as this Congress seeks to respond to the tragic suffering experienced by Enron employees and shareholders that it will not take action that will disrupt our Nation's vital energy market. Thank you.

[The prepared statement of Richard C. Green follows:]

PREPARED STATEMENT OF RICHARD C. GREEN, CHAIRMAN, UTILICORP UNITED INC.

Thank you, Chairman Barton, Representative Boucher, and members of the Sub-Committee. I appreciate the opportunity to testify on behalf of the Electric Power Supply Association (EPSA) this afternoon. EPSA is the national trade association representing competitive power suppliers, including independent power producers, merchant generators and power marketers. EPSA members provide reliable, competitively priced electricity from environmentally responsible facilities in U.S. and global power markets. EPSA recognizes that competition has brought many benefits to our customers, and seeks to continue the delivery of benefits to customers as competitive markets continue to develop.

Based in Kansas City, UtiliCorp United Inc. is an international energy and services company with customers and operations across the U.S. and in Canada, Europe, New Zealand, and Australia. Our Aquila, Inc. subsidiary is one of the largest wholesalers of electricity and natural gas and providers of risk management services in North America, the United Kingdom and continental Europe. UtiliCorp also owns traditional investor-owned utilities in mostly non-urban areas of Missouri, Kansas, Colorado, Nebraska, Iowa, Michigan and Minnesota as well as utilities in Australia, New Zealand and Canada. At September 30, 2001, UtiliCorp had combined total assets of $11.9 billion and 12-month revenues of $42.3 billion. UtiliCorp plans to adopt "Aquila" as its corporate name later in this first quarter to more accurately reflect our increasing focus on our wholesale energy and risk management business.

My great-grandfather, Lemuel Green, started the predecessor to our first regulated utility in 1908. What started as a small family business has grown substantially due to UtiliCorp being in the forefront of change in the competitive global energy market place. I have served as the CEO of UtiliCorp from 1985 through 2001, and the Chairman since 1989. I also serve on the U.S. Department of Energy's Electricity Advisory Board.

The Enron bankruptcy has shaken the confidence of government, investors, employees and the capital markets. The tragedy delivered to Enron employees, and shareholders, and the communities they served is terrible.

The Enron bankruptcy has raised questions about how the wholesale market physically works, the trading of energy, the security of pensions for employees, and corporate ethics. It is imperative that we all work together to answer these questions.

Our knowledge of the energy markets and the facts reported to date indicate that Enron failed due to questionable non-core business investments and inadequate reporting practices of financial information to investors, shareholders, and employees that dramatically reduced investor confidence. Enron did not fail because it was in the energy marketing business. The underlying business practices of Enron would have created the same result if their core business had been real estate development, software products, or sporting goods.

Despite the shock of the Enron bankruptcy, the energy markets did not panic. The energy market—in terms of delivering power and gas to customers in a reliable and efficient manner has continued without interruption. The market was stable and customers were served without interruptions. Enron was a significant competitor to Aquila's wholesale energy and risk management business. At its peak, Enron was responsible for approximately 20% of the trades in the energy market. Despite the loss of the largest participant, liquidity was maintained and there were no significant swings in prices or disruptions in the supply of gas or electricity. In this regard, the energy industry did not miss a beat. The competitive wholesale market continued to do business as usual.

The energy market, particularly from the customer's point of view, remained stable—without interruption of services because of the liquidity and stability provided by the marketplace. When Enron's situation became apparent, other parties stepped in to fill the void. The market offered choice and diversity. Cautiously, companies began to adjust their positions and move business to alternative companies and electronic trading platforms. It is a testament to the strength of the energy markets, that in only a few short weeks, the industry could adjust to the collapse of a significant player with little effect on the customer.

Energy trading volume moved seamlessly—demonstrating the market diversity—from EnronOnLine, Enron's proprietary electronic trading platform, to other open many-to-many electronic trading platforms owned by a group of shareholders such as the Intercontinental Exchange (ICE), in which my company has a minority ownership interest. Total volumes on ICE increased by 65% from October to November 2001. During that time as well, the number of ICE users increased by 30%. Specifically, ICE saw an increased volume of gas and power trades for next-day as a result of the need to replace Enron volumes. Formerly EnronOnLine provided much of this market liquidity. The ability to move to other trading platforms did not destabilize the energy market. In fact, "choice" promoted stability.

As a result of the Enron collapse, questions have been raised about the use of derivatives and accounting disclosures of derivatives. I urge members to distinguish between derivatives themselves and these accounting disclosures. Derivatives, as financial instruments, first evolved in the 1850s after the railroads and telegraph communications developed on a widespread basis. With available transportation to move agricultural products a long distance and the advent of telegraph communication, farmers could sell their crops while they were in transit or before the crops were harvested. The derivative tool, when used as a hedging instrument, removed exposure to fluctuating prices from the farmer's income. As noted by the acclaimed

historian, Alfred Chandler, "the standardizing and systemizing of marketing procedures carried out by the exchanges transformed methods of financing and reduced the costs of movement of American crops." The use of derivatives evolved well beyond agriculture to numerous industries such as metals, banking—for exchange rate fluctuations, and energy.

The use of derivatives helped to stabilize the markets after Enron's collapse. Derivatives are financial tools, reflecting the underlying value of the commodity, that allocate risk and promote liquidity. I would agree with Energy Secretary Abraham's remarks, recently appearing in *The Washington Post,* that the pioneering work in energy trading, particularly derivatives, played a central role in providing market liquidity and risk allocation during the Enron collapse.

I would also agree with the National Association of Regulatory Utility Commissioners' (NARUC's) recent comments on derivatives. NARUC adopted a resolution, passed by their Board of Directors in July 2001 that "recognizes the important use of financial and physical mechanisms to reduce electricity and natural gas market volatility". The NARUC resolution states that that these financial instruments are a "component of a comprehensive energy procurement program." Furthermore, NARUC states "that the Board of Directors of NARUC, urges each State Commission to explore and examine the potential benefits to consumers and distribution utilities of using financial and physical mechanisms to hedge against market volatility in wholesale electric and gas markets."

Derivatives are important to consumers and to regulated utilities in providing price stability. Furthermore, derivatives can be customized specifically to the purchaser's unique circumstances and needs. I would point out the following examples of customized derivative products that Aquila provides to help our customers, such as regulated utilities or businesses, control their risks and lower the costs to their customers.

Example #1—Example from Summer 2001): Sacramento, California's municipal utility (SMUD), pays close attention to weather forecasts. During droughts, because there is no water to go through the dam, Sacramento gets less of its electricity from hydroelectric dams and must pay higher prices for power on the short term, open market. To ease the pain of buying high-cost power during droughts, the municipal utility entered into a five-year derivative contract with Aquila. The Sacramento utility receives replacement power or cash to purchase replacement power from Aquila when measured rainfall is below a certain level. In this way, SMUD cushions the risk of a budget hit due to lower-than-expected rainfall. This allows the Sacramento utility to protect its customers from rate increases to cover the costs of purchasing last minute power at high prices on the open market when such hydroelectric generators cannot operate.

Example #2—Production of aluminum is a very energy-intensive business. One aluminum producer traditionally obtained its electricity from the hydroelectric facilities it owned at a nearby river. As a result, it used to schedule aluminum production based on projection of that river's spring flows. In essence, their ability to produce efficiently hinged on sufficient snowmelt and rainfall to fill the hydro dams.

Today, Aquila supplies that smelter with all of its energy, so production can be based on raw material market conditions—not weather and rainfall. In exchange for the purchased derivative, customized specifically for this plant in this location, we maximize the use of energy from company's dams on the river. Of course, if the manufacturing company requires more electricity than those dams can supply, we obtain it from regional markets and other power plants at a predetermined price. This derivative "cushions the risk" for the manufacturer and its production schedule. It allows the manufacturer to be more competitive in the global market.

Example #3—Aquila has customized a derivative product called Guaranteed Bill for the customers of a Midwestern regulated utility. Guaranteed Bill is marketed to its residential customers by the local utility. The service offers customers a fixed monthly bill for natural gas. It is designed to put the retail customer in control and allows the individual to fix his/her energy costs. Historically, a customer trying to control costs was limited to a level payment plan which offers no insulation from weather or commodity price fluctuations, only the averaging of monthly payments over the course of the agreement. With Guaranteed Bill there is no end-of-agreement "settle up" payment due at the termination of the agreement. Aquila provides the utility with a weather hedge and a fixed commodity price allowing the utility to provide its customers true price certainty.

A further illustration of the increasing recognition of the importance of derivatives is Aquila's teaming with The World Bank and the International Finance Corporation (IFC) to launch a global weather risk facility that will sell weather derivatives to companies in emerging markets. This initiative of the World Bank and the IFC

has grown out of the multilateral agencies' plans to broker weather derivatives to boost agricultural yields in North Africa.

It is imperative that the value and utility of derivatives themselves not be confused with questionable accounting practices and questionable financial reporting. It is imperative that companies reports provide accurate and transparent information concerning their actions and financial health of companies.

I understand the concerns of Congress and the other regulatory agencies such as the Securities and Exchange Commission (SEC), the Federal Energy Regulatory Commission (FERC), and the Commodity Futures Trade Commission (CFTC) in considering and examining the energy industry issues and accounting and pension issues affecting all industries catapulted into the spotlight by the Enron collapse. The Enron actions have understandably raised questions about the necessary protections required for shareholders and employees.

Congress should look at several issues that will help restore their confidence in the energy industry as well as other industries in order to ensure that employees and investors are protected.

(1) The inability of Enron employees to diversify their retirement portfolios as the stock price of Enron declined having high concentration of Enron stock ownership within their portfolios must be examined and corrected. Legislation that addresses these employee concerns and allows employees at any time to diversify is needed.

(2) The standards for disclosure of special purpose entities (SPEs) and off-balance sheet financing need examination and correction. I believe that the SEC has the proper authority to make these changes that will provide for appropriate disclosure of such entities. Investors should have confidence that such entities are adequately being disclosed.

(3) The standards required for the oversight of external auditing needs examination and resolution. Currently, the accounting industry would be characterized as self-policing. The SEC has the authority to require the independent oversight of audit procedures and standards. Investors should have confidence that there is an independent oversight function. Such an independent oversight body could also review audit failures and should have subpoena power.

Aquila has made and will make every effort for full and open disclosures within the energy industry. Just recently, Aquila executives conducted a seminar for Wall Street and investment analysts about accounting methods. I believe that it is crucial that we educate these groups and others about the accounting methods and practices applicable to our industry. Our disclosure practices and communication of our financial information are not like Enron, and we find ourselves in the position of having to explain that very clearly.

Lack of confidence by the capital markets in the energy industry has been raised as a result of the Enron collapse. Rating agencies have raised the credit standard for generators and traders. There have been steep declines in stock values. There is a new appetite for a stronger capital ratio reflecting greater equity value and less debt.

This shift in the capital structure will force many energy companies to reduce debt and to scale back investments in new gas processing, development of storage facilities and pipelines, and generation plants. The result could be a shortage of generation in the long-term.

Since 1990, the competitive power supply industry has accounted for more that half of all the power generation capacity brought online in this country, and we expect this percentage to increase as competitive wholesale markets continue. The loss of confidence by the capital markets in the wake of Enron's demise will likely result in a reluctance to invest in the critical infrastructure for our energy supply and delivery. Congress can help to encourage confidence and to encourage the capital markets to invest in much-needed energy infrastructure by passing legislation to continue to make markets more efficient.

Briefly, I would commend the Bush Administration, Chairman Bingaman, Chairman Tauzin, Congressman Barton, and the Federal Energy Regulatory Commission (FERC), as well as many others, for their various proposals for new legislation that encourage a further efficient marketplace in which consumers will benefit.

The energy areas in which I would submit that you take action include: existing federal legislative reform, the standardized interconnection to the power grid, and the formation of regional transmission organizations.

Federal Legislative Reform: While PURPA in 1978 opened a new path for independent power companies to create wholesale generating capacity outside traditional utility regulation, the independent power generation industry is now mature and robust. Moreover, subsequent law enacted by Congress in 1992 effectively deregulated the creation of wholesale generating capacity. If PURPA is repealed prospectively as part of a comprehensive federal electricity bill, there must be explicit

recognition and preservation of existing PURPA contracts as negotiated in good faith. I also endorse efforts to guarantee the recovery of PURPA contract costs as appropriate federal policy. However, such cost recovery must be explicitly related to the honoring of existing contracts. Moreover, the existing QF ownership restrictions in PURPA have outlived their usefulness. They are an artificial and outdated restriction on the transfer of ownership of QF facilities. These restrictions lead utilities that want to acquire QFs to resort to the use of complex, temporary, corporate shells or trusts to dilute the utility ownership below 50%. The artifices are expensive, cumbersome, and serve no apparent useful public policy.

Standardized Interconnection: The power transmission grid has been compared to the national highway system in terms of its importance to our economic infrastructure. The highway system, along with protections to promote interstate commerce, has allowed a flow of benefits between regions. The national power grid requires standardization to promote the flow of power between regions as the national highway systems supports the flow of goods and services.

I endorse a clarification and standardization of interconnection rules for new sources of power generation. I cannot overemphasize how important this issue is for investment and construction of new generation. For companies interested in expanding electric generation capacity—critical to affordable power rates throughout the country, the physical interconnection of the generation plant to the power grid has become too often the "choke point" for project development.

Ad hoc interconnection standards create uncertainty, extensive delays and unexpected or unfair costs for developers. Legislation needs to affirm the right of new generation to interconnect on a non-discriminatory basis to transmission facilities, provide a clear avenue for the federal review of interconnection policies, and establish a timely remedy, if necessary, for any abuse. Access to the transmission grid should be uniform just as entrance and exit ramps are uniform throughout the interstate highway system.

