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EXAMINING ENRON: DEVELOPMENTS REGARDING ELECTRICITY PRICE MANIPULATION IN CALIFORNIA

HEARING

BEFORE THE

SUBCOMMITTEE ON CONSUMER AFFAIRS, FOREIGN COMMERCE AND TOURISM

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

MAY 15, 2002

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ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

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EXAMINING ENRON: DEVELOPMENTS REGARDING ELECTRICITY PRICE MANIPULATION IN CALIFORNIA

WEDNESDAY, MAY 15, 2002

U.S. SENATE,
SUBCOMMITTEE ON CONSUMER AFFAIRS, FOREIGN COMMERCE AND TOURISM,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:35 a.m. in room SR–253, Russell Senate Office Building, Hon. Byron L. Dorgan, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. The hearing will come to order. We will ask for the hearing room doors to be closed, please. This morning's hearing is a hearing of the Consumer Affairs Subcommittee. We are joined by the Chairman of the full Committee, Senator Hollings.

This hearing is a follow-up to a number of hearings the Subcommittee has held dealing with the issue of the Enron Corporation and a series of things that have happened to Enron and to their employees and to investors and to California and to West Coast ratepayers. The hearing that we held most recently on Enron focused on what Enron was doing in the electricity markets on the West Coast. We had testimony from California officials and West Coast officials at that hearing. We had denials, of course, from the Enron Corporation that they were involved in any way with rigging or manipulating the marketplace in California. Since that time, some memorandums have surfaced dealing with specific strategies employed by the Enron Corporation and that will be the subject of this hearing.

Some long while ago, Mr. Kenneth Lay and his attorney and others involved in Enron took great exception to a statement that I had made that, having studied Enron at some length following its collapse, that I felt there was a "culture of corruption" inside the Enron Corporation. Mr. Lay and his attorney took great exception to that.

We then had Mr. Lay come before the Committee under subpoena. He took his Fifth Amendment rights and refused to testify. What we have learned in recent months is that the culture of corruption assessment was not only true, but more true than most any of us could possibly have expected.

Mr. Powers testified before this Subcommittee. He was commissioned as a new member of the Board of Directors of Enron, to do a study of what was happening inside the Enron Corporation. They did a study of only three partnerships or SPEs, only three. Mr. Powers sat at that table and said what they found inside the Enron Corporation was "appalling." This, remember, would be the best possible light put on this company because it was done by a member of the Board of Directors at the request of the Board of Directors. He found something inside that company that was appalling.

Officers of that company, and people in the company, for example, invested $25,000 of their own money and took out $4 million 60 days later. What we have discovered with respect to this corporation is, in fact, a culture of corruption.

But today's hearing is going beyond that. It is a hearing to follow on the heels of a hearing we did earlier on the issue of what happened to electricity costs on the West Coast, and California especially, but also Oregon, Washington, and the West Coast generally. What we have learned since the last hearing was that a couple of confidential memorandums have surfaced dated December 6th, 2000, and December 8th, 2000, written by Mr. Christian Yoder and Stephen Hall. They are essentially the same memorandum with different dates, but with some slightly different language.

But these two memoranda describe a strategy by which the Enron Corporation attempted to rig the energy market on the West Coast. Now, I think a culture of corruption perhaps is too mild.

What I have learned is that there is, I think, significant legal problems, and I think perhaps a substantial amount of criminal activity.

FERC needs to answer to Congress why were they shamelessly absent, where was the accountability for this federal agency that should have taken action, why did they not take action, and at whose behest were they sitting silent on their hands while California and West Coast ratepayers were being essentially stolen from?

So the question is what do we do about all of this? Well, let us learn today what we can about these memoranda. I want to hold up a chart. The strategies were called Get Shorty, Fat Boy, Death Star, Load Shift. Death Star: "Enron gets paid for moving energy to relieve congestion without actually moving any energy or relieving any congestion." Legal? Hardly.

Load Shift: "By knowingly increasing the congestion costs, Enron is effectively increasing the cost to all market participants in the real time market."

Exporting California Power: "This strategy appears not to present any problems other than a public relations risk arising from the fact that such exports may have contributed to California's declaration of a Stage 2 Emergency yesterday."

Fat Boy: "The answer is to artificially increase the load on the schedule submitted to ISO."

The memo is replete with that. It is disgusting corporate behavior without a moral base. It does, in fact, represent, in my judgment, a culture of corruption.

This was a corporate strategy to cheat West Coast consumers of billions of dollars. It is, it seems to me, a demonstration of cor-

porate greed. But, perhaps much, much more than that. I expect that we will want to see a special counsel of some type investigate not just this company, but all West Coast pricing. I suspect a special counsel is perhaps necessary to do that, No. 1.

No. 2, I think a full investigation of FERC and its behavior and its contacts is necessary to evaluate why did the referee or the regulator sit silent, which is also a strategy, incidentally, that helped rip off consumers on the West Coast.

Finally, we will call others to account to this Subcommittee for what we learn today and what we already know. It is my intention to call Mr. Thomas White to come and testify before this Committee. Mr. White, as we know, was the head of Energy Services. Ms. Lynch had a chart that shows the position of that organization inside Enron as a part of all of this. It is my expectation following this hearing to ask Mr. White to be present and testify, I expect within the next two weeks.

So that is my take on it. This is an ugly mess. I think people in this country have been cheated out of billions of dollars and I think some sunlight here is the best disinfectant.

But let me call on the Chairman of the full Committee, Senator Hollings.

STATEMENT OF HON. ERNEST F. HOLLINGS, U.S. SENATOR FROM SOUTH CAROLINA

The CHAIRMAN. Well, Mr. Chairman, let me commend you and the Subcommittee for your leadership on this particular score. I will file my statement for the record. With respect to the work of the Subcommittee, it has been totally bipartisan. I have not been to all the hearings, but I have been observing it to make sure that we just did not have a partisan assault. Now, when the minority does not show at the hearing it could probably give that impression.

I do not know whether they tried to avoid association with Kenny Boy. I know the President said "Who is he?" He is the one that flew the President's father to the Inauguration, in case he wants to know who he is. We have got all the evidence in the Lord's world that he was his best friend.

I guess that crowd does not want to be identified with Death Star, Load Shift, Inc-ing Load, and Fat Boy. After last night with a $30 million fundraiser, they are the fat boy, I can tell you that.

But I will file my statement and yield to the next gentleman.

[The prepared statement of Senator Hollings follows:]

PREPARED STATEMENT OF HON. ERNEST F. HOLLINGS, U.S. SENATOR FROM SOUTH CAROLINA

During our past hearings regarding Enron, we heard some witnesses testify and some senators claim that Enron was just a poorly run company—an aberration of deregulation. They argued that deregulation of the energy markets still had enormous benefits for consumers.

But some of us sensed that deregulation had created an environment for corporate mischief by Enron and other energy companies, especially during summer of 2000 when high energy costs shackled the California people and their economy. And now we have evidence to prove what we intuitively sensed earlier this year: three memoranda written by Enron lawyers and outside lawyers detail how Enron manipulated the California energy market. That market manipulation kept Enron's stock price

artificially high so it could continue its pyramid scheme of debt partnerships and multi-million stock cashouts for its top executives.

Former Enron CEO Jeffrey Skilling joked that California's ship would sink from problems of its own making. Vice President Dick Cheney told California's two senators that the energy crisis was caused by Californians consuming too much electricity. But it is now clear that Enron and the other energy companies exploited a vacuum of regulatory oversight to steal billions of dollars from the wallets of California's working families.

Even the cheerleaders of deregulation across all industries recognize that any deregulatory scheme must be accompanied by tough enforcement of antitrust laws. Likewise, when energy markets are deregulated, it requires tough enforcement by the Federal Energy Regulatory Commission. But during the summer of 2000, when officials at the California Public Utility Commission called on FERC to investigate and take action against companies manipulating the California energy markets, FERC ignored their pleas. We are still waiting for an explanation as to why FERC ignored California's request for help—and listened instead to Enron's lobbyists who claimed everything was fine.

FERC's indifference had real consequences for real people. The doubling and tripling of energy bills nearly broke some families—and endangered elderly residents needing air conditioning during the hot summer months. Soaring energy costs and blackouts forced some California businesses to cut back production and business hours, negatively impacting California's economy and jobs.

This personal and economic damage could have been prevented by federal regulators whose primary responsibility is to protect Americans from such exploitation. FERC must not only answer to us here today, but also to the working families of California—the poor families who emptied their wallets and bank accounts to pay energy bills that were artificially inflated by fraud and collusion permitted by energy deregulation.

Senator DORGAN. Senator Wyden.

STATEMENT OF HON. RON WYDEN, U.S. SENATOR FROM OREGON

Senator WYDEN. Thank you, Mr. Chairman, and thank you very much for holding this hearing on an issue that is so important to my constituents.

Mr. Chairman and colleagues, more and more evidence is piling up that during the West Coast energy crisis Enron, and perhaps other traders, were engaged in what amounts to a protection racket, shaking down consumers up and down the West Coast of the United States. I would like to describe how this took place, including some documents that I received just last night.

Oregon, California, and Washington, Mr. Chairman, are part of an integrated energy market. This means that every single day of the year energy is traded back and forth between the three states. If the market is manipulated anywhere on the West Coast, the repercussions are felt everywhere on the West Coast.

Now, last night I obtained evidence that reported that energy prices in the Pacific Northwest during the West Coast crisis were inflated compared to what utilities in our region were actually paying. The recent admissions by energy traders that they engaged in phantom swaps of power and other sham transactions that drove up the prices is a likely explanation for the disparity between the Northwest reported prices and actual prices that utilities paid.

I would like to illustrate this by a chart that was prepared by a Portland energy consultant, Robert McCullough. This chart compares actual prices paid by Northwest utilities with the reported prices at the most important pricing location for power contracts in the Northwest. That is the Dow Jones Mid-Columbia Index. What

the data shows is that the reported prices were consistently higher than the prices that Northwest utilities actually paid.

Manipulation of the market to inflate prices in both California and the Northwest panicked the buyers in my state into accepting higher prices than they ever paid before. The markets were so out of control that buyers were willing to lock themselves into high-priced, long-term contracts because they were worried that if they did not they would be forced to pay still higher prices in the future.

This scheme locked ratepayers up and down the West Coast into overpriced contracts through what amounted in my view to a protection racket. The memos that were released last week make it clear that Enron manipulated the market to drive up the price of electricity using schemes with the names Fat Boy and Death Star. The Enron memos also show that several of the market manipulation schemes such as Death Star and Ricochet involved swapping or selling power outside of the State of California. In fact, for Death Star, the memos specifically identify the California-Oregon border trading hub as a key location for their scheme to collect congestion payments for scheduling transmission of energy that was, in fact, not put on the grid.

Another link between California and the Northwest energy markets is that of questionable deals described in the Enron memos that were actually done on Enron's trading floor in my home town of Portland. Northwest ratepayers were clobbered by these skyrocketing power rates that resulted from Enron's deals and, as you can see from another chart, Mr. Chairman and colleagues, comparing California and Northwest energy prices, the price spikes in the Northwest were just as high and in some cases higher than they were in the State of California.

That is why it is so important that the Congress go forward with this inquiry into what was happening all up and down the West Coast of the United States, because it is my view that if consumers in my state and certainly in other western states were duped into buying overpriced power by the market manipulation engaged in by these energy traders, ratepayers up and down the West Coast would be entitled to get relief from these overcharges.

We have heard testimony already from key California officials. We know that Enron centered its West Coast operations in my home town and at the time that Enron was executing the schemes described in the memos and the California markets were going haywire, similar price spikes were going on throughout the Northwest.

So I think it is extremely important that we go forward with this inquiry that you have described, including calling Mr. White. I would also add, Mr. Chairman, that what we have learned in the last week makes the case for the toughest possible provisions in the energy bill that is now before this conference committee that would lend new transparency and new openness to the way energy is bought and sold in this country. I think it is unacceptable to pass a bill out of conference without the transparency that would have blown the whistle on these sham activities that the memos outline.

Second, I would hope that we could get that federal ratepayer advocate in the Department of Justice that is also part of the energy bill, because that too could have provided an early warning system

that could have prevented the kind of ripoffs that we have seen documented in the last week.

I commend you, Mr. Chairman, and the Chairman of the full Committee, Senator Hollings, for giving us this time and attention. This is of extraordinary importance to my constituents and warrants a full inquiry.

Senator DORGAN. Senator Wyden, thank you very much.

Before I call on Senator Boxer, let me note that Congresswoman Jane Harman and Congresswoman Anna Eshoo are with us, as well. We regret that we were not able to entertain all of the requests for testimony. We will perhaps have another opportunity. But we welcome your presence.

Let me call on Senator Boxer.

STATEMENT OF HON. BARBARA BOXER, U.S. SENATOR FROM CALIFORNIA

Senator BOXER. Thank you so much, Senator Dorgan, for your leadership, Chairman Hollings. I also want to thank Ranking Member John McCain, who was very helpful in being present in case we had to issue subpoenas for today. You have all stood with me and with Ron as we try to get to the bottom of what happened to our states' electricity rates and what happened to our people.

On December 6th and 8th, 2000, just as the electricity situation in California was reaching a crisis, Mr. Richard Sanders of Enron received memos from Mr. Christian Yoder and Mr. Stephen Hall. He received a similar memo from two other individuals, Mr. Gary Fergus and Mr. Jean Frizzell. These memos outlined in great detail a series of scams, and Senator Dorgan has named a few of them here: Death Star, Load Shift, Exporting California Power, Inc-ing. I am going to just show you a couple of others.

What I think is important is to understand the language. These attorneys were really describing what was described to them after they talked to the traders. So let us get that. This is one called Ricochet: "Enron's intent under this strategy" is to beat the spread "and not to serve load or meet contractual obligations." Imagine, a business that sets out a goal to meet contractual obligations. What business school taught that, I wonder?

Here is another one: Selling Non-firm Energy as Firm: Enron is paid for ancillary services that "Enron claims it is providing, but does not in fact provide." Another immoral scheme; illegal, it seems to me.

Export of California Power—another scam. "This strategy appears not to present any problems,"—listen to this one, that means legal problems—"other than a public relations risk arising from the fact that such exports may have contributed to California's declaration of a Stage 2 Emergency yesterday."

For those of you who don't know what a Stage 2 Emergency is, it means that everyone is panicked because the lights are about to go out, businesses are going to lose their power. That means Silicon Valley, the poultry business, the hospitals, everybody. That is Stage 2. It is a very frightening thing to live through, and we lived through a lot.

We will not go into all the other scams, but let me say that right now we have a very big deficit in California. Senator Dunn will at-

test to that. Some people think the whole deficit is attributable to this problem. Some think it is in part. Be that as it may, it has hurt the state, it has hurt our people, and that is why the Congresswomen are here, because they bear this burden of sharing this grief with our people.

Now let me tell you what these scams did on the ground, Mr. Chairman. It is not theory, it is reality. First of all, let us show this one chart. You have seen it before. I think it is worth showing. The overlay shows when Ken Lay sold out his stock. Let us take this back.

The green line is what happened to the prices. The red line is what happened to demand. I will never forget when the Congresswomen who are here today and I remember Anna Eshoo confronting Vice President Cheney. You know what he said? "You people use too much energy." And he lectured us. Well, clearly our demand was down.

What happened to the free market? We had a decrease in demand and look what happened to the price. As soon as FERC acted and put the rate caps in, rate caps that Cheney told them not to do, said they should not do, they finally did it after a year of suffering, the whole problem resolved itself.

So let me tell you, Mr. Chairman, what the scams did. They caused great anxiety for the families of my state. They affected 30 million people out of the 35 million people in my state. These memos prove what I and many members of our delegation have been saying for almost two years now: Something was rotten.

Here you see what happened as a result of these memos, as a result of these scams that the memos describe. Look here, phony shortages, unprecedented electricity costs for consumers. We paid 266 percent more for electricity in 2000 than in 1999 while the demand rose by 4 percent. Overcharges for electricity, $8.9 billion, which we have to get back from FERC. FERC has to order those refunds. Blackouts for 49 days, Mr. Chairman. Imagine your state going through these kind of blackouts, and we have listed the days. How about bankruptcies? Pacific Gas and Electric, a utility, in business since 1905, filed for bankruptcy on the 6th of April 2001. And our state debt went from a surplus of $12 billion to a deficit.

So these are the real outcomes of these schemes with all those cute and clever names that I am sure people laughed themselves to sleep at night while they discussed it. These scams were manipulative and deceptive and I believe illegal. I will not go through all of them because my Chairman did that.

But here is the point I want to make in closing here: The memos acknowledge that, should it discover such activities, the California ISO could take numerous actions against Enron, including fines, suspensions, and referral to the regulatory and antitrust enforcement authorities. But the memo is silent on potential federal crimes and federal action. I find it interesting, Mr. Chairman, that the memos mention possible state sanctions, but they are silent on federal sanctions.

Was Enron so confident in its relationship with FERC that it knew FERC would never act against unjust and unreasonable rates or market manipulation, at least for a period of time? After all, Enron wined and dined FERC. After all, more than 20 members of

the Bush Administration had ties to Enron. After all, Enron was one of candidate Bush's biggest contributors and rewarded Ralph Reed, a very conservative Bush supporter whom many expected to support another candidate, with a job. After all, Army Secretary White was Vice Chairman of Enron Energy Services and in charge of securing the privatization of electricity at U.S. military bases. How about Bush's choice to head the Republican National Committee? He was a lobbyist for Enron. And it goes on.

I am going to show you the list of federal crimes lawyers tell me are possible here: fraud and false statements, mail fraud, wire fraud, conspiracy, racketeering, securities fraud, insider trading, antitrust-collusion. These are just some of the crimes.

Now, I am to close. I ask your indulgence. We had a situation where Ken Lay handed the Vice President a memo, Mr. Chairman, told him not to act on any price caps, and that is what FERC did, and we are going to talk to the FERC Chairman about that.

I want to say that other companies are now implicated in this. We have seen articles in *The New York Times,* about Reliant and Dynegy. I ask unanimous consent to place into the record some new information on the insider trading at Duke Energy, Dynegy, and ask that it be part of the record, because it mirrors the action of Ken Lay, it mirrors the action of Jeffrey Skilling, and I think this was all about talking to each other and using these scams.

[The material referred to follows:]

U.S. REGULATORS ARE REQUIRING FULL DETAILS OF ENERGY SALES

The New York Times, May 15, 2002

By Richard A. Oppel Jr.

Washington, May 14—A new rule adopted by federal regulators will force electricity traders to report individual transactions in detail beginning in July, preventing them from concealing the sort of fake "round-trip" trades that have allowed large energy producers to inflate their volumes and revenue, regulators say.

Separately, Senator Joseph I. Lieberman, Chairman of the Governmental Affairs Committee, disclosed today that the Federal Energy Regulatory Commission investigated Enron's online-trading system last year but concluded that the "chance of Enron failing financially was remote."

An internal report by the commission in August—just as Enron's facade was beginning to crumble—raised serious concerns about Enron's online-trading system, including the "competitive advantage" it gave Enron's traders, said Mr. Lieberman, a Connecticut Democrat, who obtained the report through his committee's inquiry into Enron. But the report "settled for incomplete, unconvincing, or incorrect answers," he said, when a "better investigation may well have exposed the cracks in Enron's foundation sooner."

"Though the report identified a number of areas that ought to have troubled FERC as the federal government's lead energy regulator, it found no reason for concern and no cause for action," Mr. Lieberman wrote in a letter today to the commission's chairman, Patrick Wood III. "This, I am afraid, was a critical mistake."

In another development, the author of the December 2000 memorandums that outlined how Enron traders had increased profits by manipulating the California electricity markets says in testimony prepared for Congress that upon learning of the tactics, he immediately warned Enron officials, including the company's head trader, that the maneuvers were deceptive and should be stopped.

The author, Stephen Hall, a lawyer at an outside law firm that was helping Enron prepare for litigation and investigations in California, is expected to deliver the testimony on Wednesday. In it, he said his supervisor edited the memos to make it clear to Enron that deceptive trading tactics may not only be in violation of the rules of the California electricity-grid operator, but "also possibly of criminal statutes."

Also tonight, the attorney general of California, Bill Lockyer, disclosed what he said were newly uncovered Enron documents that originated in late 2000 and which

he said outlined schemes to manipulate energy prices. The documents discuss the trading strategies described in the Enron memos released last week and include handwritten notes by Enron's head West Coast trader, Mr. Lockyer said.

The notes suggest that Enron made large sums trading electricity in California. One note reads: "Bought power cheap a long time ago—sold expensive. We made so much money." At another point, the handwritten notes state: "Schemes = $10 million total."

And in an apparent reference to the Williams Companies and Powerex, two of the most active traders in the California market, the notes state: "Show the Powerex/Williams—hogs at trough."

"These new documents uncovered recently in Enron's Portland office provide strong confirmation that West Coast energy markets were harmed by price manipulations and distortions by a number of players," Mr. Lockyer said in a statement.

Disclosures in the last week that Reliant Resources, Dynegy and CMS Energy used round-trip trades—in which companies swap blocks of energy in deals that essentially cancel each other—to artificially bolster aspects of their financial results continued to take a toll on the power marketing and generation sector.

Shares of Reliant have fallen 40 percent since Thursday, including a drop today of $1.24, to an all-time low of $8.70. Reliant, based in Houston, acknowledged on Monday that round-trip trades in electricity and natural gas lifted its reported revenue by about 10 percent over the previous three years.

The industry had been beaten down by the fallout of Enron's collapse and concerns that other companies in the industry might have used aggressive accounting. Disclosures about the round-trip trades have made investors even more wary of backing electricity-generation companies, and that, in turn, has regulators worried that the deluge of negative news will hamper efforts to put construction of power plants, transmission lines and other crucial infrastructure back on track.

Officials at FERC say they are investigating these trades as part of their inquiry into whether Enron and other energy producers and traders manipulated the California electricity market during the state's power crisis in 2000 and 2001.

Until now, power marketers have been allowed to report sales to the commission in vague, aggregated terms with few details. But under new rules approved with little notice last week, for every transaction they will have to state who they sold the power to, at what price, how much power was sold, and when.

Officials at the agency say this information will be publicly available, allowing anyone to take records of one company's power sales and compare that with records of the companies it sold the power to, to see whether there were offsetting round-trip trades. The first quarterly reports under these rules are expected on July 31 and cover deals from April to June, officials say.

Kevin F. Cadden, the director of external affairs at the commission, said the change in rules was in the works before concerns about round-trip trades became public last week and reflects the push by Mr. Wood to make the wholesale electricity markets more transparent and easily understood.

"Pat believes in bringing this transparency to the market," he said.

Senator BOXER. I call these people the greed breeders. Why do I say that? Because that is what they were about, and they pocketed millions of dollars. It is not fair. I am just so grateful to be on this Committee, Mr. Chairman. I am grateful to be on the Subcommittee, and thank you very much. I ask that my full statement be included in the record at this time.

[The prepared statement of Senator Boxer follows:]

PREPARED STATEMENT OF HON. BARBARA BOXER,
U.S. SENATOR FROM CALIFORNIA

Mr. Chairman, I want to start by thanking this Committee—particularly Chairman Hollings, Ranking Member McCain, and Subcommittee Chairman Dorgan—for standing with me so that we can get to the bottom of what happened to the people of California, and so that we can ensure this never happens again to my state or to any of your states.

On December 6 and 8, 2000—just as the electricity situation in California was reaching a crisis point statewide—Mr. Richard Sanders of Enron received two memos from Mr. Christian Yoder and Mr. Stephen Hall. He received a similar memo from two other individuals—Mr. Gary Fergus and Mr. Jean Frizzell.

These memos outlined, in great detail, a series of scams—scams with names like Death Star, Ricochet, Wheel Out, Fat Boy, and Get Shorty. But whatever they were called, they were scams—scams that created phony electricity shortages in California; scams that allowed electricity prices in California to be manipulated—sending the cost of electricity into the stratosphere; scams that caused blackouts that endangered the health and safety of millions of Californians; scams that resulted in an unprecedented bankruptcy of one utility company that had been in business since 1905 and the near bankruptcy of another utility company that had been in business since 1897; scams that forced the state of California to take over the buying of electricity under enormous budgetary pressure, causing the state to go from a $12 billion budget surplus to a $23.6 billion budget deficit; scams that caused great anxiety for the families of California; and scams that affected about 30 million out of the 35 million people in my state.

These memos prove what I, and many members of the California Congressional delegation, have been saying for almost two years now—that something was rotten in the electricity market of California—that the electricity market was being manipulated by outrageous schemes perpetrated by greedy energy companies. I call these companies the Greed Breeders.

We should let the memos speak for themselves.

Death Star: "Enron gets paid for moving energy to relieve congestion without actually moving any energy or relieving any congestion."

Load Shift: "The effect of this action is to create the appearance of congestion through the deliberate overstatement of loads." And: ". . . by reverting back to its true load . . . Enron is deemed to have relieved congestion, and gets paid by the ISO for so doing."

Get Shorty: ". . . in order to short the ancillary services it is necessary to submit false information that purports to identify the source of the ancillary services." And: "The traders are careful, however, to be sure to buy services right at 9:00 a.m. so that Enron is not actually called upon to provide ancillary services."

Wheel Out: Enron gets paid "without having to actually send energy through the inter-tie."

Ricochet: "Enron's intent under this strategy" is to beat the spread "and not to serve load or meet contractual obligations."

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

Selling Non-Firm Energy as Firm: Enron is paid for ancillary services—that is, stand-by electricity—that "Enron claims it is providing, but does not in fact provide."

These scams were clearly manipulative and deceptive. I believe they will be found to be illegal as well.

Under one of Enron's scams known as Fat Boy or Inc-ing—which stands for increasing load—Enron purposely lied to create the appearance of extra electricity on the grid and then was paid higher rates for it. The memos describe it as "the oldest trick in the book." It sounds to me like the oldest crime in the book.

The memos themselves acknowledge that "Should it discover such activities," the California ISO could take numerous actions against Enron, including fines, suspensions, and referral to the regulatory and antitrust enforcement authorities.

The memo is, however, silent on federal crimes and potential federal actions. I find it interesting, Mr. Chairman, that the memos mention possible state sanctions but are silent on possible federal sanctions. Was Enron so confident in its relationship with FERC that it knew FERC would never act against unjust and unreasonable rates or market manipulation?

After all, Enron wined and dined FERC. After all, more than 20 members of the Bush Administration had ties to Enron. After all, Enron was one of candidate Bush's biggest contributors and rewarded Ralph Reed—a very conservative Bush supporter—with a job.

After all, Army Secretary White was Vice Chairman of Enron Energy Services and was in charge of securing the privatization of electricity at U.S. military bases. After all, Marc Raciot, Bush's choice to head the Republican National Committee, was a lobbyist for Enron.

Some legal experts have told us that Enron may be guilty of violating numerous federal laws, including fraud and false statements, mail fraud, wire fraud, conspiracy, racketeering, and anti-trust and collusion—not to mention securities fraud and insider trading, which is another story. May I remind you of how many shares Ken Lay, Jeffrey Skilling, and others sold quietly as they were scamming California.