RTOs: Congress should affirm FERC's authority to order utilities and other entities that own transmission assets to join a FERC approved Regional Transmission Organizations (RTOs) in order to realize a truly open and competitive transmission grid. I am supportive of FERC's directive to organize large, regional RTOs to reflect the way power flows. Independence in operation and market monitoring are crucial for the achievement of the open access initiated by Order 888.

The nation's transmission system is in need of upgrades and new investment to take economic advantage of available and most advantageously priced generation supply. I support market-like incentives to encourage new transmission builds in place of cost-based ROE. Pricing for transmission should preclude "pancaking" (multiple charges as power flows from one transmission system to the next) which can increase costs to customers due to excessive transmission charges for the delivery of power supply. Each user of the transmission grid must be required to take service under a single open access transmission tariff. The information system that guides the reservation and pricing and rules of transmission access should be standardized to increase transparency, reduce costs, and level the playing field.

Congress should reaffirm FERC's authority to set and enforce a clear deadline for all utilities and other transmission owning entities to join Regional Transmission Organizations (RTOs).

The continued support of Congress and FERC is necessary to re-establish confidence, to foster the creation of new technologies, to attract the necessary capital for infrastructure and to ensure a robust marketplace for the future. This will result in the reliable, affordable supply of energy.

While all companies are naturally concerned about creating shareholder value, companies must demonstrate equal concern and diligence for monitoring the human capital within their organizations. A foundation principle of our company is that the best companies are those where its people are rooted in a common understanding of expectations, and share in the ownership of the company. Furthermore, when business values and codes of conduct are integrated into performance management and business processes, they serve as a system of checks and balances as these values are upheld in practice. We all must make every effort to provide transparent information that facilitates the understanding of our financial actions and their results—which earns and maintains investor confidence.

Four important stakeholders that are vital to the company's long-term success ultimately evaluate a company's success: employees, customers, communities and shareholders. Employees vote their confidence in the company by taking advantage of ownership opportunities, referring friends for employment, and advancing their career within the company. Customers show confidence in our ability to provide superior energy solutions by selecting us over others in the marketplace. Communities cast their votes of confidence by providing us with operational franchises, pur-

chasing our services, and partnering with us on vital economic development initiatives. The value of corporate citizenship must first be demonstrated in the very communities in which we live and work. Finally, shareholders demonstrate confidence by investing in our company.

The UtiliCorp/Aquila culture identifies values that are the foundation for success. We have also recognized that by effectively executing compliance with these values, the company is creating discipline and durability to deliver performance to our stakeholder groups.

The Enron collapse is tragic for employees, their communities, and their shareholders. Enron failed, not the energy market. We must all work together to re-establish and restore confidence so that customers will continue to benefit.

Thank you for the invitation to appear before your Committee. I will be happy to answer any questions you may have.

Mr. BARTON. Thank you, Mr. Green.

We now want to hear from Mr. David Owens. Your statement is in the record. We would ask you to speak to it from 5 to 7 minutes.

STATEMENT OF DAVID K. OWENS

Mr. OWENS. Thank you, Mr. Chairman. Good afternoon, Mr. Chairman, and members of the subcommittee. My name is David K. Owens, and I am the executive vice president of the Edison Electric Institute. We certainly are pleased to testify on the effect of the Enron bankruptcy on energy markets.

Enron's employees and its investors have borne the brunt of Enron's bankruptcy. Congressional committees and government agencies are appropriately investigating the causes of this debacle. Fortunately, Enron's bankruptcy did not have an immediate harmful impact on electricity consumers.

As other witnesses have stated today, there was no disruption of service to retail customers, the lights stayed on, and prices remained stable. In addition, the Chairman of the Oregon PUC testified recently at a Senate hearing that Enron's bankruptcy does not appear to have harmed the retail consumers of Portland General Electric Company, an Enron division.

Now, as you know, allegations have been made that Enron manipulated forward prices in Western electricity markets. As we heard today from FERC Chair, Pat Wood, FERC plans to conduct an investigation of these allegations, and I think that is totally appropriate.

In other respects, Enron's bankruptcy is having important impacts on energy markets. Many energy companies have reported losses resulting from Enron's bankruptcy, and Wall Street is asking more questions about financial practices, and tightening credit standards, particularly for energy companies.

The stock prices of many energy companies have declined significantly. And many companies have delayed investments in generating capacity, raising the possibility of tight power supply markets when economic growth picks up.

In addition, there is increased scrutiny about the effect of accounting for forward trade in electricity, known as mark-to-market accounting. Selling electricity for future delivery is essential for efficient operation of electric markets.

However, when forward markets are not very liquid, there are greater uncertainties as to the proper market valuation for such transactions. Now, Enron's collapse suggests a need for many re-

forms that affect all publicly owned companies, and not just energy companies.

With respect to energy, it appears that the area of greatest concern is the transparency of financial reporting and disclosure as thinly traded electricity markets, much of what we heard from the first panel.

The ultimate cure for this is to advance measures to promote liquid trading markets, and in electricity, that would involve enhancing our transmission infrastructure. It would involve moving toward standardized power markets with efficient transmission pricing.

And it would also include facilitating independent regional transmission organizations. In other words, establishing more liquid hubs for the delivery and trading of power.

FERC has taken the lead in addressing many of these issues. However, legislation is needed in areas where FERC cannot act. H.R. 3406, together with the tax provisions of H.R. 4, already passed by the House, contain many needed electricity reforms to achieve the goal of a more robust, competitive wholesale market.

We look forward to working, and continuing to work with the subcommittee on these important legislative initiatives, and I would be happy, Mr. Chair, to respond to any of your questions and other members of the subcommittee. Thank you.

[The prepared statement of David K. Owens follows:]

PREPARED STATEMENT OF DAVID K. OWENS ON BEHALF OF THE EDISON ELECTRIC INSTITUTE

Mr. Chairman and Members of the Subcommittee: My name is David K. Owens, Executive Vice President of the Edison Electric Institute (EEI). EEI is the association of U.S. shareholder-owned electric utilities and industry affiliates and associates worldwide. We are pleased to have the opportunity to testify before the Subcommittee on the effects of the Enron bankruptcy on the functioning of energy markets.

Enron was reported to be the 7th largest company in the nation and often had been cited among the "most admired and innovative companies." Its sudden bankruptcy has shaken the confidence of the nation's investors and devastated Enron's own employees, many of whom have lost their jobs and their retirement savings. This bankruptcy has raised substantial questions that the Energy and Commerce Committee, other congressional committees and government agencies are properly investigating.

Investors must have confidence in the corporations whose stock they own. This requires the fair, accurate and transparent presentation and disclosure of financial information. Enron obviously did not meet this fundamental standard. The circumstances of Enron's demise, while not yet fully known, certainly require a reevaluation of our approaches to auditing standards, financial reporting and disclosure for all companies, no matter what industry they operate in.

DID ENRON'S BANKRUPTCY HAVE ANY IMPACT ON ENERGY MARKETS?

Fortunately, Enron's bankruptcy did not have any immediate harmful impact on electricity consumers. Nevertheless, it is affecting energy companies and future developments in the energy industry in many ways.

First, the good news. As FERC Chairman Wood testified on January 29 before the Senate Committee on Energy and Natural Resources, despite the fact that Enron was the nation's largest marketer of gas and electricity, Enron's collapse has had little or no impact on the supply or price of electricity. There was no disruption of service to electric customers. The lights stayed on. Prices remained steady.

It appears that electricity traders, including those at Enron, worked hard to unwind various deals involving Enron and to find other parties to complete such transactions. Enron and many other market participants often used a standardized electricity trading contract, voluntarily developed by traders, buyers and sellers under the auspices of EEI, which simplified the process of responding to Enron's financial

collapse. The contract provided uniformity in the terms and conditions of electric trading transactions, and contained detailed default and credit provisions which enabled parties to protect themselves if the party they were trading with (the counterparty) suddenly lacked creditworthiness. See "Using the EEI-NEM Master Power Contract to Manage Power Marketing Risks," 21 Energy Law Journal, 269 (2000).

Chairman Wood's testimony to the Senate Energy Committee contains data showing that daily power prices for electricity, which are often extremely volatile, had no unusual peaks during the fall of 2001. Electricity trading markets have proven to be robust and efficient, allowing others to step in to fill the void left by Enron.

In addition, Enron's bankruptcy does not appear to have harmed the retail customers of Portland General Electric Company, an Enron division which provides electricity to retail consumers in Oregon. Roy Hemmingway, Chairman of the Oregon Public Utility Commission, confirmed this in his testimony to the Senate Energy Committee on February 6.

I understand that Mr. McCullough, who appears with me today, has testified recently that Enron's bankruptcy was followed by a 30% decline in West Coast forward prices and suggested that Enron used its "market dominance" to "set" forward prices. I do not know whether declines were as significant as Mr. McCullough indicates or if they were the result of manipulation by Enron.

It is plausible that prices declined with Enron's bankruptcy because other sellers tried to dispose of power at one time that they had originally sold to Enron. Other factors that might have contributed to the decline in electricity prices include the sluggish economy, warmer than normal weather and falling natural gas prices. Whatever really happened, the Federal Energy Regulatory Commission will investigate these allegations, as it should.

In other respects, Enron's demise does appear to be having important impacts on energy markets.

Many energy companies reported losses resulting from Enron's bankruptcy.

Wall Street is asking more questions about financial practices and tightening credit standards, particularly for energy companies.

Accounting and reporting practices are being scrutinized and reevaluated.

Corporate Board members and officers are reviewing their roles and responsibilities.

The stock prices of many energy companies have declined significantly. Credit rating agencies have downgraded some energy companies and are re-evaluating others. All of which makes it more difficult and costly to raise capital to make needed investments in our nation's energy supply infrastucture.

Many companies have delayed investments in generation capacity and some are selling assets, raising the possibility of tight supply markets when economic growth picks up.

Many of these actions are understandable responses to the concerns of investors, customers and the public.

In addition, the circumstances of Enron's bankruptcy have raised specific questions about the effect of accounting for forward trades in electricity. A forward trade is a transaction for delivery of electricity at some future time. Selling electricity for future delivery is essential for efficient operation of electric markets. The California experience demonstrated the problems of relying too much upon the spot market for electricity and confirmed the importance, for stable electricity prices, of having a portfolio of long and short-term electricity contracts.

Where there is a transparent liquid market for longer-term commodity contracts, mark-to-market accounting is used to recognize and disclose the financial impact of such transactions. However, where forward markets are not as liquid and prices are not as transparent, there are greater uncertainties as to the proper market valuation and accounting for such transactions. Thus, the absence of transparent market prices could raise concerns about improper manipulation of anticipated prices that could distort financial reporting and disclosure. Questions have been raised regarding Enron's accounting for the income from such transactions and its treatment of the risks and valuation of the underlying trades.

In a related vein, questions have been raised whether the exemption of forward energy trades from CFTC regulation contributed to Enron's problems by giving it a greater opportunity to take advantage of illiquid markets.

Information from investigations of Enron will be helpful in addressing these questions.

ARE THERE ANY LEGISLATIVE ENERGY-RELATED RECOMMENDATIONS THAT RESULT FROM ENRON'S COLLAPSE?

Enron's collapse suggests the need for many reforms and changes that affect all publicly-owned companies. Such changes must be much broader in application than just the energy industry. We are pleased that Congress is looking into these issues, although many reforms can and should be accomplished without legislation.

Depending upon what else we learn about the circumstances at Enron, right now it appears that the "energy" area of greatest concern is the transparency of financial reporting and disclosure in thinly traded electricity markets. The ultimate cure for this is to initiate measures to promote more liquid trading markets. In the electricity context, this would involve enhancing our transmission infrastructure, moving toward standardized power markets with efficient transmission pricing, facilitating independent regional transmission organizations and establishing more liquid "hubs" for the delivery and trading of power.

FERC is taking the lead in addressing many of these issues. However, legislation is also needed in areas where FERC cannot act.

H.R. 3406, together with the tax provisions of H.R.4 already passed by the House, contain many needed electricity provisions to achieve the goal of a more robust, competitive wholesale market and to promote market liquidity. The tax provisions of H.R. 4 remove disincentives to transferring transmission assets to RTOs for both privately-owned companies and public power entities. This will facilitate the voluntary formation of large regional RTOs without federal mandates. (While many electric companies disagree with aspects of FERC's current RTO policy and the RTO mandate language in H.R. 3406, there is broad support for development of robust, large regional RTOs.)

The transmission siting and incentive rate provisions of H.R. 3406 would facilitate investment in and construction of needed new transmission facilities. The standard market design initiative being conducted by FERC would achieve greater liquidity in electric markets. And the reliability provisions of H.R. 3406 would help assure the continued reliability of the grid.

In addition, FERC must have the same level of authority over all transmission owners, no matter what type of entity owns transmission facilities, if we are to attain the consistency needed for transparent liquid markets. While H.R. 3406 moves in the direction of granting FERC some increased authority over the 25% of the transmission network that governmental and cooperative utilities own, it is too timid. FERC should have the same level of regulatory authority over all transmission providers no matter what their ownership form.

The provisions of the Public Utility Holding Company Act (PUHCA) and the Public Utility Regulatory Policies Act (PURPA) are incompatible with the current move to competitive wholesale markets. PURPA assumes we are still operating under the old vertically integrated monopoly paradigm, not with open access transmission and a competitive wholesale market comprised of hundreds of active participants. Prospective repeal of PURPA's mandatory purchase obligation is needed to eliminate future distortions in energy markets.

PUHCA's commitment to vertically integrated utilities is directly contrary to FERC's goals of a decentralized, competitive wholesale generation market and large regional transmission organizations that are completely independent of power generators and retail electric sellers. PUHCA precludes investment from non-electric companies, interferes with establishment of large regional transmission companies and promotes concentration of generation, not dispersion. A better approach, contained in H.R. 3406, is to assure strong access to books and records for all state commissions and FERC, recognizing that our responses to Enron's situation will lead to improved financial reporting and disclosure approaches for all public companies.

Finally, Congress needs more information on the role of commodities-type regulation for energy forward markets and perhaps should hold hearings on this topic.

CONCLUSION

In conclusion, I appreciate the opportunity to appear before this Subcommittee to address the energy market ramifications of Enron's bankruptcy and would be pleased to respond to your questions.

Mr. BARTON. Thank you, Mr. Owens.

We now want to hear from Mr. Raymond Plank, of Apache Corporation, in Houston, Texas. Your statement is in the record, and we would ask that you elaborate on it for 5 to 7 minutes.

STATEMENT OF RAYMOND PLANK

Mr. PLANK. Thank you very much, Mr. Chairman, members, and interested persons in the audience. My name is Raymond Plank, and I have correctly been introduced as in effect the founder and CEO of Apache Corporation, which has had an opportunity to observe energy markets for the 49 years of business, in which we have gone from the smallest of 16,000 oil and gas producers, to among the 20 largest in the world.

Mr. BARTON. You know my good friend Michael T. Halboutie by any chance?

Mr. PLANK. Yes, I do.

Mr. BARTON. He still goes to the office every day, and I think he is 95. He is as ornery as ever.

Mr. PLANK. I haven't seen him for a couple of years, but he is quite a guy.

Today, what we have as I see it, in the energy chain, natural gas is a very critical link. The reason is that it is the fuel of preference, both from an environmental standpoint, and in terms of its robust usage in commanding that portion of the natural gas and the electricity markets, which are totally interdependent.

Now, today, the greatest threat faced by the natural gas supply side is, rather than minimize price volatility, it has exasperated price volatility, contrary to the promises when Enron and others were capturing the last phase of deregulation, and assured such party purchasers as the State of California, that prices would be lower, and that supplies would be adequately abundant for their purchases to take place on a day to day basis on a spot market.

I would suggest that the committee follow the self-interests of those who make these claims, for if in the physical market the ratio of physical trading is one point for every 15 points of a virtual market, and you can command the same margin of profit on one trade to 15 trades, then in your virtual market, you have an opportunity for a multiplying factor of 15.

That then drives the psychology under which during the last phase of deregulation, which was preceded by some very constructive phases of deregulation, which they didn't really have to be, because it was such a terrible mess at the time that deregulations began some 15 years ago.

At that time the process was hijacked by the marketers. The hijackers immediately moved in between the pipeline companies and the consumers and filled that gap. They were the deregulated portion selling their commodities and their protection against volatility to whoever would buy it in the middle.

Unfortunately, from the standpoint of natural gas, paper contracts, paper agreements, futures sales, don't burn. They don't generate energy. So commitments were being made to potential consumers, but spot market prices would be very adequate for them to buy all of the supply behind which there were a pack of lies.

Those lies are coming out today as truths, and Enron carried it as far as they could, and then it collapsed. Now, credit has been taken here today and appropriately should be, for the fact that the process moved smoothly during the Enron collapse.

I want to suggest that in addition to the two reasons suggested thus far that there is a third one. The first one of course being a

period of recession, in which gas demand, particularly from industrial users, is significantly down.

The second one is an unseasonably warm winter to date; and the third one is the fact that they weren't contributing a darn thing in the first place. They were not a value-added service provider.

They were an opportunist, who saw an opportunity to create a market through current technology and go out and fill it. Now, in doing that, that process, and you know it as well as I, but it rests with you and other legislative committees, to pursue it to a point where justice has been served.

They did capture a good bit of that market, but again the value added service has not been provided, and as proof go back to the early 1970's before Ken Lay came over to the predecessor to Enron, before they then acquired Northern Natural Gas, which more recently they flipped off for $1.5 billion, as though it were a rotten apple hanging on a tree, in order that they could concentrate 100 percent of their activities on the highly profitable energy side, which is a misnomer, because they were no longer in the energy business.

They were a trader/marketer of commodities and of derivative products. That became the definition of their business. At that point in time then, one of the reasons why the industry could skate by, and the final reason that they could skate by the collapse of Enron was very simply that they were contributing so little in the first place.

Now, deregulation has contributed quite a bit in its earlier phases. I have indicated that it was a mess, and if I had more time, I would be pleased to continue, but if you ask me a question, I would be pleased to comment thereupon.

Today, our greatest problem that we confront within the industry, both as consumers and as suppliers, is price volatility. The promise was that with broader trading markets there would be less price volatility.

Gentlemen, the price of natural gas in 18 months has gone from under $2 to over $10, and back to under $2. That would represent the New York Stock Exchange or the Dow Jones average going from 10,000 points to 50,000 points, and back to 5,000 points, or wherever you want to put it.

The ratio is still on a 10-to-1, and the arithmetic I am going to leave to you, as I am certain that you will get that right. That would not be a salutary condition and the impact upon the supply side of the market is very simple.

We spend our cash-flow to replace a depleting reserve base, and it takes about a thousand rigs drilling at a time in the United States and Canada to maintain our reserve base at a level where it can meet the present known demand of approximately 60 BCF or a million Btus of gas per day. That is about our daily demand.

Mr. BARTON. Mr. Plank, you are at a little over 1 minute over the 7 minutes. I have read your testimony, and if you could try to summarize it in the next minute.

Mr. PLANK. All right. We will put it this way. We have got a bit of a ticking time bomb here, gentlemen, and your job isn't finished. The energy markets are not fractured. They are broken.

We could come a long way, but before you rebuild and improve regulatory structure or before you turn it loose for the cars to go down the streets of Washington, DC at 100 miles an hour instead of 20, we better do the counterpart of what was done in New York City.

They cleaned up ground zero before they are going to start building on it again. There is an age old principle to this old bomber pilot in the South Pacific, and to a father who said to me, son, when you grow up, I hope you will remember this word of advice.

There are a lot of very smart crooks around. The interesting thing is that they would have done a lot better for themselves and for the country if they had been honest in the first place.

There is an ethical problem here, and there is a moral problem here; the citizens of the United States understand it the more clearly as a result, Mr. Chairman, of 9/11. I hope the committee will take that into consideration as they deal with these problems. Thank you very much.

[The prepared statement of Raymond Plank follows:]

PREPARED STATEMENT OF RAYMOND PLANK, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, APACHE CORPORATION

Mr. Chairman and Members: Thank you for the opportunity to speak to the committee today.

My name is Raymond Plank, and I am the Chairman and CEO of Apache Corporation. In five decades in the oil and gas business, Apache has grown from one of the smallest to one of the larger independent producers.

Natural gas is the single most important domestic energy source—an abundant resource that warms millions of homes, fuels much of America's industrial base and plays a large and growing role in the nation's electricity industry. However, while many believe natural gas is the fuel of the future, I believe that future is in doubt because of the flawed structure of the natural gas market in this country.

The fact is the nation's energy markets skated by and escaped a disaster in the wake of Enron's collapse. Why? Certainly not because this market serves the nation's needs. No, we avoided a supply crunch because the recession and one of the warmest winters in recent history combined to keep demand in check. If the economy had been more robust, or if weather conditions had been different, the story could have been far different.

This is an issue that should be important to the other members of this panel because they have developed business plans, raised billions of dollars from investors and erected power plants based on the availability of reliable supplies of natural gas. The current market, marked by excessive price volatility, has undermined the ability of Apache and other North American producers to meet their requirements.

Mr. Chairman, I know you have worked hard to introduce competition into the nation's energy markets. But deregulation has been hijacked by traders, hedge funds and others who profit from volatility and who scorn the hardworking men and women who produce this important resource. If you don't fix the natural gas market, then all your efforts to bring competition to the electricity market will be for naught because natural gas is the fuel of choice for new generating capacity.

The uncertainty in the gas market caused by excessive price volatility endangers the infrastructure required to explore for and produce natural gas. Every time the price goes down and Apache and other companies cut back, skilled workers, from roustabouts to engineers to scientists, leave the industry. Drilling rigs are taken out of service and cannibalized for spare parts. Marginal wells are shut in, never to return to production.

Right now, the industry is not drilling enough wells to maintain production at current levels.

Yes, Mr. Chairman, Enron is gone, but the damage has been done to a vital element to the nation's economic security. In some ways, this is a homeland security issue: There is a sleeper cell out there, a ticking time bomb set to wreak havoc when the economy comes back and demand increases. I'd like to give you some background on how we came to our position.

For the last 10 years, our ability to find and produce the natural gas this country needs has been crippled by increasing price volatility. North America is a mature

producing province, which means that while there is still a great deal of natural gas to be found, producing it requires better technology, better science, more time and more money. Most of these projects take from 12 months to two years to complete. It is harder and harder to commit capital to these kinds of projects when we can't forecast what the price of our product is going to be tomorrow, much less a year from now.

Natural gas prices, like all commodity prices, run in cycles. That's been true as long as I can remember. Recently, however, as hedge funds and traders have come to dominate the market, the cycles have become shorter in duration and more pronounced. In press reports and presentations to analysts, these traders acknowledge that they derive their profits from price volatility.

The casino mentality that has taken over the energy markets has a real impact on the consumers as well as producers.

Let me give you a real example that we all remember.

In December 1999, we were paid less than $2 for a thousand cubic feet of gas. In January 2001, the price climbed to nearly $10, only to fall back below $2 by October. To put that in perspective, think about the impact on the stock market—and the American economy—if the Dow Jones Industrial Average took a trip from 10,000 to 47,000 and back to 10,000 in a year and a half. What would your constituents be telling you if the price of gasoline jumped from $1.20 per gallon to $6 and then back down to $1.20?

Last winter's price spike dealt a damaging blow to the industrial economy which in total accounts for 40 percent of U.S. natural gas consumption. Natural gas-intensive industries like steel, plastics and petrochemicals significantly curtailed or shut in production in response to extremely high gas costs. Some of this demand has been permanently displaced. In addition, natural gas volatility played a key role in California's energy problems. The consequences for the economy due to overheated gas prices are painfully clear.

But when the price falls back to $2 per thousand cubic feet, the capacity of the industry to supply natural gas is diminished—permanently. One consequence is a brain drain in the industry. The average age of oil and gas workers is 48 years old. As young engineers and scientists seek opportunities elsewhere, the nation will lose its technological edge in this industry.

When prices fall, companies like Apache reduce their drilling expenditures and seek more profitable avenues for investment, usually overseas.

As a consequence, I can assure you that the next price spike is just around the corner. It may not come until this fall or next winter, but it is inevitable and it could be severe.

As much as we know about getting natural gas out of the ground, there are many things about this market that have been hidden from view by powerful insiders who profit from its opacity. We can't find the answers because we don't have subpoena power. It's up to you to break through some of these Chinese walls and get to the bottom of this structurally flawed market.

Now, I'd like to discuss some of the most glaring problems with this market and our suggestions on fixing it.

Every month, the price we get for our natural gas production is based on indices published in one or more trade publications. The reporters who compile these price indices are hard-working, honest journalists, but their sources—the pipelines, utilities and marketers—are under no obligation to provide complete or even accurate information. Similarly, the American Gas Association's weekly storage report became a major market event because it was a proxy for supply and demand data but it was based on voluntary, self-serving data.

In a market as important as the natural gas market, the government should collect and disseminate real-time information on natural gas supply and demand from market participants, with penalties imposed for failing to file accurate reports.

Even some energy marketers acknowledge that the current rules give unfair advantages to integrated energy companies with their regulated pipelines, unregulated marketing affiliates and electric generating units. While allegedly separate, these people go to work in the same office building, share coffee—and benefit from the same corporate incentive systems.

The current rules governing the conduct of regulated and unregulated affiliates are weak and subject to abuse. To prevent the trading of insider information, these functions should be geographically separated and their dealings limited to real transactions with real money changing hands. If companies abuse these rules, they should be required to divest their unregulated affiliates.

Online trading platforms, which operate outside the longstanding framework that regulates commodities exchanges, provide their operators with vast information

about the trading positions of other market players which can be used to manipulate the market.

These online platforms are exchanges; they should be subject to similar regulation to ensure fair treatment of all parties. In the equities market, there is a basic rule that agents cannot put their trades ahead of their clients' transactions; similar rules should guide the conduct of the energy markets.

The bright light of Wall Street cast on energy marketers in the aftermath of the Enron collapse revealed them to be overleveraged. They rely on mark-to-market accounting of energy contracts that allows them to book the revenues and profits of long-term contracts up front, long before the revenues are collected and the profits realized. Though they appear profitable on the surface, a closer examination reveals that the profits may prove to be illusory. The current system incentivizes traders to book deal after deal, seeking profits from every move in the market and distorting legitimate supply and demand signals.

End mark-to-market accounting and require traders to book their revenues and profits when they are realized. Impose capital requirements to assure customers that the traders will be there to deliver the gas and electricity.

Some would have you believe that the fact that a company as large as Enron could fail without causing any disruption in the energy markets is a signal that these markets are deep and liquid. I disagree. I think it demonstrates that Enron and others like it add no value.

I also believe that failure to reform this market will cause lasting damage to the nation's energy infrastructure and economic health.

Mr. Chairman, you have before you the record of the fall of Enron—the self-dealing, the subterfuge and the apparent fraud. I think it's fair to ask whether the same behavior permeated Enron's biggest business—its natural gas and electricity trading operations. Once your committee answers that question, I hope you will conduct a thorough examination of the structure of the energy market and make the changes necessary to ensure that there are not other Enrons out there, waiting to happen.