I understand that the Justice Department has established a Task Force to look into the Enron situation. I hope to see quick action from this Task Force. It is unfor-

tunate that Attorney General John Ashcroft had to recuse himself due to the contributions he received from Enron. I would like to see his outrage at these Greed Breeders.

This Administration has disappointed me before. During the period of these outrageous and highly detailed schemes, the Bush Administration—the one party that could do something—sat on its hands and did nothing.

In California, we were suffering from rolling blackouts. There were 49 days of blackouts from December 2000 through early May 2001—and there were blackouts every day from mid-January to mid-February.

We spent 266 percent more for electricity in 2000 than in 1999, while our demand increased only 4 percent. We were overcharged at least $8.9 billion for electricity. The state had to take over the purchase of energy, which has ripped a $23.6 billion hole in the state budget.

But here in Washington, Enron was, as I said, wining and dining FERC. The Secretary of Energy was meeting with energy companies. Ken Lay was handing the Vice President a memo arguing against doing anything to help California—and the following day the Vice President told the *Los Angeles Times* that nothing would be done.

The Vice President actually blamed California consumers for the whole thing, saying we used too much electricity. In fact, at the time, we were the second most energy efficient state on a per capita basis. Now we are the most efficient.

Enron asked the Administration to do nothing—and that is exactly what this Administration did: nothing. Nothing is what Enron wanted, and nothing is what Enron got from this Administration.

When the only agency that could have helped consumers did nothing—doing nothing was in fact a policy. For nearly a year, FERC would not impose cost-based pricing. For nearly a year since, FERC has refused to require the payment of refunds and has refused to order the renegotiation of long-term contracts.

And now FERC is talking about ending the requirement for cost-based pricing—even though the agency was asleep at the switch while all of this was going on and even though the agency still has no idea whether it is continuing.

Today, as we look into these memos in an attempt to find out who blessed these schemes, I want to find out why FERC was not on Enron's radar screen when it is in FERC's charter to protect consumers from unjust and unreasonable prices.

I also intend to ask who else was engaged in these scams. The memos claim that Inc-ing "is now being used by other market participants." And, "Although Enron may have been the first to use this strategy, others have picked up on it, too."

In describing another scam—"Selling Non-Firm Energy as Firm Energy"—the memos state, "The traders claim that 'everybody does this.'"

On Monday, Reliant Resources admitted that it had engaged in fake transactions—called "wash trades"—with four other power companies. Last week, Dynegy admitted that it too, had engaged in these fake trades with CMS Energy.

Only last week, FERC sent a questionnaire to numerous electricity companies asking if they engaged in any of these schemes. FERC should have asked that question more than a year ago.

I also intend to ask about violations of federal law.

But whatever is asked, let us not lose sight of the victims—the people of California. For justice to be done, indictments must be handed down, refunds must be ordered, long-term contracts must be renegotiated, and cost-based pricing must remain in effect. Thank you, Mr. Chairman.

Senator DORGAN. Senator Boxer, thank you very much.

We are going to change the order. We had indicated that we have three panels today. The first panel is going to be the folks who wrote the memorandums that are the subject of the hearing. Following that we will have the officials from California, and following that we will have the folks from FERC.

I would like to ask Mr. Christian Yoder, Mr. Richard Sanders, Mr. Stephen Hall, Mr. Jean Frizzell, and Mr. Gary Fergus to please come forward to the witness table.

[Pause.]

Senator DORGAN. For purposes of this hearing, we will ask that you take the oath if you are on the witness table. Would you raise

your right hand. Do you swear to tell the truth, the whole truth, and nothing but the truth, so help you God?

Mr. FERGUS. I do.

Mr. FRIZZELL. I do.

Mr. HALL. I do.

Mr. SANDERS. I do.

Mr. YODER. I do.

Senator DORGAN. Let the record show an affirmative answer by all of the witnesses.

Let me thank all of you for being here. Let the record note that you are not here under subpoena, that you have volunteered to testify voluntarily.

Let us begin with Mr. Hall.

Senator DORGAN. Mr. Hall, it is my understanding that you were the principal researcher and principal writer of the December 6th and December 8th memorandums, in consultation with Mr. Yoder; is that correct?

Mr. HALL. Yes, I was, Mr. Chairman.

Senator DORGAN. Do you have an opening statement?

Mr. HALL. I do have a statement I would like to make at this time.

Senator DORGAN. Why don't you proceed.

STATEMENT OF STEPHEN C. HALL, ESQ., DIRECTOR, LEGAL SERVICES, UBS WARBURG ENERGY, LLC

Mr. HALL. Thank you, Mr. Chairman, distinguished Senators.

My name is Stephen Hall. As an attorney with the law firm of Stoel Rives LLP, which served as outside counsel to Enron North America on certain regulatory matters, I was asked in October 2000 to research and prepare a memorandum describing certain wholesale energy trading practices at Enron. That memorandum, delivered to Enron on December 6th, 2000, characterized certain of those practices as deceptive. At the same time, we advised Enron in a face-to-face meeting that deceptive trading practices could violate the ISO tariffs as well as state criminal laws. Enron has waived the attorney-client privilege with respect to these matters, and I would be happy to assist the Committee in any way in its investigation of Enron's trading practices in the California wholesale energy markets.

I would like to provide some brief background regarding the preparation of the memorandum. In fall 2000, as an associate at Stoel Rives, I did work for various clients of the firm in the energy industry, including Enron. I worked under the supervision of Marcus Wood, a partner at Stoel Rives with many years of experience in the energy industry. In October 2000, I attended a meeting in Portland convened by Enron's litigation counsel to address the company's response to a subpoena from the California Public Utilities Commission. Attorneys from the two law firms retained to advise Enron in this matter were in attendance. During the course of that meeting, Enron traders began describing certain strategies used in the California wholesale energy market. The strategies presented were extraordinarily complex and the descriptions given were highly technical. Following that meeting, Enron's counsel asked me to review the applicable tariffs, interview Enron traders,

and seek to develop for the first time a written description of the trading strategies that were identified at the meeting. Subsequently, in addition to my other ongoing responsibilities, I talked with traders at Enron and, working with Mr. Wood and Enron inside counsel Christian Yoder, who is also testifying today, developed the memorandum that has been provided to the Committee.

As I learned about Enron's trading practices, I became increasingly concerned. In the course of my discussions with the traders, I became aware that certain of these trading strategies involved deception. For example, one strategy, dubbed Load Shift, appeared to involve submitting schedules to the California Independent System Operator that intentionally overstated or understated the load in different zones to cause the ISO to make payments to relieve the supposed congestion in the overscheduled zone. As I learned of deceptive practices, I advised the traders with whom I spoke that such practices were deceptive and that they should stop such practices immediately. I also attended meetings in which Enron traders provided assurances that such practices had been discontinued.

In addition to the descriptions of trading practices I had been asked to prepare, I took it upon myself to include in the memorandum a summary of the ISO tariff rules against gaming or deceptive practices, so that Enron would understand the ISO standards applicable to these practices and the sanctions for violations. I also discussed my findings with Mr. Yoder, who shared my concerns and requested that his name be included as a co-author of the memorandum. Mr. Yoder believed that sending a joint memorandum from both inside counsel and outside counsel criticizing these deceptive practices would assist in focusing the attention of Enron management on these issues and prevent any recurrence.

Mr. Wood, my supervising partner, also had very strong concerns as a result of these findings and wanted to ensure that Enron management understood that these or any similar deceptive strategies were unacceptable. Accordingly, Mr. Wood revised the memorandum to emphasize the deceptive nature of certain of these strategies. On December 6th, I emailed the revised memorandum to both Enron in-house counsel and Enron's outside litigation counsel.

On December 7th, 2000, Mr. Wood and I met personally with Mr. Yoder at his offices, and Mr. Wood delivered a hard copy of the final memorandum together with copies of California statutes on fraud and theft. Mr. Wood wanted it to be clear to Enron that deceptive practices could constitute violations not only of ISO rules, but also possibly of criminal statutes. Subsequently, Mr. Yoder and I——

Senator DORGAN. Excuse me. Could you give me the date of that meeting?

Mr. HALL. December 7th, 2000.

Subsequently, Mr. Yoder and I met with the head trader at Enron—I would like to clarify; that was Portland—to communicate Stoel Rives' findings and conclusions to ensure that he understood our belief that many of the trading practices involved deception.

In June of 2001, I accepted a position as an in-house attorney at Enron, where I remained for 8 months. From the time I delivered the memorandum through my brief tenure at Enron, I saw no evi-

dence or received any indication that the deceptive practices which I discussed in my memorandum ever resumed.

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

[The prepared statement of Mr. Hall follows:]

PREPARED STATEMENT OF STEPHEN C. HALL, ESQ., DIRECTOR, LEGAL SERVICES, UBS WARBURG ENERGY, LLC

Thank you, Mr. Chairman, distinguished Senators. My name is Stephen Hall. As an attorney at the law firm of Stoel Rives LLP, which served as outside counsel to Enron North America ("Enron") on certain regulatory matters, I was asked in October 2000 to research and prepare a memorandum describing certain wholesale energy trading practices at Enron. That memorandum, delivered to Enron on December 6, 2000, characterized certain of those practices as deceptive. At the same time, we advised Enron in a face-to-face meeting that deceptive trading practices could violate the ISO tariffs as well as state criminal laws. Enron has waived the attorney-client privilege with respect to these matters, and I would be happy to assist the Committee in any way in its investigation of Enron's trading practices in the California wholesale energy markets.

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In addition to the descriptions of trading practices I had been asked to prepare, I took it upon myself to include in the memorandum a summary of the ISO Tariff rules against "gaming" or deceptive practices, so that Enron would understand the ISO standards applicable to these practices and the sanctions for violations. I also discussed my findings with Mr. Yoder, who shared my concerns and requested that his name be included as a co-author of the memorandum. Mr. Yoder believed that sending a joint memorandum from both inside counsel and outside counsel criticizing these deceptive practices would assist in focusing the attention of Enron management on these issues and prevent any recurrences.

Mr. Wood, my supervising partner, also had very strong concerns as a result of these findings and wanted to ensure that Enron management understood that these or any similar deceptive strategies were unacceptable. Accordingly, Mr. Wood revised the memorandum to emphasize the deceptive nature of certain of these strategies. On December 6, I emailed the revised memorandum to both Enron in-house counsel and Enron's outside litigation counsel.

On December 7, 2000, Mr. Wood and I met personally with Mr. Yoder at his offices, and Mr. Wood delivered a hard copy of the final memorandum together with copies of California criminal statutes on fraud and theft. Mr. Wood wanted it to be clear to Enron that deceptive practices could constitute violations not only of ISO rules but also possibly of criminal statutes. Subsequently, Mr. Yoder and I met with the head trader at Enron to communicate Stoel Rives' findings and conclusions to ensure that he understood our belief that many of the trading practices involved deception.

As a point of clarification, this committee has been provided two copies of the Stoel Rives memorandum, one of which bears the date December 6, 2000 and one of which bears the date December 8, 2000. The Committee should be aware that there is only one Stoel Rives memorandum, which was finalized on December 6. The two memoranda are identical, and we believe the date on each copy simply reflects the date that copy was printed off of the computer. There is also a third memorandum before the Committee that was subsequently prepared by the Brobeck law firm. Stoel Rives had no involvement in the preparation of the Brobeck memorandum.

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

Senator DORGAN. Mr. Hall, thank you very much.

Next we will hear from Mr. Yoder. Mr. Yoder, would you proceed.

STATEMENT OF CHRISTIAN G. YODER, ESQ., DIRECTOR, LEGAL SERVICES, UBS WARBURG ENERGY, LLC

Mr. YODER. Good morning, Mr. Chairman, Senator Dorgan, and Members of the Subcommittee. My name is Christian Yoder. I am currently a Director in the Legal Department of UBS Warburg Energy, LLC, in Portland, Oregon. Prior to joining UBS Warburg in February of 2002, I was employed as Senior Counsel. I worked in Enron's Houston offices from 1994 to 1998, at which time I was relocated to its Portland, Oregon, offices.

As a lawyer for Enron, my job was to provide legal advice to the company on transactional matters, including the negotiation and drafting of master agreements with other wholesale power trading entities. In September of 2000, Stephen Hall, a third-year associate attorney at the Portland law firm Stoel Rives, outside counsel for Enron, was detailed from his law firm to work in Enron's Portland office, although he remained an associate of Stoel Rives and was not an Enron employee at that time. Around that time, I and other members of Enron's Legal Department anticipated that litigation might be commenced against Enron and other power traders who conducted business in the Western United States, and especially in California. I asked Stephen Hall to attend litigation preparation meetings, perform some basic factual research, and draft a memorandum regarding Enron's trading practices, including any problematic aspects he might identify. In connection with this assignment, Mr. Hall produced a memorandum dated December 6th,

2000. There is also a December 8, 2000, version of the same memorandum, but I believe only the date is different. Although Mr. Hall drafted the memorandum, my name was added as a co-author to indicate that I had participated in discussions regarding its preparation and content. When I received the memorandum from Mr. Hall sometime in early December 2000, I provided a copy to my supervisor, Mark Haedicke, the Managing Director of the Legal Department of Enron North America. I also believe that Richard Sanders, the Associate General Counsel, who had responsibility for overseeing litigation matters, also received a copy, although I cannot recall whether I or Mr. Hall provided it to him.

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

Senator DORGAN. Mr. Yoder, thank you very much.

Mr. Sanders, you were the recipient or the intended recipient of the memorandum that is in question. Would you please present your testimony.