The task before you is clear: To introduce effective oversight and transparency in this market and restore the environment that will encourage producers to make the investments to meet the nation's vital energy needs.

Thank you very much for the opportunity to be here today.

Mr. BARTON. Thank you, and I will provide a Washington translation of the straight Texas talk that you just gave us, since I am also a Texan. I will translate that into Washington legalese so that the audience will understand some of those words that you put before us.

We now want to hear from Mr. Gerald Norlander, who is the executive director of the Public Utility Law Project. Your statement is in the record, and we would ask that you elaborate on it in 7 minutes.

STATEMENT OF GERALD A. NORLANDER

Mr. NORLANDER. Thank you, Chairman Barton. In addition to being the executive director of the Public Utility Law Project, I am also the Chairman of the Electricity Committee of the National Association of State Utility Consumer Advocates, also known as NASUCA.

And we didn't have enough time to put together a NASUCA position on this today, and so I am speaking for PULP, Public Utility Law Project. We represent low income consumers, primarily up in New York State, on issues affecting universal service, consumer protection, and affordability.

Although most eyes were turned toward California last year, we had a near-California experience in New York City with respect to the deregulation plan that was put into effect and implemented there.

That was the plan that was very much like the model that Enron had proposed and the effect of that in the summer of 2000 was a

1-month jump of 43 percent in consumer bills. There were hearings, and consumers living day to day with just a few dollars of discretionary income for themselves, just simply can't make ends meet with bills like that, nor could businesses.

And the hearings were crowded by business people whose business plan was spoiled. People who ran grocery stores, and ran coolers, and things like that, had no remedy whatever from the price spikes.

And subsequently the utility which was buying the energy for the consumers in primarily the spot market, didn't know what had been going on, subsequently said they had been buying from only 2 or 3 sellers at times and locations in the city.

And they went to FERC under the prior administration I might add, and couldn't get relief. And I would like to point out that under current leadership at the FERC, we are quite pleased that one utility in New York called a runaway train heading for disaster, and that has at least been slowed down.

And I think they are beginning to ask the correct questions about market manipulation in the spot markets, and about the standards for granting market based rates. I would urge the committee that in looking at this that we apply a different test, and which is not that we will do harm to the markets, but will we do harm to the people.

And people who demand and expect reasonable rates under the old law, which is still law, were quite sensitive to that in New York, because New York never changed its law, and the Commission went out and asked the utilities to divest their plants, and then buy back the energy for consumers in the spot markets.

The theory urged by Enron, and that is why I bring this back to Enron, is that it was their model that—and certainly others bought into it, that we would have a spot market and it would be volatile, but it would be efficient, and it would be competitive, and the marketers would come to the rescue when the volatility got to be too much.

And I think they are wrong on just about every count, at least so far, in our ISO markets. And we have markets that are riddled with market power. We don't have enough sellers. It seems to us from our look at the problem that we simply don't have enough sellers in these markets, and that the traditional anti-trust screens are not sufficient in the electricity markets.

So that an entity that passes the traditional tests will still be able with their friends to bid up the markets in these spot markets without conspiracy, and without overt manipulations.

So if we are out looking for smoking guns and really bad conduct, and price rigging, we may not see it. What we may see is a system that is not generating an efficient price. Now, the markets were relied upon too soon I think without looking at things like reliability, the costs of going forward in them, market design, and whether we had remedies.

And I think that today you have asked what remedies might we look at. We think that a good remedy would be, or would help us get to that test, and are consumers going to be better off.

We should have the regular reporting of costs by generators. What does it cost to run the machine, and they don't have to bid

that perhaps, but when something goes wrong, or when there needs to be an investigation into the market, not only is the information readily available, but there is a reset or fallback price that can be utilized to correct a market power problem.

I think that in the States that haven't done this yet, they are going to be looking very carefully at whether these new measures of FERC will indeed control market power at times of shortage.

We are also seeing a situation where the reliance on the new market to bring new plants is a major question. We had a situation where 19 plants were on the list to be built in New York, and last week in an article reminiscent of Willie Nelson, that says turn out the lights, the party is over. They say that about half of those plants will look like they are going to be built now.

New York does need new energy supply. It didn't come and we had to build and have the Public Power Authority from the State come in to build the emergency plants in the last couple of years.

We are concerned that with Enron that some of the marketers like Enron will go bankrupt. We had that happen with a gas marketer in Buffalo, and 19,000 people lost a contract, and many off them had paid in advance, and their money is in the bankruptcy court and the bank has a priority, has a secured interest.

And so they had to pay twice. On a larger scale, Enron seems to have defaulted on some of its retail contracts in the Chicago area, leaving consumers holding the bag and fortunately being able to go out in a low market and replace what had been breached.

Now, NASUCA, in its resolution last summer, recommended that the FERC adopt measures to provide a cost-based fallback when market power is found, and we do believe that that is a corrective measure that is very important for FERC to pursue. We think that from a legislative prospective we need to look at the problem of market power in these unique electricity auctions as a particular problem.

And I think that the problem of mergers I think is one of the major problems, and that if we go to the effort to get more sellers in through the larger markets, we are going to spend a lot to get larger markets and more people selling. And if at the end of the day if sellers can merge, we are back where we are today. Thank you very much.

[The prepared statement of Gerald A. Norlander follows:]

PREPARED STATEMENT OF GERALD A. NORLANDER EXECUTIVE DIRECTOR PUBLIC UTILITY LAW PROJECT OF NEW YORK, INC.

I am Gerald Norlander, Executive Director of the Public Utility Law Project.[1] Thank you for inviting me to testify on the effect of Enron on energy markets, and for the opportunity to suggest remedial measures. PULP is a nonprofit organization, created by community organizations during the 1970's energy crisis, to represent the interests of low income utility consumers. We focus our efforts on matters affecting universal service, consumer protection, and affordability. Our website is: www.pulp.tc

I am also Chairman of the Electricity Committee of the National Association of State Utility Consumer Advocates (NASUCA). NASUCA is an association of state utility consumer advocates from 43 states, and has several members from nonprofit organizations such as PULP.

We did not have time before today's hearings to develop specific NASUCA positions on the impact of Enron on energy markets, and so my remarks today are on

[1] My curriculum vitae is attached as an exhibit to this testimony.

behalf of PULP. In the course of my testimony, however, I will mention the NASUCA resolution on the problem of market power in the energy markets.

The hasty rush to restructure the electric industry is now characterized by higher rates for consumers in California and New York City, which experienced 43% bill increases in the Summer of 2000. Last year, I pointed out in an article that the electricity restructuring "Juggernaut" had already ground to a halt, and observed that the legendary Juggernauts of India crushed overzealous worshipers. I argued that much more attention must be given to consumer concerns such as rate stability and predictability, universal service, consumer protection, and affordability.[2] The halt or slowdown of restructuring in the states had already occurred well before the collapse of Enron, but restructuring adherents had still urged staying the course. Consumers were promised that even if rate decreases were not in sight, after a period of higher rates, competition would lower them at some unspecified future date. Customers were exhorted to "let go" and trust the market and that the trust would grow with experience. That panglossian optimism evaporated with the fall of Enron. Paraphrasing a great Texan, Willie Nelson, the New York Times titled a recent article reviewing New York's restructuring experience "Turn Out the Lights, The Party's Over."[3]

THE PRE-BANKRUPTCY IMPACT OF ENRON ON ENERGY MARKETS

Enron was a major driving force in an effort throughout the country to restructure regulation of wholesale and retail electricity prices, replacing cost-based regulation with market mechanisms widely assumed to yield better results. The key element of the model was the creation of volatile wholesale spot markets under federal, not state, control.

Once the spot markets were established, Enron offered respite from the price volatility they introduced, through long term energy contracts and financial derivatives at Enron Online. Enron claimed to be able to hedge energy prices either through contracts or energy market derivatives that would protect wholesale buyers from future market price volatility. Similarly, in the retail markets, it was assumed that Enron and other marketers would smooth out the volatility that had been introduced by the old utilities, which in the past had striven to make rate changes glacially.

Enron avidly supported wholesale spot markets with high volatility and without upper limits on price sellers could demand, and participated in the spot and bilateral wholesale markets in New York and other states as a buyer and a seller. In addition, in some states, Enron affiliates sold energy and energy services to retail consumers.

Enron generally called for states to introduce retail competition, and to begin passing through of wholesale spot market prices to retail consumers who had not yet left the incumbent utility provider. Under the model, the utility would sell its power plants and cease efforts to hedge forward prices for its remaining retail customers. Competitive interstate energy companies, including Enron affiliates, would then offer retail consumers respite from the volatile pricing.if they preferred predictable, stable rates.

Electricity spot markets, so critical to Enron's strategies, were created, with varying degrees of attention to:

- *Reliability*—the challenge of mirroring additional market transactions in an already complex electricity grid that was not physically designed for that purpose,
- *Cost*—is it worth enormous expense to modify the electric grid in transmission constrained areas—ostensibly so more sellers can compete in presently constrained areas—when at the end of the day, as wider geographic scope is created, market power may be maintained by reducing the number of sellers, through merger and consolidation?
- *Market design*—did market rules ensure efficient pricing and adequate information?
- *Market power*—could the new markets be "gamed" by bidders?
- *Remedies*—are regulatory tools sufficient to protect the public from market failure, exploitation, and results inferior to traditional regulation?

All of the federally approved spot markets created to date have been found to be vulnerable to the exercise of market power.

[2] "Disconnected Policymakers," *The Electricity Journal* p. 22 (Aug./Sept 2001). A copy of the article is attached.

[3] *The New York Times,* Feb. 10, 2002. A copy of the article is attached.

THE POST-BANKRUPTCY IMPACT OF THE ENRON BANKRUPTCY

It is probably too soon to assess the full impact of the Enron bankruptcy on energy markets. The information needed to determine the full impact of the demise of Enron is not publicly available. Some reports suggest that wholesale energy prices, to date, may not have been significantly affected by the Enron bankruptcy. The market role of the special purpose entities and partnerships created by Enron is unclear. The first "JEDI" partnership with the California Public Employees Retirements System apparently was a party to some energy transactions.[4] It is possible that partnerships or special purpose entities were the ultimate counterparties of some of Enron's wholesale energy market-making activities. If so, the question arises whether there are some still-outstanding forward contracts held by Enron or the partnerships, and whether those will be honored. There is no answer without access to the books of the partnerships, which apparently are not in bankruptcy. Some parties with contracts for energy to be provided by Enron may have "unwound" their positions, and may fortuitously have found substitute supplies at low cost from other sources in the energy markets, which are currently characterized by surplus and low prices. Some Enron contracts may still be fulfilled in vestigial operations now taken over by a successor. It has been claimed that Western wholesale electricity prices actually dropped due to the demise of Enron. Further investigation is needed.

Enron retail energy services contracts are reported to be cancelled, adversely affecting some consumers who had long term contracts that will not be fulfilled:

> "T]he guaranteed prices and energy-bill predictability that Enron offered have evaporated along with the energy-trading giant's profits. Amid the rubble of Enron's bankruptcy, some of Chicago's most prominent corporate and civic names are now moving to find a replacement for Enron, who had sold them contracts worth hundreds of millions of dollars stretching over several years or more."[5]

The Enron bankruptcy has been followed by major financial setbacks for other market participants.[6] This could lead to more mergers, a consequent reduction in the number of electricity suppliers, and a slowdown in the building of new generating facilities. If there is an insufficient number of sellers to make markets competitive, this could have serious future policy impacts.

If, as Enron asserted, it was stabilizing energy prices in the forward markets, it remains unclear whether future electricity and natural gas prices will become more volatile, and whether the wholesale markets will be characterized by more frequent periods of boom and bust. Such volatility could cause new problems down the road for both business and residential consumers.

The majority of states that have not restructured their electric industries as urged by Enron are now even more reluctant to accept on faith that if they allow their utilities to sell off their generating plants, "the market" participants like Enron and generators like Mirant and Reliant will actually provide the future supply and price stability needed. Similarly, consumers may have even less appetite to risk the major rate instability and price increases experienced in California and New York, for relatively little in the way of promised savings.

The larger question for Congress is whether the public can have confidence that federally approved wholesale markets and market-based rates are free from strategic bidding, gaming or manipulation. Market-based rates established in or influenced by federally approved spot markets must yield results as good or better than traditional cost based regulation to satisfy the existing statutory command to establish reasonable rates.

At Enron's urgings, heavy reliance was prematurely placed on some markets flawed in design, vulnerable to market power, and without effective remedies. Enron is currently under state and federal investigation to determine whether it and others manipulated the markets to drive California ISO energy prices up to unprecedented levels in 2000 and 2001. Congress should lend its powers to see that this issue is cleared up.

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[4] See Report of Investigation By the Special Investigative Committee of the Board of Directors of Enron Corp. ("Powers Report"), p. 5 (Feb. 1, 2002).

[5] "Enron's Former Customers Try to Find a Replacement," *Chicago Tribune,* Feb. 8, 2002.

[6] See, *e.g.,* "Reliant Energy Unit Startles Market with Accounting Issue," Houston Chronicle Feb. 6, 2002 ("[T]he accounting problem involves purchases of natural gas and electric power that were made by its wholesale energy group"); "Utility Company Mirant Tries to Recover from Enron Debacle, Economic Downturn," *Atlanta Journal Constitution,* Feb. 11, 2002 ("Its stock price has lost about 80 percent of its value from its high point"). Copies of these articles are attached.