STATEMENT OF RICHARD B. SANDERS, ESQ., VICE PRESIDENT AND ASSISTANT GENERAL COUNSEL, WHOLESALE GROUP, ENRON CORPORATION

Mr. SANDERS. Good morning, Mr. Chairman, Senator Dorgan, and Members of the Subcommittee. My name is Richard Sanders. I am currently Vice President and Assistant General Counsel for Enron Wholesale Services, a division of Enron Corporation. I have been employed as a lawyer for Enron since 1977. Prior to joining Enron I was a partner in the trial section of Bracewell and Patterson, a Houston law firm.

From the time I joined Enron's Legal Department until the present, my responsibility was to advise my clients—the company and its employees—with regard to pending and anticipated litigation matters.

The trading of electricity in California by Enron traders has been the subject of much litigation. In the summer and fall of 2000, because of the California energy crisis, there was a great deal of media coverage regarding the activities of electricity traders, including Enron's traders. I and other members of the Enron Legal Department anticipated that litigation might be commenced against Enron and other power traders. In or about September 2000, Enron received a subpoena from the California Public Utilities Commission regarding its electricity trading activities in California. On November 29th, 2000, Enron was sued in a class action lawsuit in California entitled *Hendricks v. Dynegy Power Marketing Inc., et al.*, which was filed in San Diego Superior Court [GIC

758565]. In connection with this pending and anticipated litigation, in early December 2000 I was provided with a memorandum from Christian Yoder and Steve Hall regarding certain trading practices. I did not direct Mr. Yoder or Mr. Hall to prepare this memorandum. After receiving it and reviewing it, I was not confident that it completely or accurately described many aspects of the trading practices. However, I directed that certain trading practices described therein be suspended and I authorized additional outside counsel to review the memorandum and the trading practices and to prepare a subsequent memorandum on these matters, so I could provide appropriate legal advice to the company. I reported the substance of these memos, as they pertained to pending and anticipated litigation, to my superiors at Enron. I understood that the trading practices that I directed to be suspended in December 2000 did not continue.

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

Senator DORGAN. Mr. Sanders, thank you very much.

Mr. Fergus and Mr. Frizzell, you were commissioned by Mr. Sanders, as I understand it, to do another evaluation. Would you proceed.

STATEMENT OF GARY S. FERGUS, ESQ., BROBECK PHLEGER & HARRISON, LLP

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

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

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

In addition, Enron had a number of other firms that regularly advised the company in areas of their expertise. These included the Stoel Rives firm located in Portland, Oregon, and Bracewell & Patterson, which has offices throughout the United States. Stoel Rives had an energy regulatory experience and routinely advised Enron with respect to such issues. At the time, Stoel Rives had what they called, "seconded," Mr. Stephen Hall to Enron to be available on premises in Portland to provide additional resources to Mr. Christian Yoder and to be available on the trading floor to respond to questions from traders.

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

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

It is my understanding that between the meetings in early November and the beginning of December 2000, Mr. Hall continued to meet with traders and gather more information. As a result of his interviews, he prepared the December 6th memorandum, which I believe is also dated December 8th.

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

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

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

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

the events that transpired during the summer of 2000. At the end of these meetings, all the defense lawyers who had been interviewing the witnesses jointly prepared the first draft of a memorandum summarizing what we had learned. This memorandum was circulated only to outside counsel and to Mr. Richard Sanders, who was part of the virtual team. There were several revisions that were exchanged amongst the lawyers in the next few days while the interviews were still fresh in our minds. This memorandum was a work in progress. The next step was to check back with the head trader in Portland to make certain that the lawyers had understood the facts correctly. Other events, however, such as the litigation with the California Power Exchange and the subsequent bankruptcy, motion practice in these California cases, and retention of experts overtook the defense team.

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

The draft memorandum was never completed because we had not resolved the factual conflicts. Other events in litigation took precedence over the factual investigation of what had happened during the summer of 2000. On December 2, 2001, Enron filed for bankruptcy and all defense efforts ceased.

I stand ready to answer any of your questions. Thank you.

Senator DORGAN. Mr. Fergus, thank you for your testimony.

Finally, we will hear from Mr. Frizzell.

STATEMENT OF JEAN C. FRIZZELL, ESQ., GIBBS AND BRUNS, LLP

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

My firm was hired in late November of 2000. We were engaged by Enron to defend Enron Power Marketing, Inc. and Enron Energy Services in previously filed class action lawsuits brought in California asserting claims that Enron and others had manipulated the markets in California for wholesale electrical power. Gibbs and Bruns was one of several firms that Enron hired, including Brobeck of San Francisco, to defend the class actions. Enron also hired regulatory specialists to represent the Enron entities in proceedings before the Federal Energy Regulatory Commission. The draft memo co-authored by me that is one of the subjects of this research was prepared by litigation counsel during the course of preparing to defend the class action lawsuits.

As is required in the defense of any lawsuit, one of the immediate tasks undertaken by the defense team was to begin a preliminary investigation of the merits and the defenses of the existing lawsuits. In this case, very shortly after we were engaged, we re-

ceived copies of a memorandum authored by Mr. Hall and Mr. Yoder. I and other members of the defense team were thereafter involved in a series of interviews with a number of Enron traders wherein the traders described the California market, the strategies outlined in the Stoel Rives's memorandum and their understanding of the impact of those strategies in the California marketplace.

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

Following our interviews, I and other members of the defense team prepared the initial draft of the memorandum on Mr. Fergus' portable computer. Mr. Fergus agreed to send the draft to us for our review and comments, which he did. However, we decided that before it would be finalized Mr. Fergus would again visit with the head trader to make sure it was accurate.

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

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

In light of the fact that Enron has waived its attorney-client privilege, I am prepared to answer any questions of the Committee and any questions they may have concerning my role as a trial lawyer in the defense of the class actions. Thank you.

[The prepared statement of Mr. Frizzell follows:]

PREPARED STATEMENT OF JEAN C. FRIZZELL, ESQ., GIBBS AND BRUNS, LLP

My name is Jean C. Frizzell. I am a partner in the law firm of Gibbs & Bruns, L.L.P. ("Gibbs & Bruns") in Houston Texas. Gibbs & Bruns is a litigation law firm whose practice consists primarily of the prosecution and defense of commercial disputes.

In late November of 2000, our law firm was engaged by Enron to defend Enron Power Marketing, Inc. and Enron Energy Services in previously filed class action lawsuits brought in California asserting claims that Enron and others had manipulated the markets in California for wholesale electrical power. Gibbs & Bruns was one of several firms that Enron hired, including Brobeck, Phleger & Harrison, L.L.P. of San Francisco, to defend the class actions. Enron also hired regulatory specialists to represent the Enron entities in related proceedings before the Federal Energy Regulatory Commission ("FERC"). The draft memorandum co-authored by Gary Fergus and me that is one of the subjects of this hearing was prepared by litigation counsel during the course of preparing to defend the class action suits.

As is required in the defense of any lawsuit, one of the immediate tasks undertaken by the defense team was to begin a preliminary investigation of the potential merits of the claims and the potential defenses to the claims made in those suits. In this case, very shortly after we were engaged, Enron provided the defense team copies of the memorandum authored by Steve Hall and Christian Yoder. I and other members of the defense team were thereafter involved in a series of interviews with a number of Enron traders wherein the traders described the California electricity

market, the strategies outlined in the Stoel Rives' memorandum and their understanding of the potential impact of those strategies on the California market.

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

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

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

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

In light of the fact that Enron has waived its attorney client privilege, I am prepared to answer any questions the Committee may have concerning my role as a trial lawyer in the defense of the California class actions.

Senator DORGAN. Mr. Frizzell, thank you very much.

We have been joined by Senator McCain, the Ranking Member on the full Committee. Senator McCain, do you wish to make a statement?

STATEMENT OF HON. JOHN MCCAIN, U.S. SENATOR FROM ARIZONA

Senator MCCAIN. I would ask my statement be made for the record. We have a long hearing and should proceed with the testimony. Thank you, Mr. Chairman.

[The prepared statement of Senator McCain follows:]

PREPARED STATEMENT OF HON. JOHN MCCAIN, U.S. SENATOR FROM ARIZONA

Thank you, Mr. Chairman, for holding this hearing on recent developments in the investigation of price manipulation in West Coast energy markets. Last month, this Subcommittee held a hearing to examine Enron's alleged gaming of the California energy market. While serious, there was little concrete evidence to substantiate widespread concerns that Californians and other West Coast consumers had been bilked by unscrupulous and largely unregulated companies.

Last Monday, however, the Federal Energy Regulatory Commission revealed what has been called the "smoking gun": a legal memorandum written at the height of the California energy crisis in December 2000, to Enron from its own attorneys, that claims to describe the energy trading strategies the company was using to manipulate the California energy system.

The memo is shockingly unvarnished—in it, a trader is quoted as talking about "the oldest trick in the book"; the memo concludes in one section that "The net effect of these transactions is that Enron gets paid for moving energy to relieve congestion without actually moving any energy or relieving any congestion"; and in another section that "One concern here is that by knowingly increasing the congestion costs, Enron is effectively increasing the costs to all market participants in the real time market." Describing Enron's strategy of "shorting" ancillary services, the memo further states that ". . . in order to short the ancillary services it is necessary to submit false information that purports the source of the ancillary services."

In stark contrast to this "smoking gun" memo, FERC also released another memo written later for Enron by other lawyers, which dismisses many of the conclusions of the first memo, suggests that some strategies that were used were not used to a significant extent, questions the inflationary effect of Enron's actions, and gen-

erally put a much more legitimate, if not altruistic, spin on the activities previously documented. I am curious as to the circumstances that led to such differing perspectives.

The facts surrounding the Enron's collapse have forced many to ask how one company could deceive so many people, at so many levels, in so many ways, for so long. I hope we will get some answers to these questions today. Disturbingly, however, while the focus of today's hearing is Enron, the memoranda released by FERC suggest that the manipulative practices described were widespread. I understand that FERC has recently asked scores of utilities to state whether or not they engaged in practices similar to those described in the Enron memos, and has instructed these companies to retain their records in anticipation of a thorough investigation.

While I commend FERC for its new-found zeal, I would like to know why the Commission took so long to act to assuage the crisis in California, a crisis that rippled throughout the West. I would also like to know, if it is shown that energy companies did bilk consumers, what remedies exist to compensate them.

Thank you Mr. Chairman, I look forward to today's testimony.

Senator DORGAN. We are also joined by Senator Cleland and Senator Carnahan. If you wish to have a short statement we would be happy to entertain it.

STATEMENT OF HON. MAX CLELAND, U.S. SENATOR FROM GEORGIA

Senator CLELAND. Mr. Chairman, thank you for holding this hearing.

The studio promotions for the movie "Get Shorty" say: "In Hollywood everybody wants, but the way they get can be outrageous." It is ironic that Enron used the title "Get Shorty" to describe one of its schemes used to get profits while all California residents wanted was their lights on.

However, this is not just about a company taking advantage of the system and making a profit. The Enron memos to me show a company on the prowl, like a young lion ready to spring on unsuspecting prey. The Enron memos show, in effect, no regard for the consumers of California, no regard for basic American energy policy, but a predator on people for profit.

What made Enron believe they could get away with such practices as scheduling pretend transactions to get paid for relieving congestion without, as is described in one memo, actually moving energy or relieving congestion? It is much like the pretend 600 companies offshore that Enron pretended to have money in but did not.

In the December 6th, 2000, memo drafted by Mr. Christian Yoder and Stephen Hall, the analysis of this practice, described in the memo by the name "Death Star," is that the California Independent System Operator "probably cannot readily detect this practice because the ISO only sees what is happening inside its control area, so it only sees half of the picture." Therefore, Enron sprang upon the State of California and took it for a ride.

Enron was looking for ways to end run or circumvent the system to maximize profits without regard to the effect on California consumers. As we examine the practices used by Enron to manipulate California's energy markets, it is essential we keep in mind the effect these practices had on consumers. Between May 2000 and June 2001, California residents experienced 38 state 3 emergencies with rolling blackouts of electricity. Certainly a lesson to be learned from Enron is that we must work to ensure an environment of

strong regulation and strict accountability to prevent consumers from suffering such a disaster like this anywhere in America.

Thank you, Mr. Chairman.

Senator DORGAN. Senator Carnahan.

STATEMENT OF HON. JEAN CARNAHAN, U.S. SENATOR FROM MISSOURI

Senator CARNAHAN. Thank you, Mr. Chairman, for convening this hearing.

I was sickened to read of Enron's strategy for manipulating the California electricity market. It is evident that the so-called energy services that Enron provided to California were as questionable as Enron's accounting. While electricity is just another commodity to Enron, another means of enriching itself, to Californians electricity is a daily necessity. Electricity is necessary to keep the lights on at the day care centers, to keep factories running, and to keep stores open for business. Without electricity, we have no economy. That gives suppliers of electricity tremendous power in a flawed market.

Thirty-eight times California was forced to declare energy emergencies and during these emergencies the state initiated rolling blackouts. The lights went out, the food spoiled, workers lost wages. We will probably never be able to quantify the price paid by California during their energy crisis.

But now we see clearly what kind of attitude Enron had to the suffering of Californians. Enron's own memos describe how Enron got paid for services it was not providing. These memos show how Enron created the appearance of congestion on transmission lines so it could be paid for alleviating congestion. That sounds to me like the arsonist who works for the fire department. They cause the problem, then rushed in to save the day.

In one memo, an Enron employee claimed that the value of congestion payments can be greater than the value of energy itself. If you talk to business owners or senior citizens who had their lights turned out, I think they would tell you that Enron did not understand the true value of energy.

While we thank competitive markets for so many improvements in the quality of life, clearly this was not a competitive market. This is an example of markets at their worst. This was a market open to gross abuse and in need of regulation and reform. Enron was a company in need of a very vigorous watchdog.

I hope that the witnesses from California can share with the Committee the wisdom gained through their experience. How can government prevent such market abuses in the future and how can electricity markets be structured to truly reflect the value of the product being traded, and how can we protect Americans from being at the mercy of rolling blackouts in the future?

I also was disturbed to learn that Enron Energy Services, a division managed by current Army Secretary Thomas White, was involved in market manipulation. I would be interested in hearing from today's witnesses exactly what Secretary White's level of involvement was in these transactions.

Thank you, Mr. Chairman.

Senator DORGAN. Senator Carnahan, thank you. I did mention at the beginning of the hearing that it will be my intention to call Secretary White as a witness at a hearing within the next two weeks.

Mr. Hall, you indicated that in the fall of 2000 you became involved in writing this report and you said you became increasingly concerned about the deception that was involved. Then you described a December 7th meeting in which you said that there was possible criminal behavior. Can you amplify that for us? What kind of possible criminal behavior?

Mr. HALL. The purpose of my memorandum was to understand and describe the trading strategies. As I noted in my opening statement, as I came to understand these strategies I realized there were deceptive aspects to certain pieces of them. Generally, the strategies involved taking advantage of loopholes in the tariffs.

At the meeting on December 7th with Mr. Yoder, Mr. Wood, the supervising partner at my firm, was there and we discussed with Mr. Yoder that under California State criminal statutes that some of these deceptive practices might possibly violate those laws. Now, I am not a criminal lawyer, and neither is Mr. Wood. So, we never made a formal analysis of whether these practices constituted violations of the criminal law. We were just——

Senator DORGAN. I understand that, but nonetheless you expressed concern about both the fact that these practices were both deceptive and potentially criminal?

Mr. HALL. Yes, Mr. Chairman.

Senator DORGAN. Is that correct?

Mr. HALL. I'm trying my best to answer your question. I'm not sure what you're asking.

Senator DORGAN. Well, Mr. Yoder, you seemed to back away just a bit. Mr. Hall said that you actually asked to have your name attached to this report. Is that the case?

Mr. YODER. Yes. They came over to the office and delivered the memo, Marcus and Steve, and we had a serious discussion of the issues. And I was advised as the in-house attorney dealing with general trading matters that there might be serious issues involved and——

Senator DORGAN. What's that mean, "serious issues"? Is that a euphemism for something I should know about?

Mr. YODER. Well, we didn't—the memo was not a legal opinion or obviously my name wouldn't have been on it. It was a preparatory memo to decide and help the litigation team with some factual analysis. And we knew there were some possible serious things under those statutes that others have cited, and so my response was to immediately get it down to Houston to the top legal officer in the company, Mr. Mark Haedicke, and make sure that the seriousness of the memo was reflected to upper management.

Senator DORGAN. Mr. Sanders, this memo, December 6th or 8th memo, is directed to you. When you received that memorandum were you surprised?

Mr. SANDERS. In one way I was surprised, which is I had not directed them to write the memo.

Senator DORGAN. I'm talking about the content. I'm not talking about whether you were surprised at receiving it. I'm talking about

whether the content surprised you, because this memorandum suggests a company that was engaged in wholly deceptive marketing practices.

Mr. SANDERS. I was not surprised by the content of it because we had had several discussions with the traders prior to the memo coming out. I participated in two of them and I knew generally of the sophomoric nicknames, and I knew that there was some question about some of the trading strategies, yes.

Senator DORGAN. How long had you known of names like "Get Shorty," "Fat Boy," "Death Star"?

Mr. SANDERS. The first time we talked to the traders.

Senator DORGAN. Which was when?

Mr. SANDERS. Which was October 3rd, 2000.

Senator DORGAN. So, is this an activity that was going on inside the company without a lot of knowledge of others, or is it something that the company itself countenanced as a strategy in which they could maximize profits? The reason I ask the question is we've had at that table Mr. Skilling and Mr. Lay and they would have us believe this is a remote control company, that really no one is running it personally. And I'm trying to understand whether there was actually someone or some group of people, which is one of the reasons we'll call Mr. White. We want to know whether there were a group of people that understood these strategies, that, A) they were deceptive and, B) they were being employed.

Mr. SANDERS. As far as I could tell, the Portland office of Enron operated mostly on its own. The head trader did report to the head trader in Houston, so you had an electricity trader from the West that reported to other upper management in Houston. And I cannot say the extent to which they knew about these strategies, but my job was to identify them and then report them to my upper management when I learned of them.

Senator DORGAN. Mr. Sanders, did you report this memorandum to Mr. Skilling?

Mr. SANDERS. I did not. I want to make a distinction between reporting the memorandum and reporting the content of the memorandum.

Senator DORGAN. The content, did you share the contents of this memo with Mr. Skilling?

Mr. SANDERS. I did.

Senator DORGAN. What was his response?

Mr. SANDERS. I told him in June, June 20th of 2001. He was preparing to travel to San Francisco to participate in a forum, I think called the San Francisco Forum, which many may remember because Mr. Skilling got hit with a pie in the face. I was trying to prepare him for questions that might come up in that forum, which was an open mike forum, and that's when I told him about the strategies, some of the nicknames and in general terms what had happened.

Senator DORGAN. If I might take just 1 minute more, Mr. Hall, in your memorandum, page 3, relieving congestion, you say congestion was created by Enron traders in the PX day ahead and then the strategies used by traders involved structuring trades so Enron got paid the congestion charge. They created the congestion, then got paid a congestion charge for relieving it.

And Death Star, you say: "This strategy earns money by scheduling transmission in the opposite direction of congestion, but no energy is actually put onto the grid or taken off the grid," and they make money from that.

Load Shift, you say: "Our concern here is by knowingly increasing the congestion cost, Enron is effectively increasing the costs to all market participants in the real time market."

Based on what you've said with respect to these strategies, is it reasonable for this Committee to believe that the strategies by Enron would have cost California and West Coast consumers substantial additional electric costs?

Mr. HALL. Mr. Chairman, with all due respect, I don't feel qualified to answer that question. Obviously, they must have had some impact, but the magnitude of it, I just, I never looked into that.

Senator DORGAN. It was probably a rhetorical question. But let me thank you for your testimony and call on our colleague, the Ranking Member of the full Committee, Senator McCain.

Senator MCCAIN. Thank you, Senator Dorgan.

Mr. Hall, in your memo you wrote that the practice of inc-ing was being used by other market participants, right?

Mr. HALL. Yes, sir.

Senator MCCAIN. What other ones?

Mr. HALL. At the time that statement was based upon a comment of one trader who I had discussions with and he said that one or two of the people who had worked on the real time desk had left and gone to other companies. So it was based upon that that I felt that other people might be using that as well.

Senator MCCAIN. I'd like to repeat the question: What other companies?

Mr. HALL. The company that I recall that was mentioned was Coral Trading.

Senator MCCAIN. In your testimony, you indicate that you met with the head trader at Enron to communicate your findings and conclusions that practices involved deception. What was the response?

Mr. HALL. The response was, first of all, that he said that he understood Stoel Rives's advice, that he understood what I was saying. He disagreed with me on several facts, particularly with respect to Death Star. He said there were technical and physical things that I wasn't taking into account in my analysis.

Senator MCCAIN. Mr. Yoder, what did you do when you were made aware that certain strategies used by Enron appeared to violate ISO tariffs and maybe even violate criminal laws?

Mr. YODER. Well, you know, what I did was work with Steve to develop the memo and discuss the strategies and make sure we understood them as best we could. We weren't traders. We did not ever implement the strategies. They were in an area of the California ISO tariff that we normally didn't pay a lot of attention to because it was a FERC-approved tariff and it was a business that was running under legal conditions that were fixed. There were no contracts to negotiate. And so——

Senator MCCAIN. Go ahead, please.

Mr. YODER. And so what I did was work with Steve to go into that complex area and dig out as much as we could of the facts.

He would come to me, we would discuss, and I was part of the preparation of the memo for giving to our litigation team that was already involved, that had come up to Portland and had meetings with us, for the purpose of getting serious legal analysis done for the company.

Senator MCCAIN. You got a memo. To any objective observer, even a non-expert such as myself, these strategies violated ISO tariffs and there was a potential violation of criminal law here. I think you clearly saw that. Didn't you see that they were in violation of ISO tariffs and potentially criminal law? Yes or no?

Mr. YODER. Well, there were arguments about the strategies, Senator.

Senator MCCAIN. Did you see a potential "violation of criminal law?"

Mr. YODER. I saw a potential which I recognized as very serious and I conveyed it to the litigation team and my superiors at the highest level in the company.

Senator MCCAIN. And what was the response of your superiors in the company?

Mr. YODER. They were concerned, and I can't testify as to exactly what they did. I got the memo down to Mark Haedicke immediately and he would have to testify what he did in that regard.

Senator MCCAIN. So, there's no visible evidence of any action being taken. Is that correct?

Mr. YODER. Well, during that time the trading strategies were stopped. I mean, the first thing you do, even before we realized or had made a final—our team had not rendered a final legal opinion on the strategies, but out of prudence we suspended them, stopped them. It was always my belief that they had stopped.

Senator MCCAIN. Thank you.

Mr. Fergus, Mr. Frizzell, either one or both of you can answer. Why did you write the memo to Mr. Sanders entitled "Status Report"? Was it requested or you thought it ought to be written? What was the circumstances there?

Mr. FERGUS. The memo was requested.

Senator MCCAIN. By Mr. Sanders?

Mr. FERGUS. Yes, it was requested by Mr. Sanders and I believe Mr. Gibbs.

Senator MCCAIN. Why did he say he wanted the memo?

Mr. FERGUS. Our job was to evaluate in the litigation that we were retained to give them advice on, was this all of the evidence? There were facts that were stated in the memo that some of us who had been in earlier meetings had different notes, different recollections, and so part of it was let's figure out what the facts are, what the evidence is, so we could give a recommendation to the client as to how they should approach the litigation.

That was the purpose. We had three lawyers or four lawyers in the room trying to understand the trading strategies, and afterwards the four lawyers were trying to get it down on a piece of paper. We found that we just had different recollections, having just heard it. Part of it is because it's so complex.

Senator MCCAIN. Just from reading the memo,——

Mr. FERGUS. Yes.

Senator MCCAIN.—do you believe that any of the trading strategies that were outlined in the memo constitute violations of ISO tariffs or criminal statutes?

Mr. FERGUS. You're referring to the December 8th or the draft?

Senator MCCAIN. Yes, December 8th.

Mr. FERGUS. December 8th. Not being a regulatory lawyer, to be perfectly honest, at that time I had not read the tariff, so I had no opinion. I was concerned——

Senator MCCAIN. Didn't reading that memo cause you any concern that those strategies might not be really in keeping with corporate behavior?

Mr. FERGUS. I didn't understand that to be your question. My concern about the strategies that were described in that memo gave grave concerns about a number of different possibilities as to that those strategies could be violative of, absolutely. But my answer was——

Senator MCCAIN. Well, if that's true, if you had grave concerns, what did you do?

Mr. FERGUS. The first thing that was done is that those strategies were stopped. I believe that the memo came out on December 8th and that following Monday, by December 10th, they were stopped. There was a period of time in November and October where those of us who had just been hired were trying to understand what we were being told.

But clearly, when the memo came out it was a very clear recollection that those strategies were suspended until we could reconvene in January and the decision was made again in January that they would stay suspended and stopped.

Senator MCCAIN. My time has expired. I thank the witnesses. Thank you, Mr. Chairman.

Senator DORGAN. Senator McCain, thank you.

Senator Hollings.

The CHAIRMAN. Well, I haven't followed this case closely, but this chart was just put up this morning by Senator Boxer. Mr. Yoder, it's quite obvious that the shortages and the price stayed up until June the 19th, when FERC then put on the price caps, isn't that right? Do you disagree with the chart?

Mr. YODER. I'm not an economist. I don't know what——

The CHAIRMAN. You don't have to be an economist. You've got 20–20 eyesight. Look at this thing and see that the price is up all during 2001.

Mr. YODER. I can see the price is up on that chart.

The CHAIRMAN. That's right, and it stayed up, and what brought it down, what stopped the practices, was FERC when they put on price caps, isn't that right?

Mr. YODER. I don't know. I'm not an economist.

The CHAIRMAN. You don't see the chart?

Mr. YODER. I can see the two events coincided in time, sure.

The CHAIRMAN. Well, maybe I can get some candor out of Mr. Hall. Mr. Hall, the proof of the pudding's in the eating. Now, we know that the practices that kept these prices going kept continuing until June the 19th, when FERC stepped in and put on price caps; isn't that correct?

Mr. HALL. Senator, do I understand your question—I think you just said the practices continued until June?

The CHAIRMAN. Yes. Everybody here at this witness table says, oh, they had the memorandum and their understanding was that they had stopped. My understanding from this chart, that they did not stop, because the prices stayed up, the shortages showed they stayed up all during 2001 after the memorandum of December 2000.

So whatever continued to keep those prices up continued; isn't that correct?

Mr. HALL. Senator, to the extent that you're saying that whatever was causing the prices to be up looked like it continued past December, I would agree with that statement.

The CHAIRMAN. You would agree with it, thank you. I thought maybe I could get some candor out of the gentleman.

Mr. Yoder, you didn't know it, but you signed this memorandum. I find Mr. Hall saying deceptive and criminal, but you signed "dummied up," "artificially increasing," and then "the oldest trick in the book." That's what you signed in the memorandum in December, isn't that right? I've got the memorandum from Christian Yoder and Stephen Hall.

Mr. YODER. Yes, I signed, I had my name put on as an author to the memo.

The CHAIRMAN. That's right. So you knew about all this Fat Boy and all of these funny things, isn't that correct?

Mr. YODER. We had discussed the strategies, yes.

The CHAIRMAN. And then as the good experienced counsel that you are, you still wondered whether or not a crime was involved?