The theoretical goal of the spot markets is that competing generators will bid to sell their output at their marginal running costs, recovering their investment and earning a fair return to the extent their plant is more efficient than the least efficient unit called to run at any particular time. A major flaw detected in the spot market models, however, is that strategic bidding ("gaming") can readily occur, even at non-peak times by sellers who do not have a large market share. Despite this, markets are being approved with too few sellers using obsolete or inapplicable screens to test for anti-trust compliance.

Mathematical analysis and game theory has shown that many participants are needed before spot auction markets, and the bilateral markets informed by spot prices, can possibly be competitive.[7] Characteristics of electricity and the repetitive nature of the auctions permit participants to establish a Nash equilibrium mutually benefitting the players, (without overt cartel price-fixing or anti-trust conspiracy), through strategic bidding. This is not limited to the most extreme bidding behaviors noticed at times of peak system demand. Recent economics laboratory simulations of electricity spot market auction bidding behavior found that rates could be driven 50% above cost, with or without price-caps, confirming the need for many more sellers, and the inadequacy of federal agency policies that still rely on traditional notions about what constitutes a sufficient number of participants and maximum market share.[8]

The Committee has requested suggestions regarding information disclosure and for making markets more transparent. States that have not yet restructured, and customers throughout the nation, can have no confidence that proposed new federal markets would be better than traditional regulation if there is no information upon which to measure the difference, and no fallback price readily available when the markets fail to yield reasonable rates. NASUCA in its Resolution 2001-01 urged "cost-based price regulation and/or other appropriate means of mitigation in any wholesale market where rates are not demonstrably and reliably just and reasonable."[9] Similarly, PULP has urged that generators file their running costs as a routine matter. This information disclosure will facilitate prompt analysis of bidding behavior in the markets and provide the necessary information upon which remedies can be based.

CONCLUSION

Five years ago consumers were given the impression that the electric industry restructuring urged by Enron would offer at least as good or better service at a better price than traditional cost based regulation.

A year ago, after California, they were told to be patient, they "may have to pay higher prices, before they pay less," but to "let go," it was only "a matter of trusting the free market and trusting free-market entrepreneurs. Trust grows with experience."[10]

After Enron, the lesson is that restructuring, while it may be beneficial to some industry stakeholders, does not appear to be a value proposition for the ordinary consumer.

Before going any further to restructure the electric industry, Congress needs to do more to assure universal service, consumer protection, and affordability of energy for ordinary energy consumers.

Thank you for the opportunity to present this testimony. I look forward to any questions from the Committee.

Mr. BARTON. Good. Thank you very much, Mr. Norlander.

We are now going to hear from Mr. McCullough, who is from Portland, Oregon. He is the managing partner in McCullough Re-

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[7] Mathematical findings by the Tellus Institute showed that under many conditions twenty equal-sized generation owners might be required to create competitive outcomes. Rudkevich, Duckworth, and Rosen, *Modeling Electricity Pricing in a Deregulated Generation Industry: The Potential for Oligopoly Pricing in a Poolco. Energy Journal,* (July 1998).

[8] T.D. Mount et al., *Testing the Performance of Uniform Price and Discriminative Auctions,* presented at the Rutger's Center for Research in Regulated Industries 14th Annual Western Conference: Advanced Workshop in Regulation and Competition, Competitive Change in Network Industries, San Diego, California (June, 2001).

[9] Resolution 2001-01, "Urging That The FERC Employ Price Regulation and/or Other Mitigation Measures Where Effective Wholesale Competition Does Not Exist, And Where Market-Based Pricing Therefore Does Not Produce Just And Reasonable Rates" *National Association of State Utility Consumer Advocates,* (June 19, 2001). A copy of the NASUCA resolution is attached.

[10] "Disconnected Policymakers," *The Electricity Journal* p. 22 (Aug./Sept 2001).

search, and we will put your statement in the record, and we will give you 7 minutes to elaborate.

We have a vote, a 15 minute vote, and if you were actually to give us about 4 minutes, we might actually be able to let each member take one or two questions, and then adjourn the hearing. But if that doesn't work, we will come back about 6 o'clock. So I put you on your behavior.

STATEMENT OF ROBERT MCCULLOUGH

Mr. MCCULLOUGH. Mr. Chairman, I can't talk as directly as a Texan, but I will move fast. Thank you, Mr. Chairman, and thank you members of the committee. I am addressing directly Enron in California.

California was a bad design, bad incentives, bad results. Enron was a major player in the creation of the system, and had a large market share, and we have some evidence that their ethics may be in question.

We don't yet know how far that goes, but obviously we are going to have to wait until the investigation at FERC and the SEC runs its course. We have had 20 years of a good power market on the West Coast. It wasn't created by Enron.

It was created by the availability of real power, Mr. Plank, in excess because of the Columbia River. It has lasted through droughts, and it has lasted through earthquakes, and it has lasted through resource shortages, and it has lasted through high fossil fuel prices.

It was very stable with one exception. Last year, we had a series of price spikes and emergencies. If we now look at the WSEC, Western Systems Coordinating Council, reports, we now discover that our load resource situation was better last year than it had been for the previous 5 years.

Moreover, the Columbia River was at 92 percent of average flows, and not good, but not in fact a crisis during the initial summer of the California problems. In 1994, we had less resources, more load, and a lower river, but we didn't have blackouts.

The bottom line on it is real simple. We had a situation where it was easy for the incentives to go the wrong way and that led us to generators bidding into the California PX, but led us into emergencies on an ongoing basis.

Chairman Wood and FERC implemented price controls, and suddenly plant operations improved, and the prices fell. Now, I am a price theory economist, and I am not someone who likes price controls. They don't work in a competitive market, but we didn't have a competitive market in California.

Do we know that Enron was responsible? No. We won't know more until we get those investigations. Do we know that they seem to have had enough market share to have price leadership? The answer is yes.

We know that we have long-term pricing problems throughout the industry on the west coast, and prices that had left the just and reasonable standard, and that they were a multiple of what they would have cost to build a new power plant.

That is worrisome, and we need to get to the bottom of it. The bottom line is that we need to know more. Transparency is not simply a goal. Practical issues need to be addressed. We need to know

market shares. We know those in regular markets, but we don't know them on the West Coast.

We need to know whether or not one party is driving the prices or whether it is an open and competitive market. Those are issues in front of Chairman Wood, and I trust he will do a good job. Thank you, Mr. Chairman.

[The prepared statement of Robert McCullough follows:]

PREPARED STATEMENT OF ROBERT MCCULLOUGH, MANAGING PARTNER, MCCULLOUGH RESEARCH [1]

Thank you for your invitation to testify.

Six words characterize the California market since April Fool's Day, 1998—"bad design, bad incentives, bad results". The market was overly complex, checks and balances were absent, information (except to suppliers) was virtually non-existent, and market concentration was very high. This is an expert's list of the factors that lead to market failure.

Enron had a strong role in this market. Enron also had a central role in designing this market. Since Enron's accounting practices have failed any sensible business ethics test, the question we will have to wrestle with in days to come is whether the ethical problems we have seen at LJM and Whitewing will surface in its commercial transactions as well.

It seems very likely that Enron had the ability to affect prices in California. This is not an indictment of free enterprise. Market power is a continuing problem in competitive markets. In California we do not have ready access to market information as we do in other markets. What little we know makes a careful review of Enron's role very necessary.

A BRIEF OVERVIEW

Market based pricing for short term markets started in 1980 on the West Coast. This was the first time we had seen an open, competitive market in the electric industry. We weren't entirely pleased. The Bonneville Power Administration averages a "non-firm" surplus of nearly 3,000 average megawatts on a yearly basis.[2] Traditionally BPA had allocated this surplus among its customers.

After the passage of the Pacific Northwest Electric Power Planning and Conservation Power Act of 1980, with its complex rate provisions, BPA decided to market this power on a monthly basis. A number of BPA customers actually litigated against this decision, but the Ninth Circuit found in favor of BPA's discretion.

After the first two years of this arrangement, other Pacific Northwest utilities began to appreciate the benefits of an open market. For example, we introduced the first commodity/electric derivative in 1982 and 1983, in part because access to the new market gave us new choices. Known in the markets as "variable rates" this is now the standard approach across the world for energy-intensive industrial customers

California utilities hated the idea since prices tended towards the running cost of the highest cost unit along I-5 as opposed to the extremely low embedded cost of the Columbia River dams.[3] After a number of cases before FERC, the WSPP (Western Systems Power Pool) experiment was put in place in 1987. This allowed members of the WSPP to buy and sell short term energy without FERC cost based regulation. In 1991, market based pricing for short term sales became permanent.

By this time we had established a competitive market in energy across the WSCC. The market was open—any buyer and any seller could enter and exit the market at will. California's barriers to market entry—rules and regulations that made participation difficult—were years in the future.

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[1] Special thanks to Ann Stewart assistant director of the Harvard Electricity Policy Group and James Harding of Seattle City Light, City of Seattle for detailed comments and input.

[2] Non-firm and secondary are terms of art in the Pacific Northwest that mean firm power that may not be available during the following year if a drought occurs. Electric utilities are not allowed to use "non-firm" power in their planning to meet system peaks.

[3] The geography of the West Coast is divided into the "west side"—the major cities from Vancouver, British Columbia to San Diego—and the "east side"—the utilities nestled into the Rockies. For transmission reasons, the I-5 corridor is the most integrated. The reliability of the western half of North America is in the hands of the Western Systems Coordinating Council (WSCC). Market participants often use WSCC as a shorthand way of describing the market from Edmonton to Tijuana.

Data from this period is not hard to find, but since there was no centralized reporting, it tends to be taken from the books of the individual utilities rather than a central source. Commodity/electric derivatives and spot pricing contracts were common and this provides much of the data on the monthly spot markets. Because of the vast ability of the Columbia River to factor off-peak energy, the real time markets were not (and still aren't) terribly important.[4]

Almost all transactions in the market were monthly. This is still the case today. Short term transactions tended to reflect special operating issues—plant outages and load spikes. Longer term transactions were common, but these tend to reflect alternatives to resource purchases. Due to a peculiarity in BPA's enabling legislation, five years was a logical time horizon for forward transactions.[5] We have little organized data on long term costs. Bonneville's often issued "future focus" diagram gives a sense of the overall firm costs since 1980.

From 1980 through 1996, long term prices fell from $75 per megawatt-hour to $18. In the late 1990s, BPA frequently expressed its concern that market competition might expose it to bankruptcy. By comparison, a five year transaction today will cost a wholesale customer $28 per megawatt-hour. One year ago, the same transaction would have cost a customer $80 to $100 per megawatt-hour.[6]

The wholesale market was surprisingly stable before May 2000. In spite of three major droughts, fossil fuel price spikes, and true resource shortages in the early 1980s, prices reflected the operating cost of the least efficient unit currently operating. In the past twenty two years, this rule was only violated from May 2000 to June 2001.

West Coast markets reached their greatest level of competition in 1996 and 1997. At that time there were more than twenty active competitors. Today, by comparison, there are usually very few players in the long term market. In the absence of PG&E and SCE, California is only represented by Sempra. Enron was present until its bankruptcy and Morgan Stanley, Calpine, El Paso, and Aquila continue to be active. Many Pacific Northwest utilities have dropped out of the market. Idaho Power and Powerex are still active, but Powerex is very cautious and requires board approval to make deals. On the Canadian side of the market, Edmonton and TransAlta have largely dropped out as well.

Long term transactions have tended to be complex in an effort to capture transmission and operating advantages. The PX/ISO structure discourages that level of optimization. More importantly, the winter of 2000-2001 led to the ISO breaking most of the interregional agreements on "operational emergency" grounds. Overall, the choices available to ultimate consumers like utilities and industries have diminished markedly.

CALIFORNIA'S MARKET EXPERIMENT—"BAD DESIGN"

Prices increased almost immediately after the California experiment started. One reason was the elimination of the buying power of Pacific Gas and Electric. Prior to that time, PG&E's enormous buying power allowed it to dictate prices to the market for much of the year. Since it was a net buyer, it negotiated ferociously to keep wholesale prices as low as possible.

Another reason was the enormous complexity of the California market. Enron was a major participant in the process that created two state agencies—the Independent System Operator and the Power Exchange—to run the market. While Enron's involvement in the CPUC process and the negotiations leading to the passage of AB-1890 was significant, it was just one of many groups that maneuvered for advantage in this byzantine process.[7]

While this observation is unpopular with the proponents of "market design", the sheer complexity of the California market (and equally complex institutions elsewhere) discouraged suppliers from entering. As late as a year ago, a confidential ISO report (posted on its web site) noted that even PG&E was unable to understand

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[4] One of the ironies of the failed California centralized market experiment is that it concentrated on a part of the market that might never have gained prominence without California's disastrous prohibitions on forward markets.

[5] BPA must include a "pullback" condition in its long term contracts for sales outside the Pacific Northwest. While there are exceptions to this rule, it tended to make the five year duration a logical choice in the market.

[6] Newcomers to these markets often confuse current events—weather and streamflows—with long term prices. Since weather, streamflows, and plant outages are unknown and unknowable for future years, prices reflect fundamental conditions of supply and demand as opposed to current events.

[7] Enron's central role in the CPUC hearings, passage of AB-1890, and the prolonged implementation process has been carefully detailed by Eric Woychik in "Enron—'Leader of the Pac' in California", February 6, 2002.