Mr. YODER. I knew that there was a possibility of crime and I was working with the litigation team that was studying it in depth and I kept my upper management fully apprised of the seriousness of the matters.

The CHAIRMAN. Now let's get to that upper management. Who did you tell?

Mr. YODER. The Managing Director of Enron North America was Mark Haedicke at the time, and I sent him the memo immediately after Steve and Marcus delivered it to me.

The CHAIRMAN. Who was above him?

Mr. YODER. Jim Derek, the General Counsel of Enron Corp.

The CHAIRMAN. And who was above him, do we know? I'm just trying to get the chain.

Mr. YODER. Nobody was above Jim Derek.

The CHAIRMAN. Nobody was in charge of him?

Mr. YODER. Well, I mean, the Board of Directors of the company, I guess. He was the General Counsel of Enron Corp., Jim Derek.

The CHAIRMAN. The lawyers didn't institute this price-fixing scheme of Fat Boy and shortages and all these other things. The lawyers didn't.

Mr. YODER. No.

Senator DORGAN. You all were just investigating the thing.

Mr. YODER. We didn't—we were asked to get in there and try to understand.

The CHAIRMAN. Find out what was going on.

Mr. YODER. Yes. We were an investigatory, fact-finding, first cut at the strategies team. That's what we were supposed to do.

The CHAIRMAN. And as an investigatory team, who did you determine had set up this system?

Mr. YODER. Well, the commercial trading wing of the company was the wing that was doing the trading, doing the trading strategies, the commercial traders.

The CHAIRMAN. The commercial traders are the ones that set up Fat Boy and shortages and everything else, is that it?

Mr. YODER. Yes, that was the team. We didn't trade energy.

The CHAIRMAN. And what was the commercial team as you remember?

Mr. YODER. Well, in Portland there was a Managing Director of Trading who reported down to his superior in Houston.

The CHAIRMAN. Who was he?

Mr. YODER. His name was Mr. Tim Beldin.

The CHAIRMAN. Anybody else?

Mr. YODER. Well, all of the names of the—I can't recall. I could give you some of the names, but a list has been submitted to FERC of all the names of the participants in those trading strategies, and I would invite you to look at that list.*

The CHAIRMAN. Will you advise the Committee and furnish it when you get a chance?

Mr. YODER. Yes. Yes, we will, of course.

The CHAIRMAN. I appreciate it.

Mr. Hall, did you have any other than these memoranda here? Did you have any emails or any other records? Is this your complete investigation as we know it or do you have any other papers that you would like to furnish the Committee, or maybe that you would not like to furnish the Committee?

Mr. HALL. Mr. Senator, I'd be happy to furnish all of my notes that are back at my law firm.* There's a couple pouches of things there. However, I would add that all of my learning is put into this memorandum right here.

The CHAIRMAN. Please do that for the Committee. I appreciate it.

Thank you a lot.

Senator DORGAN. Senator Hollings, thank you.

Before I call on Senator Wyden, Mr. Sanders, you indicated that you advised Mr. Skilling of the contents of the memorandum, and I think Senator Hollings was trying to get at with his questions of Mr. Yoder, who's up the line here? You seem to suggest that the General Counsel reports to the Board of Directors and somehow is not involved in the line relationship. I suspect that the General Counsel has a relationship with the Board, but I suspect the General Counsel also has a relationship with Mr. Skilling and Mr. Lay; is that correct?

[Pause.]

Senator DORGAN. The answer is yes, right? I mean, this is not a virtual corporation.

Mr. YODER. No, the legal team within the company talks and advises and works with the commercial team at all levels, from the top to the bottom.

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*The information referred to was not available at the time this hearing went to press.

Senator DORGAN. I understand.

Mr. Sanders, the purpose of the question that we're trying to get an answer to is where does this strategy originate? These are very complicated, very sophisticated strategies by which people were bilked out of a lot of money, perhaps billions of dollars. Does that just originate at a corner bar someplace with some traders talking about how they might enhance revenue? Or is this a corporation in which those strategies are developed as a part of a management strategy about how to maximize profits in these markets? And I don't think you've answered that question. Could you give me your impression of where these strategies originated?

Mr. SANDERS. I believe they originated in Portland with the traders in Portland. Again, I cannot say to what extent the supervisors of Tim Beldin, the head trader in Houston, knew about these strategies. But each market, you have to understand, each market is different, so it really is incumbent upon the individual trading desk to develop strategies.

Senator DORGAN. It seems to me it would have been very hard to have created these strategies without many others having known it.

And I think the California witnesses will testify that you're wrong when you say these strategies stopped. You alerted somebody and they mysteriously, or predictably according to you, stopped. I think the California testimony will be that's not the case at all.

As I turn to Senator Wyden, would you give us the evidence that these strategies stopped when you alerted the top level management of Enron? Anybody have any evidence of that?

[No response.]

Senator DORGAN. Hello?

Mr. HALL. Mr. Chairman, I would echo the comments that were made earlier by Mr. Sanders. One objective confirmation that these strategies had stopped was that by January the Enron traders had stopped trading in the PX auction because the PX—well, the decision was made early in January, but by January 15th the California Power Exchange was bankrupt, and so there was no more strategies in that auction.

Then with the California ISO, a commercial decision had also been made to withdraw from selling into that market.

Senator DORGAN. My expectation is the California witnesses will contest that. Because you've all indicated you alerted upper management and that the strategies stopped, I would like you to, if you would, prepare in writing for this Committee any evidence that exists that you know of that these strategies stopped upon alerting management of the strategies.

Let me apologize for taking the time and call on Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman.

Last night, gentlemen, I got the handwritten notes that were prepared in conjunction with writing the December 6th memo. It sure looks to me as I review those handwritten notes that Enron was trying to keep the truth from coming out, finding excuses, and even encouraging the removal of the notes. I'm looking at one of the handwritten documents that says "Notes show Portland deals. Remove notes," exclamation point.

Another one of the handwritten documents says "No one can prove, given the complexity of our portfolio."

Gentlemen, any of this ring a bell? What it looks like are documents certainly that would have at some point gotten to you, Mr. Sanders, and could possibly have been prepared by you, Mr. Hall or Mr. Yoder. But I'd like to know if any of you are familiar with any of these handwritten documents.

Mr. SANDERS. I did review what I believe to be some of the documents you're talking about prior to my testimony. I do not know who wrote the notes. They certainly were not mine. I can say that there was no effort to conceal what was going on. My job as the litigation manager was to do the opposite: to find out what had happened, to formulate defenses to lawsuits, and to report it to upper management. So at least as far as I am concerned, there was no effort to conceal it.

Mr. HALL. Senator, this is the first time I've heard of these notes.

Mr. YODER. If the notes you have are the same ones I saw late yesterday afternoon, they're not my notes and, in fact, I don't know who wrote them. I can't testify to anything about them.

Senator WYDEN. All right, let's go to the documents that I did get yesterday and start with Death Star. The Death Star document that is of special concern to the Northwest, it says "Sometimes we sold non-firm and didn't get to save on ancillary services. E.g., if the market in the Northwest is strong, this makes our case stronger."

Does this mean that Enron was selling non-firm power in the Pacific Northwest and claiming that it was firm power?

Mr. SANDERS. Let me answer that, Senator, because I recall discussions about this particular issue, and this is why I respectfully would say that it's just a very complicated issue. It is my understanding that Bonneville Power Authority did not sell firm power in the Northwest. They did not call their power firm. We were buying BPA power and selling it as firm in California, and at least the defense the traders gave me was that Bonneville Power Authority had never cut power ever and that non-firm BPA power was actually more firm than any other power that you could buy.

So the answer was—and this just underlines the complexity of this—at least as far as that strategy was concerned, we had the arguments from the traders that that actually decreased prices in California by exporting into California non-firm power that they were calling firm.

Senator WYDEN. Now, another one of the background documents that were released last night that was used in preparing the Enron memo states: "Analyzed the ISO tariff to determine if certain trading strategies violate the tariff." What trading strategies were being analyzed that were referred to in this document?

Mr. SANDERS. I would say all the trading strategies.

Senator WYDEN. Another document refers to "Legal research on legislative history of the Bonneville Power Act." Why was Enron researching this particular matter?

Mr. SANDERS. I'm not sure the context of that. I do know that we had other issues with BPA that were not related to trading strategies in California.

Senator WYDEN. Another document, dated 10–3–2000, states: "PGE got hurt by high wholesale prices in California." Is that a reference to Portland General Electric, gentlemen?

Mr. SANDERS. I don't know, Senator.

Senator WYDEN. I got to tell you, folks, you just look at all these documents. They talk about removing notes, they talk about how complex everything is, and everything's hidden. Then you all basically say, well, look, we don't know much about it. It's awful hard to swallow all this.

Let me just continue with this particular line of questioning and a couple of questions for you, if I might, Mr. Hall. The California-Oregon border trading hub is cited in the memo as a key location for the Death Star scheme. Are you aware of practices of megawatt laundering, round-tripping, or other real or phantom transactions that involved Oregon in the schemes to circumvent the California rules?

Mr. HALL. Senator, the practices that I described in my memorandum, as they were described to me at that time, were not described as what is now being called megawatt laundering.

Senator WYDEN. What were they called at that time?

Mr. HALL. I believe the practice that you're referring to is what was referred to in the memo as "Export of California Power" or possibly "Ricochet."

Senator WYDEN. After you wrote the memo, Mr. Hall, you went to work for Enron; that's correct?

Mr. HALL. I joined Enron in June of 2001.

Senator WYDEN. At that time what did you do to notify the Enron management or Board about possible illegal activity that you've said this morning you were so concerned about?

Mr. HALL. Senator, I had already notified Enron in-house counsel and talked with Enron traders about these practices back in December of 2000.

Senator WYDEN. And you felt that everything was so hunky-dory at this point that you weren't going to work for anybody who had been involved in potentially criminal activity?

Mr. HALL. My understanding was that these were isolated incidents. I had concerns because there were certain deceptive practices. I had brought those to the attention of in-house counsel and those practices had ended. In addition, I knew that I would be working with Christian Yoder, who is a man I know to be of high integrity and who shared my concerns about those practices.

Senator WYDEN. Mr. Sanders, after you got the Hall memo, I'm still not clear what you did after receiving the memo. Did you contact Ken Lay, for example?

Mr. SANDERS. I did not.

Senator WYDEN. Why? Why wouldn't you do that?

Mr. SANDERS. Let me back up in time——

Senator WYDEN. Did you contact Jeff Skilling?

Mr. SANDERS. Not at that time, I did not.

Senator WYDEN. Who did you contact? I mean, you all come and say continually that, by God, we were out there trying to make it clear we're not for these questionable practices, we're blowing the whistle, and yet I can't see any followup.

So go ahead, Mr. Sanders. Tell us what you did to try to protect people on the West Coast. I mean, there is a trail of devastation now up and down the West Coast, and I'd like to know what you did to try to protect some of those people after you got this memo.

Mr. SANDERS. My role as a lawyer for the company was the litigation manager. I obviously wanted to get my hands around these very complex strategies to understand them so that I could either defend the company or cease the practices if I thought they needed to be stopped.

After the first meeting in Portland on October 3rd, I had many discussions with Mark Haedicke, who at the time was the General Counsel of Enron North America. On October 31st, I had a meeting with David Delaney and John Lavaratto, who were, I believe, the brand new Chief Operating Officer and the President or Chairman of Enron North America, to explain to them what we had discovered in our first meeting in Portland.

On November 20th, after the second meeting in Portland, I had a meeting with Jim Derek, who is the General Counsel at Enron, about the trading strategies. Mind you, the memos had not come out, but I'm already telling people the substance of my conversations with the traders and the substance of what had happened in these strategies.

Then on December 15th, after the memo came out, there was a meeting with myself, Mark Haedicke, Jim Derek, and Robin Gibbs, who was the head of the defense team that had been hired and an excellent attorney, in Mr. Derek's office, in which we discussed the lawsuit and the strategies.

Senator WYDEN. Is it correct—I'd be interested, Mr. Sanders, and also for you, Mr. Yoder—is it correct that Jeff Skilling was aware of these memos?

Mr. SANDERS. I don't know that he was aware of the memo. He was aware of the content of the memos.

Senator WYDEN. Mr. Yoder?

Mr. YODER. I don't know whether Mr. Skilling saw the memo or not. All that I know is what Richard has said to me, that he talked to Jeff in June. That's all I know about that process.

Senator WYDEN. Mr. Yoder, one question for you because of your expertise in energy contracts: Is it correct the prices for contracts for energy in the Northwest went up astronomically as a result of what was happening to spot prices for energy in California?

Mr. YODER. Well, as an attorney that negotiates contracts, the commercial decisions and the commercial analysis of pricing and how markets work is not my area of expertise. I mean, that's a complicated market. There was a lot going on, and I negotiate boilerplate terms of master agreements. The prices were what they were then. But I'm not an expert on interpreting or understanding markets.

Senator WYDEN. But it's correct that long-term contracts were trading at around $30 a megawatt-hour before the California market went haywire and more than $200 per megawatt-hour afterwards, isn't it?

Mr. YODER. I'm just simply not aware of the market analysis work. When I did the work and the litigation counsel got involved, it was my understanding that economists were at some point

brought in to say whether these had an effect on that market. Those people are the people that need to explain and talk about that. I'm an attorney who doesn't know much about that.

Senator WYDEN. I think my time is up for this round. But here's where I'm left, gentlemen. We've got handwritten notes that certainly suggest to me that not only was Enron trying to find excuses for what went on on the West Coast of the United States, but that you all were actively engaged in an effort to cover this up. When I see things like removing notes, that's over the line. It's not just an abstract kind of concept. It says: "Remove the notes!"

So I will tell you that I find all of this awfully hard, awfully hard to believe.

Mr. SANDERS. May I respond to that?