ISO operations. Many utilities and marketers elsewhere in the WSCC were in the same boat. Participation in the ISO requires a detailed knowledge of hundreds of thousands of pages of rules, regulations, protocols, studies, directives, investigations, and committee reports. Literally, thousands of individuals either work at the ISO or are committed to its "stakeholder processes" on a daily basis. Even large utilities have found the resource commitment to enter this market daunting.[8]

On April 1,1998, the new California market was launched. One unforeseen side effect of the rules was the complete irrelevance of the retail side—the original goal of the entire process. Enron, although initially aggressive in the retail market, dropped out after just a few months. This decision proved clairvoyant since the difference between market prices and retail price was one of the most catastrophic features of the California crisis for entities trying to serve retail load.

May 22, 2000 was the beginning of the California crisis. Everyone has heard the slogan that "California hadn't built a plant in ten years while rapid load growth had taken place." Enron's representatives have repeated this refrain throughout the entire debate concerning the California crisis. This slogan was audacious in its mendacity.

In reality, the industry was in better load/resource condition in the summer of 2000 than it had been in some time. Peak loads were lower and total resources were higher than in previous years. The following chart shows actual reserve margins in the WSCC from 1992 to the present.[9]

The reserve margin is the ratio between electric resources and peak loads. Like the ratio between snacks and hungry teenagers, the reserve margin is better when it is high. Industry practice is to keep the reserve margin above 15%. As the chart shows, reserve margins in the WSCC reached as low as 15% in 1994 and actually crossed this line in 1998. Columbia River runoffs were 20% lower in 1994 than they were in 2000.

The source of this data is the Western Systems Coordinating Council yearly reports summarizing the past year and the upcoming decade. The WSCC provides these reports because it is responsible for preparing the authoritative load resource balance for the western half of the continent—Canada, U.S., and Mexico—in order to ensure electric reliability. They have been preparing these studies for the past 35 years.

The chart illustrates a simple truth. The WSCC's load resource balance was better (more snacks than teenagers) in 2000 than it had been since 1993. A large part of this was the low peak loads that occurred in California that year. Peak California loads in the ISO's control area in 2000 were the lowest since 1997.[10]

When faced with this data, proponents of the resource shortage theory usually fall back on two secondary explanations. First, the crisis in California was caused by the drought in the Pacific Northwest, and second, that environmental authorities forbade plant operations. While there is a little more truth to these arguments than the resource shortage argument, they turn out to be very, very weak. While the Pacific Northwest did have roughly normal water in 2000, the severe drought actually occurred in 2001. The worst of the drought occurred after price controls had gone into effect and prices—both short and long term—had fallen to historical competitive levels.[11] The environmental argument blames low plant operations on local environmental rules. In fact, the environmental authorities granted exceptions, changed market rules, and accelerated permits. The comments of two of the most important districts, L.A. and San Diego's, on February 6, 2001 used very blunt language to describe the value of the generators' claims.[12]

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[8] Paula Green, power manager of Seattle City Light, has estimated that contract administration costs in California were as high as 10% of the total energy cost.

[9] WSCC Coordinated Plan Summaries from 1993 through 2000. Monthly data for 2001 are a forecast from the 2000 Coordinated Plan since this data has not yet been released by the WSCC.

[10] Historical Coincident Peak Demand and Operating Reserve, California Energy Commission, December 7, 2000, page 1:

1997	44,059
1998	44,406
1999	45,884
2000	43,784

[11] Hydroelectric generation in the 3rd quarter of 2001 was only 74% of hydroelectric generation the year before. In spite of the low hydro in the summer of 2001, prices returned to normal.

[12] February 6, 2001 letters by Barry Wallerstein (SCAQMD) and Richard Smith (San Diego APCD). Mr. Wallerstein's letter includes the phrase "[t]hese statements by AES are completely false and call into question AES' motivation in this matter."

MARKET FAILURE—"BAD INCENTIVES"

A simpler explanation lies ready to hand. Starting in 2000, the WSCC had established a database showing the hourly plant operations of many of the plants on the West Coast. The California ISO provided plant data to the WSCC which, in turn, provided it to any interested WSCC member. While secrecy of operating data is a cornerstone of the California market design, the practice of secrecy at the ISO was unusual. The ISO provided this secret data in contravention of its FERC filed tariff throughout the summer and fall of 2000.[13] Any market participant equipped with this data would be able to easily adjust their operations to accentuate the California ISO's problems during an hour when demand was high. Curiously, Portland General Electric, Enron's subsidiary, did not contribute data to the database. Enron had access to the data of others, but did not welcome access to its own plant operations.

The California ISO has provided numerous charts that show that as its system approached peak, supplies offered to the California PX would begin to drop off. The resulting deficit would become an operating problem at the ISO. Once emergency conditions were declared, prices would skyrocket and supplies would reappear.

Documenting this was not easy. During the first part of the crisis, the generators' representative was the Chairman of the ISO board. ISO market surveillance was rudimentary and timid. Generators' lobbying at the WSCC made access of the operating data to non-market participants slow and controversial.

Ironically, the hourly data is public outside of California—even today—as part of the EPA's emissions database. Unfortunately for the ratepayers in California, access to this data is usually delayed from three to five months.[14]

The following chart shows the monthly operations of the units owned by Duke, Dynegy, Southern, Reliant, and AES over this period. While plant operations in the rest of WSCC reached 100%, plant operations for the groups who have primarily profited from the crisis averaged 50.3% from May 2000-June 2001. Interestingly, plant operations were actually slightly higher for the three months that followed price controls, even though market prices were significantly lower.[15]

We have been unable to explain the hourly operations of these five generators even after enormous effort. Frequently, plants went undispatched during system peaks and even during ISO declared emergencies. Whistleblowers from the plant operations staff have indicated that their directions from management were inexplicable. Operations at plants outside of California have shown none of these problems. In fact, outside of the plants in the chart above, operations have been as close to 100% of capacity as the owners could reach.

From November until the onset of price controls, the five generators reported massive plant outages. The ISO did not reliably solicit or record plant outage data until 2001, so it is difficult to compare the outages in November 2000-May 2001 with previous years for the same plants. Detailed historical data on the performance of similar plants—by age, size, technology, and fuel—are accumulated by the North American Electric Reliability Council. Its data shows vastly lower outage rates on similar equipment.[16]

IMPLEMENTATION OF PRICE CAPS—CORRECTING "BAD RESULTS"

While predictions of widespread blackouts were common through the spring of 2001, FERC's decision to implement a WSCC wide price cap appears to have had a significant impact on plant outages, short term prices, and long term prices in the late spring. As always, shifts in long term prices are the most interesting, since they are not affected by weather or other operating problems.

The onset of price caps in June led to the larger of the West Coast's two long term price reductions in 2001.

The success of the price caps can be seen immediately. The presence of a counterweight to California's fragile power markets almost immediately returned long term prices to the levels we have seen for the past twenty years. As FERC's recent report notes "the average price (both simple and weighted) at which the Western utilities sold power in the daily spot market was significantly below the price cap of $92/

[13] California ISO Information Availability Policy, originally dated October 22, 1998, modified November 1, 2001.

[14] One of our first roles in the summer of 2000 included providing this "secret" information back to policy and regulatory agencies in California after it had been supplied to the Oregon Public Utilities Commission.

[15] This chart was based on data provided by the EIA. The EIA has faced substantial pressure to reduce the amount of such data available to public, as has FERC, the WSCC, and the North American Electric Reliability Council.

[16] NERC's Generation Availability Data System (GADS) can be used to review the history for any type of plant. It is available on NERC's web site.

MWh."[17] This is quite an understatement—by the end of June, prices had fallen to $43/MWh at Palo Verde.

While price caps are unlikely to work in a competitive market, the California market was hardly competitive. The incentives under AB-1890 rewarded shortages. Once the ISO entered an emergency, it offered prices five to thirty times higher than normal levels for emergency supplies. Once FERC eliminated the ISO's ability to pay such distorted prices, generators in California were rewarded by producing more rather than less electricity. All of the data indicates that once the incentives were repaired, plant operations improved and prices fell.

ENRON'S ROLE IN THE MARKET

Clearly, enormous concentration in California markets was required for this to take place. FERC does not accumulate the data necessary to show the degree of concentration on a systematic basis. FERC does require energy marketers to file quarterly reports. Enforcement of this provision is weak. Some marketers fail to file their reports. Others file their reports in illegible or illogical formats. Still others, like Enron, do not specify any detail on the hubs where they bought and sold electricity.

The following chart shows Enron's share of the major California hubs over time. The data used to generate this chart was taken from sales and purchases of major Enron trading partners who do show where Enron's transactions take place.

This chart matches our detailed research on Enron's trading activities.[18] Enron's market share—for both sales and purchases—increased dramatically in 2000. By the fourth quarter of 2000, the evidence from FERC's quarterly marketing reports indicated that their sales were nearly 30% of the market. As Enron entered 2001, the growth of their wholesale operations appears to have stalled. Overall statistics indicate that Enron's physical sales declined after 4th quarter 2000.

In almost any other commodity market a 30% market share is clearly sufficient to exercise price leadership. Pacific Gas and Electric's share of California wholesale markets before April 1, 1998 was similar and their ability to use their scale to affect prices had long been observed.

Enron's sales directly to the California ISO were not large. Enron's sales at the hubs were vastly greater than their sales to the ISO. This simply reflects the fact the market leader need not show up in every transaction. Price leadership sets the prices for all participants. Each transaction would reflect the price leader's price even though the price leader only had 30% of the market.

Do we know whether Enron exercised its market power in an attempt to increase prices during the market crisis that occurred between May 2000 and June 2001? No.

Publicly available data simply isn't that detailed. And while the California ISO continues to restrict availability of such data through its aggressive use of confidentiality agreements, the public debate will not become much clearer. The irony of the situation is that the ISO, the victim, has restricted market information to the market participants since they must have access to participate in the FERC refund cases and ongoing litigation, but has taken the same data out of the hands of the public, the press, and policy makers.

As it turns out, we are not obligated to prove that hourly prices in California aren't just and reasonable. FERC has already made that finding and has a proceeding underway to determine the refunds necessary to correct the situation.

If arrogance is a clue, Enron's behavior during this period was legendary. During one transaction we were involved in, a junior Enron trader simply hung up on a senior executive of a Fortune 500 company because he would not move fast enough. This is market power with a vengeance.

ENRON'S LONG TERM PRICE LEADERSHIP

Our research into Enron's financial and accounting arrangements indicates that it was probably more interested in forward markets than spot markets. The pervasive use of mark-to-market revenue and earnings estimates would reward Enron for exercising price leadership in forward markets. As one trader said to the Chicago

[17] The Economic Impacts on Western Utilities and Ratepayers of Price Caps on Spot Market Sales, January 31, 2002, page 4.

[18] Deconstructing Enron's Collapse, January 10, 2002.

Tribune, "We would go further out on the futures contracts than anybody else would... So you could pretty much make up your own numbers".[19]

The decline in forward markets that took place when Enron declared bankruptcy provides some evidence that they did have price leadership in forward markets. While Enron was not a seller to California in Governor Davis' long term contracts signed in the first quarter of 2001, Enron did have a major share in long term markets. Snohomish PUD, the Bonneville Power Administration, Sierra Pacific, and Palo Alto have all indicated that they had made significant purchases in the forward markets from Enron. Snohomish and Palo Alto have cancelled their purchases, citing credit language in the contracts. Sierra Pacific has asked FERC to review their contracts under its authority to determine just and reasonable prices. Bonneville has not taken any steps so far to revisit these out-of-market contracts.

FERC has indicated that it will review Enron's impacts on the forward markets. Clearly, FERC's role as a regulator should include review long term purchases as well as short term purchases. The question of whether these long term prices were just and reasonable is easily addressed. Long term prices aren't just and reasonable if they bear no relationship to the cost of constructing new electric generating plants.

Many of the long term contracts signed during the California market failure from May 2000-June 2001 were considerably more expensive than any conceivable new plant. These contracts need a careful review under the just and reasonable standard. To the degree that the pricing of these contracts was based on the short term markets, this determination has already been made in FERC's existing orders.

In sum, Enron was a major player in California markets. If their market share was as high as 30%, their ability to affect prices is not in question. We don't yet know what share of the more robust long term market Enron had. This will only become clear when FERC accumulates data from the region's utilities concerning their long term purchases. At that time, FERC will be able to determine market share and discover just what caused these contracts to depart from the "just and reasonable" standard.

A PETITION FOR TRANSPARENCY

It is worth remembering that concern over market power is not an indictment of free enterprise. The nature of any competitive market is that it can become a victim of market power. The prosecution of Archer-Daniels-Midland in 1996 for anti-trust was not a signal to adopt state regulation of the prices of agricultural products. It simply reflected a continuing need for vigilance. California's contorted market provided bad incentives and created a shortage out of a surplus. The crisis started when a small number of participants had access to operating data that their customers did not. At the California ISO, these problems still exist.

Perhaps the worst part of the California market is its continuing opacity. Keeping information from consumers can prove an incentive for abuse all in itself. Reserving the same data for market participants is clearly an inversion of effective public policy. Economists call this "transparency." With transparency the standard checks and balances function smoothly. Without it, competitive markets will function in the dark.

Thank you.

Mr. BARTON. The Chair would recognize Mr. Sawyer for 5 minutes for questions.

Mr. SAWYER. I am not going to use my entire 5 minutes, but I have to tell you, Mr. Plank, that I was tempted to say deregulation is a mess and would you care to comment, but I am not going to do that, because we are going to run short on time.

I throw this to everyone, but Mr. McCullough seems to have the most direct experience with it. The price exchange in California was supposed to provide the kind of transparency that you were talking about. The PX apparently failed. Can you tell us why and what lessons we should learn?

Mr. MCCULLOUGH. Two reasons. One, the rules were simply too complex. They allowed end-runs that enabled smart players to get

[19] "Huge bets paved way to Enron's downfall", Flynn McRoberts and Melita Marie Garza, Chicago Tribune, 1/31/2002.

special results. Two, the flow of information in California is constipated.

Literally, I have more information on the California situation in this short piece of testimony than we have yet had available in California through their process. That was a policy error and it needs to be corrected.

Mr. SAWYER. Any other comments on that?

Mr. OWENS. I am not going to comment on the transparency, but I think there were other things that were taking place in California which we are all aware of. There was a high dependency on the spot market, and there were not bilateral contracts.

Mr. MR. SAWYER. I understand that, but I am talking specifically about the failure of the PX to perform adequately.

Mr. OWENS. The failure of the PX to perform, many would suggest, is because the rules were not clear that the PX operated under.

Mr. SAWYER. Thank you, Mr. Chairman. I yield back.

Mr. BARTON. I am going to give the panelists an option. I can ask one or two questions and adjourn the hearing, and you can go have supper, and I can go vote and come back, and spend 30 minutes asking questions.

So you folks want to get out of here quick, or do you folks want me to go vote and come back, and maybe a few more members come back.

Mr. OWENS. We want to be helpful to the committee. If there are questions that you need in the record, we would be pleased to do it. If not, I would like to go home.

Mr. SAWYER. I agree with Mr. Owens.

Mr. BARTON. Well, let me ask just a few quick questions then, and we will have some written questions for the record that you can elaborate on. Mr. Plank says in his written testimony that we should just eliminate the concept of mark-to-market accounting and require traders to book revenues and profits as they are actually realized.

Now, that has a lot of appeal to me, and I can't book votes in advance, no matter how good my poll numbers look. I have to wait until they are voted that day of the election, and then I get to count them.

So, Mr. Green, should we end mark-to-market accounting as Mr. Plank recommends?

Mr. GREEN. Right now, mark-to-market accounting is a requirement as you know, and I think it is one of the most rigorous accounting processes here. People can abuse almost any process, and I think we have seen some abuses of that, but mark-to-market accounting exactly does that.

You have to put the fair value of your contracts, and we do it on a daily basis. I think there came be some more disclosure of that, and how you value those contracts, either the current or as well as the extended.

But used correctly, it is the most rigorous accounting process we have for the trading environment that we are in.

Mr. BARTON. Mr. Owens, would you have a comment on that?

Mr. OWENS. I would agree with him, and say that there are two things that you could do. One would be uniformity in the price

curves. Mark-to-market accounting is not just used by the energy industry. It is used by a broad range of industries, and it is very complicated.

But I think it also has tremendous value. The second thing would be link it to transparency.

Mr. BARTON. Okay. Mr. Markey, we are about to end the hearing. I have asked two questions, and Mr. Sawyer has asked a question. Would you like to ask one or two questions and let this panel go?

Mr. MARKEY. Mr. Chairman, we are fortuitously scheduled to be here until 3:30 a.m., and we——

Mr. BARTON. Your definition of fortuitous and my definition of fortuitous are different.

Mr. MARKEY. Well, these are really important people in terms of discussing this energy marketplace, and I don't have anything to do. I mean, if they don't have anything to do, I don't have anything to do. I can stay here. I mean, if you don't mind.

Mr. BARTON. We are going to recess the hearing and we will reconvene at 6 p.m.

[Brief recess.]

Mr. BARTON. The subcommittee will reconvene. Congressman Markey should be on his way back. He promised me that he would, and he keeps his promises, and so I will ask some questions until he gets back, and then we will recognize him for questions. I would like to ask—oh, Mr. McCullough is not here. Did he have a plane to catch? Oh, he is on his cell phone.

I just saw Mr. Markey just come in and so I will wait until he gets here and then we will recognize him. The Chair would recognize Mr. Markey for 5 minutes for questions. Well, let me put it this way. How much time do you think you are really going to use, and I will recognize you for that amount of time?

Mr. MARKEY. If I had 10 minutes, I think that would do it.

Mr. BARTON. Okay. The Chair would recognize Mr. Markey for 15 minutes for questions.

Mr. MARKEY. It won't take that long. It won't take that long. Mr. Green, did you ever see those Ed McMahon adds that say congratulations, you may have already won millions of dollars from the Publishers Clearinghouse Sweepstakes. Well, congratulations, Mr. Green, you may already soon be an unregistered mutual fund.

Are you aware that Enron sought and obtained an exemption from the Investment Company Act of 1940, the law that protects mutual fund investors?

Mr. GREEN. I am not.

Mr. MARKEY. You're not? Well, Enron apparently obtained an exemption from that Act from the Securities Exchange Commission staff back in 1997. Were you aware of that?

Mr. GREEN. I was not.

Mr. MARKEY. Now, were you also aware that there is a provision in Mr. Barton's electricity restructuring bill, Section 125, that would allow every exempt and registered holding company to transform itself into an unregulated mutual fund without any of the protections that the Investment Company Act provides with respect to self-healing, leveraging, independent boards, and excessive fees?

Mr. GREEN. I am not aware of that.

Mr. MARKEY. Did you know that the SEC has warned Mr. Dingell and me in a letter we just received today that if this particular provision were passed, quote, hundreds of unregulated investment companies would result, and that, quote, that it would be virtually impossible to determine an exact number of potential unregulated investment companies created by Section 125?

Mr. GREEN. Well, these are areas that I really don't have an interest in.

Mr. MARKEY. Are you aware that the Investment Company Institute, which represents mutual fund industry, is strongly opposed to this provision, and in a letter that they sent me today, they have requested that Section 125 should be deleted from H.R. 3406 in its entirety?

Your company, Mr. Green, could already be an unregistered mutual fund, in other words; a benefit that perhaps you are not aware of, but something that with the right MBA who gets hired this summer could put you into a position of diversification than the person that you are today?

Mr. GREEN. Well, that's not our business. We stick to our core businesses, and don't diversify in that sense.

Mr. MARKEY. And that's good.

Mr. BARTON. Would the gentleman yield on this line?

Mr. MARKEY. I would be glad to.

Mr. BARTON. That particular provision in the bill was put in for a company or companies in the midwest, and it has nothing to do with Mr. Green's company, and we have already told at the staff level that due to the concerns of Mr. Dingell and yourself, that we will be very willing to clarify the specific language in it, and if it is controversial, we will take it out in its entirety. So I don't see a reason to berate Mr. Green on this.

Mr. MARKEY. I am not berating him.

Mr. BARTON. It has got nothing to do with that particular paragraph.

Mr. MARKEY. I know that. Well, let me ask Mr. Owens. What is the EEI position on that provision?

Mr. OWENS. We have no position.

Mr. MARKEY. No position?

Mr. OWENS. No. We are not concerned about that.

Mr. MARKEY. Okay. I guess the point that I am trying to make here is that Mr. Green and his company may not be interested in taking advantage of that, but we know that Mr. Lay and Mr. Schilling would have taken advantage of it, and did take advantage of it.

So if it is a broad exemption that is universal, then while Mr. Green may decide not to do it, it would not be because he was restricted from doing it. It would just be a choice to stay home and to do the things that he does well.

But it wouldn't mean that others wouldn't be able to get out into the field without the safeguards, the protections that are in the 1940 Act. Mr. Plank, in your opinion—let's do this. Tell me, Mr. Plank, what is the one think you want us to remember from this hearing? Give me the one big truth you want us to have?

Mr. PLANK. Commodity price volatility and natural gas is excessive to the point where our responsibility as producers to Ameri-

cans, to consumers, to our shareholders, and to our own integrity, is threatened by our inability to determine with any degree of accuracy whatsoever what our cash-flow may be, and thereby what funds we may have available to reinvest in a business which depletes its wells on a day-to-day basis. That is my primary message and primary hope.

Mr. MARKEY. And your solution is?

Mr. PLANK. I think before you reconstruct, Congress Markey, on the site of ground zero regulation, the sifting through what the failures have been in this particular phase can be very rewarding as you adopt new regulation, which on the one hand still does your very best to maintain human and individual freedom and dignity, and on the other hand, reinforces the American ethic of morality, and protects against the invasions of all kinds of financial side institutions.

Such as Forbes has an article out this week, and there is another one in another major publication that puts the contingent unbooked liabilities of major banks at the present time at somewhere around $5 trillion.

A lot of that money is predicated and is at risk due to their guarantee to pick up commercial paper in the event of credit unworthiness. But be that as it may, the credit unworthiness that stands behind these trades and these virtual activities, which are supposed to be mark-to-market every day, was frequently predicated upon making sure that you don't recognize dollar income before you have got a cash receipt to go against that mark-to-marketing.

Mr. MARKEY. So it really isn't mark-to-market is it? It is mark-to-marketing?

Mr. PLANK. That's correct.

Mr. MARKEY. They actually don't have the receivables here. What they are saying is that we have got a good idea that somewhere down the line, 2 or 3 years from now, because our marketing is so good, that we will have that thing that we are promising is going to serve as the collateral.

Mr. PLANK. Mr. Markey, could I add that it is a very difficult situation at the present time because there is trading speculation that has extended to the securities market itself, to such a degree that those who are running the hedge funds have no interest in the company or the performance of the company.

They are interested only in the momentum of that particular trade. We see that day after day, and we have 40,000 shareholders, 137 million shares of stock outstanding, and our stock in a given day based upon information which is we believe generated internally to serve those that can profit by creating the volatility, we have seen gas markets on a daily basis change by as much 15 percent——

Mr. MARKEY. I am going to run out of time, Mr. Plank, and that is——

Mr. PLANK. And that is what I wanted to say.

Mr. MARKEY. But you just finished it?

Mr. PLANK. I just finished.

Mr. MARKEY. Then let me ask you then do you think Enron was able to manipulate the gas marketplace because of Enron On-Line?

Mr. PLANK. In my opinion, absolutely, and I am absolutely satisfied that they did.

Mr. MARKEY. How did they do it?

Mr. BARTON. Would the gentleman yield?

Mr. MARKEY. Sure, I would be glad to.

Mr. BARTON. We would like to see some documentary evidence of that. You are entitled to your opinion.

Mr. PLANK. So would I, and I don't have the power of subpoena and you do. So, I suggest you are closer to it than I am.

Mr. BARTON. Well, we just had all of the people who would have it in evidence and they said just the opposite, that there is absolutely no evidence to indicate that.

Mr. PLANK. Then I would look to their self-interests.

Mr. BARTON. No, these were the government witnesses. They would have no self-interest. The EEI is purely a gatherer of information. EIA, I'm sorry. So I know that you feel that very sincerely, but——

Mr. PLANK. Well, may I give an example?

Mr. BARTON. Yes, sir.

Mr. PLANK. You recognize that storage figures of course on natural gas were published this past year, and have been for quite some time, on a Wednesday at 1:30 p.m., Washington, DC time, or New York time.

And these storage figures are basically—and what they gambled on was either storage fill or storage draw down, and that also allowed Enron to be in the weather trading business.

So it would be very much to Enron's interests to know whether a gambling point at 1:30 on a Wednesday afternoon, the information which was going to be released then to the general market, would show either a larger than anticipated storage fill, or a decline, at that particular point in time.

Mr. Ferris, or president, who happens to be here, and I happened to meet with a gentleman for lunch in his office, and we——

Mr. BARTON. We will give the gentleman from Massachusetts additional time.

Mr. MARKEY. No problem.

Mr. PLANK. We met in his office at—or he met in our office, and we asked him what is your guess as to the storage fill for the week, and he said I think I know. And he said that the storage fill would be 74 billion cubic feet this week.

And we said where did you get the information. A senior Enron official. And within 10 minutes the man walked into our office and our staff, and got it released to the public, and the storage fill for the week was 74 bcf.

The market response is instantaneous, and people who can either control that information or gain access to it in advance of the other in a speculative market can move that market and does to the major personal benefit thereof. And I charge that is a reality.

Mr. BARTON. Everything you said is absolutely, totally factually true. Let's say that.

Mr. PLANK. Okay.

Mr. BARTON. The fact that you know something is going to be released, and you can take a position, and you have got prior knowl-

edge, and you have insider knowledge, you may be guilty of a securities violation for trading on it.

But how does that manipulate the market? How would that manipulate it? Mr. Markey's question to you is does it manipulate the market?

Mr. PLANK. It means that the benefits of the insider market are able to get insider information.

Mr. BARTON. But that is different.

Mr. PLANK. And are able to be captured.

Mr. BARTON. But that is different.

Mr. PLANK. What is different?

Mr. BARTON. Being able to benefit from insider information may in fact be a criminal violation, but I thought Mr. Markey asked you if you thought that Enron was manipulating the market, and actually taking the market to a different location than it would be otherwise, and that particular story, even if totally true, does not indicate market manipulation.

Mr. PLANK. My belief is that those who were supplying storage fill information were in a position to and did act in concert.

Mr. BARTON. I am also told that AGA no longer does that. That EIA does it, and so that information would be instantaneously available to the public and not procured and perhaps given to certain insiders like it may have been in that instance. I don't know when your story occurred.

Mr. PLANK. If I may, sir, they are in the field of regulation, and it would be very important that there be teeth behind the information which the storage people provided.

Mr. BARTON. I agree with that.

Mr. PLANK. At the present time, there is not.

Mr. BARTON. I don't disagree.

Mr. PLANK. So if they have a predisposition either not to answer the storage fill question, or to tilt it in terms of where they feel their self-interests may lie, I think you have been looking at that in the normal 1:30 Wednesday afternoon reporting.

Mr. BARTON. I don't disagree with that.

Mr. PLANK. And that doesn't do the consumers any good. I can tell you that it doesn't do the producers any good at all, in terms of predicting or having a less volatile market out of which to predict our capital flows, and therefore to make larger commitments in the United States.