Senator WYDEN. That would be great.

Mr. SANDERS. I do not believe that is accurate at all. When the litigation came up in Portland, Gary Fergus and I made a specific effort to remove shredders from the floor at Enron. We also undertook, because of the subpoena that had been issued, to save every scrap of paper that Enron had related to the Portland office. That included, in a fairly widely circulated story in California——

Senator WYDEN. Mr. Sanders, I'm going to hand you this document and I'd like to know what you'd say to people at a town hall meeting in my state, where we've got people who've been flattened by this. I mean, that's something that was prepared in connection with the December 6th memo. Take a look at that.

Mr. SANDERS. And I don't know where this memo came from, and I'm happy to answer. But if I could finish what I was saying, which is the extent to which we tried to save memos—so I don't know who wrote this, I don't know what the context was. But the reality was we saved every scrap of paper, including the recycling at Enron, and saved them into boxes. And it was widely reported when we produced those for the California authorities that we oversaved, to the point where we were saving pizza boxes and et cetera.

Senator WYDEN. You're saying no documents were destroyed? We had people from California who said documents had been destroyed.

Mr. SANDERS. To my knowledge, no documents were destroyed, and, in fact, we went to great lengths not to destroy them, including saving the recycling.

Senator DORGAN. Mr. Sanders, let me just observe that the entire world knows that shredders were very busy at Enron. That's been widely reported.

Mr. SANDERS. Well, it has been widely reported, but if you go back to the facts of what was occurring in the Portland office where the trading was taking place, the shredders had been removed immediately when the subpoenas came in. Mr. Fergus and I personally removed them.

Senator DORGAN. One wonders whether they were taken to Houston.

Let me ask—I don't mean to make light of this, but let me just ask a question as I call on Senator Boxer. Do any of you have any knowledge of any sanctions that were employed against any trader that was engaged in this activity? I think to some extent, Mr.

Sanders, you seem to say, well, this is a bunch of traders who got together and decided to do these things. If that were the case—I don't necessarily believe that was the case, but if that was the case and top management was alerted to that, including your alerting Mr. Skilling about it, do you have any evidence of any trader being sanctioned or losing their job or any action taken against any trader as a result of this?

Mr. SANDERS. I'm not aware of any action.

Senator DORGAN. If action were taken, do you think you would be aware of it?

Mr. SANDERS. I don't know whether I would be or not.

Senator DORGAN. If any of you have any information, please submit it to the Committee.

Mr. YODER. I don't have any information, sir.

Senator DORGAN. OK.

Mr. HALL. Obviously, I was outside counsel, but I did observe at that time that the head trader for the real-time desk was transferred to Houston.

Senator DORGAN. Transferred to a warmer climate.

The reason I ask this question is I think it speaks volumes, if, in fact, you create a memorandum here that talks about pretty widespread deception and you alert Mr. Skilling and top management and you're not aware of anyone essentially losing their job because of it. I merely ask the question.

Senator Boxer.

Senator BOXER. Thank you.

I'm going to pick up on the issue of this memo. I just want to appeal to you gentlemen. You are not here as lawyers for Enron. You are here to help the people of the United States of America. This is serious stuff. We need you to help us, please. This is—you could say what you want here. You've been given that authority to do that, and I'm just telling you now as someone who's married to a lawyer, my son's a lawyer, my father's a lawyer, I like lawyers. Please understand your role here today. It's not to defend anybody; it's to help us. And you could really help us here if you think back.

So I'm going to help you do that. We're going to give you the front page of this memo that Senator Wyden had shown you. You said you didn't know anything. You'll see four of you except for Mr. Frizzell, four of you were at this particular meeting you said you didn't remember. I'm going to give this to my colleague to follow along here. This is the document. Could you give it to Senator Dorgan, please?

Now, you'll see your names are at the top. Maybe it will jog your memories. Mike Day was there, Mike Smith, Jeff Dosavitch, Paul Kaufman, Richard Sanders, Christian Yoder, Steve Hall, and Gary—they said the wrong names—Fergus. Now, obviously the person wrote "Ferguson," so you didn't write that memo. I sort of feel like I'm a detective here.

Now, you see this handwriting. Does anyone at all recollect this meeting you were at?

Mr. YODER. Yes, this was an October 3rd meeting. This was when Richard, the litigation team, including outside counsel, came to Portland and we had an all-day meeting to go over the trading

strategies, and our head trader came to that meeting and drew on the board and talked to us about the strategies.

Senator BOXER. Good. OK, good. Thank you.

Mr. Sanders, you still don't remember this meeting?

Mr. SANDERS. Oh, no, I remember the meeting.

Senator BOXER. You remember. OK, then let me get to this. It says "FERC docs" right there on that front page, "I'll do this." Who do you think may have written that, "FERC docs, I'll do this"?

Mr. SANDERS. I believe that these notes are Mary Hanes' notes.

Senator BOXER. Mary Hanes, Mary Hanes.

Mr. SANDERS. Hanes.

Senator BOXER. Who was Mary Hanes?

Mr. SANDERS. She was a regulatory lawyer who was in the first meeting that we had with the traders.

Senator BOXER. This is very helpful. So Mary Hanes, you believe, wrote this memo?

Mr. SANDERS. I believe so.

Senator BOXER. And it reflects her real-time notes* of what occurred. Now, one of the things she says is, "Look like we're forthcoming, show the Power Ex/Williams hogs at the trough."

Who's "Power Ex/Williams," Mr. Sanders? Do you know who that is?

Mr. SANDERS. Powerex is the state government in Canada.

Senator BOXER. Sorry?

Mr. SANDERS. It's the Vancouver power, it's the trading arm.

Senator BOXER. So "hogs at the trough," "hogs at the trough," what does that refer to?

Mr. SANDERS. I don't know.

Senator BOXER. It says "Look like we're forthcoming, show the Power Ex/Williams hogs at the trough." What do you think she meant? Can someone hazard a guess as to what she meant by that? Thank you, Mr. Yoder.

Mr. YODER. There was always a perception—there are many players in the market. Powerex is a big British Columbia government utility and many of the allegations that were thrown around involved mentioning their name. I think maybe that's what Mary is talking about. I don't know.

Senator BOXER. But what does she mean, "Look like we're forthcoming"?

Mr. YODER. I don't know.

Senator BOXER. You don't know?

Mr. SANDERS. Senator, in looking at this——

Senator BOXER. Wait a minute, wait a minute.

You don't know?

Mr. YODER. Well, I didn't write those words.

Senator BOXER. She says "Look like we're forthcoming." She's taking contemporaneous notes. Let's move on.

The next page says "Schemes," "Schemes." That sounds to me like you sat in a meeting and there were schemes being discussed. Would you agree that that's what you would take from this? Mr. Hall, do you remember this meeting?

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*The notes have been retained in the Subcommittee files.

Mr. HALL. Yes, I do, I remember the meeting. I remember the trading strategies being described.

Senator BOXER. Did you get upset when somebody may have said "Look like we're forthcoming" or that might have been discussed or the word "schemes" was used? Did it start to dawn on you that something was rotten here?

Mr. HALL. Senator, I don't remember either of those things.

Senator BOXER. You don't remember, OK. How about this. "Paid us for service we didn't provide." She was a lawyer, right?

Mr. SANDERS. Correct.

Senator BOXER. And she's sitting there taking notes, "Paid us for service we didn't provide, don't show up. Counterflow, you know you'll get paid congestion, no penalties if you don't show up. We weren't causing the congestion, say that. No one can prove, given the complexity of our portfolio."

This is a lawyer writing these contemporaneous notes.

Mr. HALL. That sounds like a description of the strategies. That sounds like what's expressed in this memorandum.

Senator BOXER. "No emails except to Richard"—that must be you, Mr. Sanders—"at his discretion." Why would that be written? "No emails except to Richard at his discretion"?

Mr. SANDERS. I remember giving the instructions that I didn't want legal analysis to be written other than with my instruction.

Senator BOXER. Why would that be, you wouldn't want emails?

Mr. SANDERS. I wanted to control the flow of emails. I thought it was a prudent matter in light of the litigation risk we had.

Senator BOXER. Because?

Mr. SANDERS. Because as a litigator I had seen many instances where memos that you would not have thought would be produced were in fact produced in litigation.

Senator BOXER. So you ordered no emails except at your direction. So this sounded like this was a meeting that you had a big say in, is it not?

Mr. SANDERS. A big?

Senator BOXER. Say in, this meeting?

Mr. SANDERS. When you're talking about litigation strategy, I was the litigation manager at Enron North America. So, yes.

Senator BOXER. How about this line, "We made so much money"? I thought that was interesting.

How about this. What does this mean, Mr. Yoder, "How long can we not disclose bookouts"? What does that mean?

Mr. YODER. I don't know.

Senator BOXER. What does that mean, Mr. Sanders, "How long can we not disclose bookouts"? What's a bookout?

Mr. SANDERS. I don't know that these are the same meetings that we attended, or if these notes that they're talking about are even in the same meetings.

Senator BOXER. Well, they're in the same handwriting.

Mr. SANDERS. Well, it talks about meeting with Jim, Bob, and Jim, and "fight with exceptions," which is not anything we were talking about.

Senator BOXER. OK. Well, what is this? What is a bookout?

Mr. SANDERS. A bookout is when you had a trading partner who, if you were selling him power and he was selling you power, you

would just agree to a financial settlement, which they called a bookout, to even out the two trades.

Senator BOXER. And why wouldn't you want to disclose it?

Mr. SANDERS. I don't know the context of this. Certainly I can say that we weren't talking about bookouts in our meetings and not disclosing bookouts. So this must be another meeting.

Senator BOXER. Well, we will verify if it's another meeting. It looks like the same handwriting, so it looks like this other lawyer was at the same.

What's the benefit of not disclosing a bookout, Mr. Hall? Do you know? What do you know, Mr. Hall?

Mr. HALL. I'm reluctant to speculate.

Senator BOXER. Well, could you try? Just speculate. What do you think it means? But you can speculate. Help us. What does it mean, "Don't disclose bookouts"? "How long can we not disclose bookouts"?

Mr. HALL. One regulatory question as it relates to power trading is physical transactions versus those that are netted out. There's lots of transactions back and forth and when power is scheduled to actually flow physically it's found to be efficient for companies to say, you're delivering 50 megawatts to me, I'm delivering 50 megawatts to you, the price difference is $10, send me $10 and we won't each flow the energy.

So there were questions that came up over time about whether, do you include everything that was ever transacted or just the things that went physical. I think that's the context, but I'm speculating because you asked me to.

Senator BOXER. Well, my question is what's the benefit? But I'll ask David Freeman that. He'll know the answer.

Then we see the "remove notes," "remove notes." "Put burden whether PUC has the jurisdiction, say no. Put burden on the PUC to go to superior court." "Put burden on the PUC to go to superior court." "PUC," that's the Public Utilities Commission, so it sounds like you wanted to push this all to court.

I know that my time—can I do a second round later or should I finish up my questions?

Senator DORGAN. Senator Boxer, I think we're going to ask the California witnesses to come next, and so if you'd just take another minute and then we will have the California witnesses.

Senator BOXER. All right. Well, can we hold the record open?

Senator DORGAN. Yes.

Senator BOXER. Because I feel that we have not covered as much territory as we need to.

Mr. Sanders, did you brief—this is a repeated question, but I want the answer on the record. Did you brief any top executives at Enron, such as Jeffrey Skilling or Ken Lay, about the information in the memos? If you did, when did you brief them?

Mr. SANDERS. I never talked to Ken Lay about the substance of the memos. I did talk to Jeff Skilling, as I said, prior to his trip to San Francisco, which I believe my meeting with him was on June 20th. It is reflected in my calendar.

Senator BOXER. And you briefed him on the schemes?

Mr. SANDERS. We talked generally about many, many things that were going on in California.

Senator BOXER. I'm asking you, did you brief him on the schemes? Did you translate to him your concern that these were illegal possibly and that you had ordered them stopped and that, according to the memos, it could be running afoul of California law? Did you brief him to that extent?

Mr. SANDERS. My recollection of talking to Mr. Skilling was I certainly told him the sophomoric nicknames that the traders had attached to the strategies, I certainly told him of at least three of the strategies that were discussed in the memo.

Senator BOXER. What was his response?

Mr. SANDERS. I know he was surprised by the nicknames, which led me to believe that he had not heard the nicknames before, which surprised me.

Senator BOXER. What about the practices?

Mr. SANDERS. The practices, I don't think I have any recollection of his reaction one way or another.

Senator BOXER. OK. Well, let me tell you something. On June 22nd, two days after you briefed him and expressed your concern about these practices, he was asked who was to blame for what was going on. His answer was: "While the Governor is not to blame, neither is Enron or other producers." The ones who are at fault in his opinion he says are the members of the State Public Utilities Commission.

I would like to submit for the record what he said and put that in the record, Mr. Chairman.

Senator DORGAN. Without objection.

[The material referred to follows:]

ENERGY EXECUTIVE SAYS DAVIS ISN'T TO BLAME IN CRISIS
ENRON CEO ALSO IS CRITICAL OF BUSH POLICIES

San Jose Mercury News, June 22, 2001

By: Chris O'Brien, *Mercury News*

Despite being smacked in the face with a pie from a protester, the chief executive of a Texas energy company with close ties to President Bush absolved Gov. Gray Davis of responsibility for the state's power woes in a speech Thursday.

And, in another unexpected twist, Enron CEO Jeffrey Skilling criticized several major points of the Bush administration's energy plan. Skilling's remarks were surprising because Enron and its chairman, Ken Lay, have been the largest donors to Bush during his political career. His conciliatory remarks toward Davis come just four days before generators and state officials begin to negotiate over the $8.9 billion that Davis claims the energy companies have overcharged the state.