We are reducing our capital commitments by 70 percent in North America and during the year, which means a reduction in just this little company of $700 million. We are not doing it deliberately to bring down the sword of Damocles around the consumer's head.

We are doing it because there is too great a risk in the market at the present time of continued price volatility. Multiple that by the other producers in this industry, and we have got a ticking bomb in terms of a respike of natural gas prices, which you can't deal with quickly enough to bring enough LNG in here to make a difference.

Or which coal can't gear up rapidly enough, which totally leaves us at the mercy of volatility and the amount of capacity that needs to be erected and constructed in terms of cogent facilities, or the amount of replacement capital that needs to go into our infrastruc-

ture. And I have not touched yet on what is being done to human capital. I am all through lecturing, unless you give me another chance.

Mr. MARKEY. No, thank you.

Mr. BARTON. It is Congressman Markey's time.

Mr. MARKEY. No, you are obviously a brilliant man, Mr. Plank, and what you just said is very frightening. You are basically saying this volatility that is now being built into the marketplace discourages long term investment, and discourages the kind of drilling that could give us the extra margin of energy security which our country needs.

And that is a frightening warning that you have just given to our committee, and you are pointing the finger of responsibility back at this now out of control marketplace that is based upon speculation and short term trading.

Mr. PLANK. I knew there was a reason that I liked you.

Mr. MARKEY. I am trying to restate it in a way that I could explain it to my mother. I don't think I can repeat what you just said. It was too well-thought out and intricate in its detail.

Let me ask you this, Mr. Plank, and Mr. McCullough. If you were Enron On-Line,and you were trading as a principal with hundreds of companies, and as a result got non-public information about who was long, and who was short in the market, couldn't you use that data to front run those other countries in the NYMEX, and how would the CFTC ever even know that you had done it?

Mr. PLANK. Well, if we couldn't use that information to our great benefit, again absent any integrity and morality, then you would have to write another book about when stupidity failed.

The current hot book so far as I am concerned and are excellent books to be considered in this context, is the misnomer itself of a company called Long Term Capital. And in that particular instance, the title of the book was When Genius Failed.

So for someone not to know how to utilize insider information outside the bonds of morality and of legality, and of criminality, you would have to be very stupid indeed.

Mr. MARKEY. So what you are saying is that Enron On-Line was in a position to take proprietary information of hundreds of companies, and to then use that information because they were essentially creating the marketplace to their own advantage as a player in that marketplace simultaneously, and to the disadvantage of hundreds of other companies.

And right now you are saying this committee and the American public isn't aware of the full extent to which that may have occurred?

Mr. BARTON. Would the gentleman yield?

Mr. MARKEY. Sure, I would be glad to.

Mr. BARTON. The gist of the gentleman's question, I share the same concern. I don't think that we have shown, and I don't think the record will show, that Enron manipulated the market that it was making.

I think the fact that they could take some of this information that they received as a result of creating this market, and use it in other markets, may in fact be something that we need to look at.

And if I know who is long and short in the electricity market that I am a player in, and I can take that to the NYMEX with advantage because I have information that nobody else has, then that is an issue that we need to look at.

So I am with you on going into other markets. I don't see that the record is showing that they took their position in the on-line trading market to their own advantage, but I am going to ask some questions after you do, and I am going to ask Mr. Green and Mr. Owens to comment.

Mr. MARKEY. Well, I think Mr. Plank is saying to us is that if he had the subpoena power which this committee has, there would be a whole bunch of people that he would ask to sit at this table to answer questions, and that we would play the role that a whole bunch of companies like his, and a whole bunch of investors and consumers out there really aren't in a position to ask, and be afraid to ask, because they are not in a protected position like we are.

But I think we could perhaps get some suggestions from some people as to who we might want to have sit here and answer the questions as to what they were doing with the marketplace.

And not trying to overextend your courtesy to me, but Mr. McCullough, I would like for you to answer the same question that I asked Mr. Plank.

Mr. MCCULLOUGH. I don't know the answer. I am going to yield to Mr. Plank, because it is a natural gas question.

Mr. MARKEY. No, it is the on-line—if they were trading electricity, for example, would they have the capacity to use that information to position themselves against the other electricity companies trading on-line, Mr. McCullough?

Mr. MCCULLOUGH. We don't have an active NYMEX electricity market. So moving back and forth for electricity would be different than moving back and forth for gas.

Mr. MARKEY. I have also been told that it was a practice at Enron to quote a price for electricity or gas OTC contract, and then come back to the customer in a day, or a week, and say the bid asked has now changed.

And since some customers did their mark-to-market based on Enron's quotes, the customer would be taken to its position limit, and would have to cash out their position at a loss. Have you ever heard of that practice taking place either at Enron or elsewhere, Mr. Plank, or anyone else?

Mr. PLANK. I have heard it referred to, but I have no basis to verify or comment further. I don't know whether that is accurate or not.

Mr. MARKEY. Do you think it is a worthy subject of inquiry? Would that be an important subject of inquiry for the committee?

Mr. PLANK. I think it is an important subject of inquiry, and a particularly important subject of inquiry is the fact that when you have 120 points at which natural gas can either be received or sold, then you have got 120 equivalencies of gambling casinos, all of them unregulated, all of them unreported.

The net result is that we, insofar as price volatility, have a 150 pound tail wagging a 10 pound puppy, and this 10 pound puppy ain't going to be able to deliver the gas if the demand increases. That's the essence of my concerns throughout as an American.

Mr. MARKEY. Mr. Plank, I am going to have to let you stop right there. If any of that was happening in the stockmarket, it would be a violation of the Securities Exchange Act.

Mr. PLANK. And it ought to be a violation of the Corrupt Practices Act in some way.

Mr. MARKEY. It would be, and Mr. Green, I just want to say I apologize for my line of questions in the beginning. It was only meant to point out that you would be turned into a mutual fund as an opportunity for your company to pursue, and not meant in any other way or to make any other reference to the good company that you represent.

Mr. GREEN. Understood.

Mr. BARTON. The Chair would recognize himself for some brief questions because we do have one more vote, and we are not going to ask you folks to sit through another vote.

Mr. Plank had a recommendation that deals with some of the questions that Mr. Markey was asking, and since Enron could actually take a position in trades in its on-line trading system, and in fact did take a position, Mr. Plank's recommendation is that—and I will just read it.

It says that these on-line platforms or exchanges, they should be subject to similar regulation to ensure fair treatment of all parties, and in the equities market, there is a basic rule that agents cannot put their trades ahead of their client's transactions. Similar rules should guide the conduct of the energy markets.

Now, the Enron On-Line trading system, everybody knew that Enron was half of every trade. They were in a sell position or a buy position. So my first question to you, Mr. Green, and to Mr. Owens, is should we just prohibit that in its entirely and say you couldn't have that kind of a market, and that in fact you ought to have a market similar to the New York Stock Exchange, or the NYMEX, where the market maker is simply a broker, but not a participant?

Mr. GREEN. I think the key ingredient there, and obviously I think it is going to be looked into, is there other types of exchanges besides the Enron On-Line, which we would say is a thin exchange, meaning it is many trading with one.

Some of the more successful electronic exchanges that have been developed, like ICE, the Intercontinental Exchange, is many on many. So you have full disclosure or transparency. And it is one of the key developments in the industry to bring real transparency.

Obviously, people who are playing in the market can see what is going on, but even customers, many utilities, will set up——

Mr. BARTON. But as a general rule should we prohibit a market maker like Enron from participating—if they want to have an on-line trading system, fine, but you can't buy or sell.

You just create the forum for the market. Is that intrinsically letting Enron be a buyer or seller, and then doing what Mr. Markey and Mr. Plank said they may have done, which is take that information from the fact that they were buying and selling, and take it into other markets?

Should we just eliminate that potential conflict of interest by saying you cannot take a position in a market if you are going to be the market maker? That's my question.

Mr. GREEN. Yes. That certainly could be an outcome, because I believe in transparency in the market, and nobody should have a right to more information than others.

Mr. BARTON. Mr. Owens?

Mr. OWENS. I would respond the same way. I think those were thinly traded markets. It seems to me that the results should be that we should have a deep market and a transparent market, and we would avoid an entity being able to manipulate the market as has been alleged by Mr. Plank.

If, in a transition, it is important to make sure that an entity that also is trading in the market also can't set the market rules until the markets are deeper and more liquid, that may be a compromise.

Mr. BARTON. Okay. Good. And, Mr. Plank, you have been in the energy business, or at least Apache as a company, for 49 years. So I would assume you have been with Apache for 49 years, is that correct?

Mr. PLANK. I started it, so I had better be.

Mr. BARTON. Now, I have never had to put money into an oil well or a gas well. I have just been an observer, and so I have never had to put my money where my mouth is so to speak.

But the gas market, once upon a time, Texas gas prices intrastate were unregulated, and gas prices interstate were regulated by the gas policy or Natural Gas Act of 1935. And pipelines bought the gas from the producer and had long term contracts.

And some pipelines made bad deals, and they agreed in the 1930's and 1940's to supply gas to the northeast for 5 cents an MCF, or 10 cents, or one cent. Texaco had a famous contract where it was like 3 cents an MCF forever. You had a very structured market, and everybody knew what the price was.

But the producers kind of chaffed under that, and they came to guys like me when we were getting ready to run for Congress, and said you ought to decontrol natural gas prices. Now my guess is that you probably wrote me a check or two way back then, saying if you get elected, I want you to help to decontrol natural gas prices in the interstate market, and maybe you didn't.

But if we wanted to totally take the traders out of the market like you recommend in your testimony, you almost de facto go back to a regulated situation, where you would have these long term contracts and you have got stability, but you don't allow for changes in economic conditions.

Are you advocating that we go back to the system that we had where wellhead prices were regulated, and pipelines bought the gas, and they sold it to distributors, who then sold it retail?

Are you advocating that, or are you simply saying that as these markets emerge, we need to get more transparency, and we need more reporting, and we need to make sure that people cannot create inside information, and then take advantage of it? Exactly, what are you trying to tell this committee?

Mr. PLANK. Mr. Chairman, I would like to think that if some of the potential securities violations here and other violations were acted to be eliminated, and with other accounting considerations having been effectively dealt with, that it might be adequate to clean up the fringes.

Also, I, of course, am thrilled that Enron is out of the ball game. I am one of those people who saw it coming. And like some people who testified here today, it took longer than I thought it would.

It could be, particularly if the appropriate courts find that criminal acts have been performed, and that the bad apples go to the hoosegow——

Mr. BARTON. We have got an oversight subcommittee that is doing the most aggressive investigation of any of the Congressional committees just down that line, and I am strongly supportive of that.

Mr. PLANK. Then I would be delighted to see one hang on to as much freedom as possible, but still balanced with appropriate regulation, and based on what we found didn't work, so that we could try to improve it a little bit the next time around.

Mr. BARTON. But you are not advocating reregulation of wellhead natural gas prices?

Mr. PLANK. I would just as soon not have reregulated natural gas prices, although on the other hand, if it were—if you can't get stability back into the price market, I would hope that later on down the road you could give some consideration to price band opportunities, and in which you traded a minimum price for a maximum price, and allowed the volatility to take place between two base points.

Mr. BARTON. But my position is that I believe a market, if properly structured, with transparency and ease of entry, and egress and ingress, is a better system than a regulated system, but you have got to have a fair system.

And if the old system that Enron was—I think they had like 90 percent of the trades, or some huge number, and if that gave them an insider position that could be used for manipulative purposes, that's wrong.

And if we need to change the legislative statute to deal with that, we are going to do it. We have got a bill that is coming hopefully in the next month or so that we can do it. If on the other hand, we just need to fine tune the system, and then throw the book at people that have abused it in the past, that's a whole different thing.

So I don't think we can go back to a regulated electricity market like we had prior to 1992. I don't think we can go back to a regulated energy market like we had in the Natural Gas Policy Act of 1978. I don't think we can go back to regulated oil prices like we had in the windfall profits tax that came in during the mid-1970's.

I think we almost have to stay with the market system, but perfected, reform it, whatever the verb you want to use, so that the stockholders, the stakeholders, the investors, the consumers, know that it is a fair system, and that nobody has insider ability to affect it in an unfair way.

Now, that is just my position, but I think that is a position that a majority of the Congress may hold once we get through all these hearings. Mr. Norlander, did you want to say something? And I am going to have to go vote and adjourn this hearing.

Mr. NORLANDER. I think that there is an alignment of interests at the consumer end and the producer end for some system that puts some stability out there for the good of the country, and for

planning. We have to have a playing field and decide what we want here.

Do we really want to have power plants allocated based on the market. In New York City, they are not doing it now. So to get the next power plant, do we have to bid for it with the highest rates in the world? And I think the answer is yes, unless we have a system in place that looks at it.

The other piece is that this committee is a wholesale power committee mainly, and we are now seeing that directly impact consumers, and originally when this was started the idea was everybody will be at least as well off, and will be better off, and if we hold in place the network of programs for the poor, and everything else, and let the States work out these things, prices are coming down, and we will all be better off.

That is not the message that people are receiving in the real world today in New York City, and it is not what they received in Buffalo with natural gas. That the price volatility is intolerable for ordinary consumers living on fixed incomes.

Mr. BARTON. Well, thank you. I am going to release you folks, and we want to thank you for being patient and being here all day basically. Thank you for your testimony, and we will file a report on this, and digest this.

And if you have potential amendments to the pending electricity restructuring bill, we would ask that you get them to us, because some of these issues we can put in the bill when we mark it up, which I would hope would still be in the very near future. We thank you for your testimony, and this hearing is adjourned.

[Whereupon, at 6:32 p.m., the committee was adjourned.]

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