Skilling also used his hour-long address to the Commonwealth Club in downtown San Francisco to deflect charges that Enron has gouged consumers or manipulated markets. He also repeated the company's assertions that the state's deregulation plan was flawed from the start.

"It is not the governor's fault," Skilling said. "He was dealt a bad hand. But it is also not the generators' or the power marketers' fault."

Before Skilling could utter a word, he received a rude introduction to the city's history of protest and pranksterism. A woman who called herself "Agent Chocolate" rushed forward and threw a pie of unidentified flavor in Skilling's face.

Police immediately escorted her out. Police later identified the woman as Francine Cavanaugh of Oakland and charged her with battery. Marla Ruzicka, a fundraiser for Global Exchange, was cited by police and asked to leave after interrupting Skilling later.

"I'd like to recognize the emotions around this issue," Skilling said at the start of his speech. "I think you'll still be angry when I'm finished."

Skilling said several times that, while Davis could have handled the emergency better, overall the governor shouldn't be blamed for a bad deregulation scheme.

"I am being genuine when I say I feel for the man," Skilling said. "He stepped into something not of his making."

Davis has made the Texas energy companies the main target of his charges that generators have manipulated the energy market.

Skilling went on to disagree with Bush's call for building more nuclear power plants and providing incentives for more exploration and drilling of fossil fuels to increase supplies.

Skilling said nuclear power is too expensive and generates waste that's dangerous to store. And he also said he doesn't believe there is a shortage of natural gas.

In addition, Skilling said he strongly differed with Vice President Dick Cheney, a former energy executive, who said recently that conservation couldn't help Californians. He applauded Californians for reducing their consumption.

"That's simply unprecedented in markets in developed countries," he said.

Senator BOXER. So two days after Mr. Skilling was told about these outrageous schemes, he goes and blames the state PUC in the newspaper.

I have to say, Mr. Chairman, that I am very sorry that we can't have another round of questioning. First of all, there was a meeting two months before the memo was written. Now, Mr. Sanders, you knew about these practices at that meeting. They were described and discussed. We have the contemporaneous notes. You were at the meeting. It took you—you said in December you put a stop to it, but you don't really know—we don't really know who you told to stop. You didn't go to the top of the company, so I don't really get it.

If I was in your position and I found out these schemes and these scams that you discussed, I would be excited about putting a call through to Mr. Lay and saying: I got to tell you as your lawyer what I just learned. But you waited until December to put a stop to it and yet you can't—none of you can prove that it ever stopped.

I read these memos, Mr. Hall. I'm glad you wrote those memos, but I didn't get a sense of outrage from you in those memos. I didn't see clear language, I recommend the company stop this. You didn't really say that, did you? You started off, "This practice is"—what is it—"the oldest trick in the book." Inc-ing, I think, was the oldest trick in the book.

But you never once said in the memo—and Mr. Yoder, you joined Mr. Hall—stop these practices. And I'm concerned about that. Why didn't you tell them flat out, stop these practices, Mr. Hall?

Mr. HALL. Senator, we did tell them to stop these practices.

Senator BOXER. In the memo?

Mr. HALL. The memo was one part of it. They were supplemented by face-to-face meetings with myself and with Marcus Wood.

Senator BOXER. Why didn't you put in the memo how you felt?

Mr. HALL. The purpose of this memo was to describe the strategies and they were extraordinarily complex, although——

Senator BOXER. Well, they weren't complex enough so that you couldn't tell what state laws might have been broken. And by the way, why didn't you touch on—could you give me the federal laws—some of those federal laws that could have been broken?

Did they ever ask you to give you a memo about what federal laws might have been broken?

Mr. HALL. Senator, I'm not a criminal lawyer.

Senator BOXER. OK, so none of these came to your——

Mr. HALL. Senator, it wasn't necessary for me to go to that level. Once I understood there were deceptive practices there, I advised in-house counsel, and I understood the practices to stop.

Senator BOXER. Well, I have to conclude. But it seems to me stunning that people of your caliber wouldn't in the memo be more direct. You said you stopped it afterwards. We want proof, I would love some proof of that. I'd like to know, and I would like the record to remain open, I want to know who each of you talked to about these shocking schemes that were called "Schemes" at the meeting you sat in on—at least that's what our notes show. We'll have to get to it. Those are at the Attorney General in California.

And you didn't in plain English in that memo say, until we talk I recommend you stop this immediately. I'm shocked after October, that meeting, none of you said—and I'd like to talk to the woman—say her name again?

Mr. SANDERS. Mary Hanes.

Senator BOXER. Mary Hanes, who wrote that, who wrote things in there that I view with great alarm, with great alarm.

Is there anything any of you want to add? I'm going to stop here.

Mr. SANDERS. I would like to add a couple things.

Senator BOXER. Yes, please, if you would.

Mr. SANDERS. I appreciate your advice to help you understand what went on at the time. I know you say that we're not under attack. I've heard a couple things that make it sound like we were trying to hide what was going on. The truth is this is an extraordinarily complex matter. In fact, I described it early on and have described it many times, it was like learning calculus in French.

We tried to understand what was going on. There were strategies, including one that I talked to some of the Committee lawyers about, that we put a stop to immediately because it was obvious that it was something that should not go on. The other strategies in talking to the traders there was an incredible amount of complexity and advocacy by the traders as to why it was good for California, why it didn't increase prices, and I think——

Senator BOXER. Well, none of that came out at that meeting. I didn't see one word that said in these memos this is good for California, make that argument. I saw things like "We made so much money," "No one can prove, given the complexity of our portfolio."

So Mr. Sanders, I really, I am distressed that you're——

Mr. SANDERS. Well, I'm trying to explain to you what occurred.

Senator BOXER. Well, I don't buy it; how's that? I don't buy it.

Mr. SANDERS. Well, I can't speak for what these memos, the context of these memos. But, in my notes, there was nothing about how much money we made in California. There was some notation as to whether it was good or not for California.

Senator BOXER. Well, I'd like to see your notes of this meeting.

Mr. SANDERS. I'd be happy to provide them.*

Senator BOXER. Thank you. I would appreciate it, because none of it, none of it, none of what you're saying in any way, Mr. Sanders, jibes with the reality, the fact you said it stopped and yet our prices went to the sky; the fact you said, oh, this is complex, as an

* The information referred to was not available at the time this hearing went to press.

excuse, that was used as a reason. No one can prove because of the complexity. It sounds like you're following her directions here.

Mr. SANDERS. No, not at all, Senator, not at all. It's to walk into an atmosphere where you're trying to learn things. As Mr. Fergus and any lawyer who was involved in the process will tell you, it was extraordinarily complex, and to try to get your arms around it I think was a difficult task.

But having said that, shortly after the October 3rd meeting, I informed many people at Enron as to what I learned. So it wasn't a process of trying to hide it, trying to deceive anybody.

Senator BOXER. I'd like a list of who you talked to and who you told. And I just have to say I'm very disappointed in your responses. I'm concerned, and the facts just don't, just don't equate to the things that you're saying.

The last point I'll make, Mr. Chairman. When somebody says this is so complicated, watch out and hold onto your wallet. Nothing is that complicated. These were scams. Mr. Hall figured it out, he put it in writing. I can understand it. And I'll tell you something: You didn't do enough. It's my opinion. It's a matter of we differ on the point. That's all.

You hurt our people, Mr. Sanders, by not stopping it, really stopping it right in that October. When somebody says hide behind the complexity, tear up the notes, no emails, and all that—I don't see how you helped us. We were suffering. Our old people were afraid that they couldn't get air conditioning or heating. It's not a matter of sitting in a nice suit in a nice meeting. It's a matter of what was happening to our people. You didn't help us and I'm really sorry. That's all I can say.

Senator DORGAN. The time is expired.

Mr. Sanders, you in a statement to Senator Boxer said that those that were "clearly wrong" were stopped immediately. Would you provide for the Committee a description of which of those practices were "clearly wrong"?

Mr. SANDERS. It's not a practice that is reflected in the memos.

Senator DORGAN. That's right, but I would ask that you describe those practices that were stopped immediately for this Committee following this hearing.

Senator Wyden wishes to make one additional question, and then we will have the California witnesses.

Senator WYDEN. It's very straightforward, Mr. Sanders. You admitted in your questioning earlier that you were selling non-firm Bonneville power as firm. Now, that just strikes everybody in my part of the world as plain old garden variety fraud. Now, I think what you are saying is, well, everybody in the neighborhood is doing it and that's kind of why it happened, and it's complicated.

But why don't you just, in something resembling English, explain to people in my region how you can sell non-firm Bonneville power as firm power?

Mr. SANDERS. Let me take the questions one by one.

Senator WYDEN. No, there's only one question. How can you justify selling non-firm BPA power as firm?

Mr. SANDERS. Because it was so reliable that it was never going to be cut, because BPA, at least as I was informed, has never cut power to anyone that they have sold to.

Senator WYDEN. Well, I guess anybody who would look at what was happening in that period of time, and the risk that this would subject people to in the Northwest, would have been a little bit more careful, rather than just fliply saying, "well, gosh, it's not going to happen."

Mr. SANDERS. I was not being flippant about it. I was trying to understand it, and I was illustrating that that was the complexity of the market.

Senator WYDEN. It's misrepresentation, Mr. Sanders. How is it anything else if you've got non-firm power and you're selling it as firm? Why wouldn't you tell people, well, gosh, we don't think it's going to happen, and be truthful with people? Why wouldn't you have been truthful with the people of the Pacific Northwest?

Mr. SANDERS. Senator Boxer is, I think, exactly right that we're here to assist you in understanding these things. I'm not here to advocate that that was correct or incorrect. The arguments that I heard from the traders, the people who I was talking to, was that the California Independent System Operator knew about it, that everybody knew about it. And when you talk about fraud—put my lawyer hat on for a second—there has to be some sort of reliance on representations, and if the ISO knows that you're doing it and is condoning you doing it, then that isn't necessarily fraud.

I'm not here to provide a defense to it——

Senator DORGAN. Well, Mr. Sanders, we will have California witnesses be able to respond to that in just a moment. Might I just make one additional point. It seems to me that the last point you and I engaged in just now suggested there were more demonstrably abusive practices going on that were not a part of Mr. Hall's memo that you stopped immediately. Is that the case?

Mr. SANDERS. There was one.

Senator DORGAN. One?

Mr. SANDERS. That I know of, that I stopped personally.

Senator DORGAN. And you stopped that immediately? What was that?

Mr. SANDERS. There was a trader in Portland who was scheduling megawatt sales in fractions, in increments. So he would schedule a sale of 22.49 megawatts. And when the power flowed, the ISO or whoever the authority was would round down in terms of delivery of the product, so they would only require delivery of 22, but they would round up for purposes of paying us.

So the net effect was we were getting paid for 23 megawatts when only 22 flowed. That's the example. And the minute I heard that, I said, not only do you have to stop that, but you have to send the money back immediately. And I remember it specifically because they argued with me that if we send the money back they'll figure out what we did. And my response was: I don't care; send it back anyway.

Senator WYDEN. How much money was sent back, Mr. Sanders?

Mr. SANDERS. I believe it was $15,000. That's what I have in my notes as to what was——

Senator WYDEN. How long did this questionable practice go on for, in your opinion?

Mr. SANDERS. My notes reflect that it was only done twice. But I mean—and this goes to sort of trying to get our arms around it—

there were clearly—that strategy, it wasn't complex, it wasn't anything other than dead wrong, and we told them that they had to stop doing it and send the money back.

Senator DORGAN. Let me thank this panel. I note again you came here voluntarily. Mr. Hall and Mr. Yoder, without your memorandum, we would not have the road map with respect to these deceptions. I think that the memorandum is helpful to us to try to understand what is happening here.

I know it is judgmental on my part, but having sat through many hours of hearings, I must say, Senator Boxer's comment rings true. One would think with what was happening here someone would just stand up and say: What in the hell is happening? This is grand theft. We cannot do this. And yet there was not that kind of outrage.

But having said all of that, I believe that the memorandum represents a road map that is helpful to us and, Mr. Hall and Mr. Yoder, I'm pleased that you wrote the memorandum and that we have the advantage of being able to follow it and understand its consequences.

Thank you all for coming to Washington, D.C., and appearing before this Committee. As I excuse you, I ask the California witnesses to come forward.

Our next panel will be a panel comprised of Ms. Loretta Lynch, President of the California Public Utilities Commission; Senator Joseph Dunn of the State Senate in Sacramento, California; Mr. S. David Freeman, Chairman of the California Power Authority; and Dr. Frank Wolak, Professor of Economics at Stanford University.

We ask that the room be cleared as quickly as possible and the witnesses on the next panel will please take their seats at the witness table.

[Pause.]

Senator DORGAN. Please clear the room, if we can, as quickly as possible.

Let me thank the next panel of witnesses for being here. We have heard from a number of you before. Let me call first on Ms. Loretta Lynch, President of the California Public Utilities Commission. Ms. Lynch, you have had the benefit of hearing from our previous panel of witnesses, and I hope that you will consider that benefit in the testimony that you are about to give.

STATEMENT OF LORETTA M. LYNCH, PRESIDENT, CALIFORNIA PUBLIC UTILITIES COMMISSION

Ms. LYNCH. Thank you, Mr. Chairman and Senators. I have submitted written testimony as well as charts and, while I want to refer to some charts, I believe you all have copies of that. I think I am going to let the written testimony speak for itself largely and actually address myself to what I have just heard.

Certainly with the publication of the Enron memos we can all now not hide from a basic truth: The California energy crisis has never been about supply or demand or any other set of economic fundamentals. It has been about the complete lack of appropriate enforcement and lax or nonexistent federal regulation.

The Enron memos describe only some of the means by which California was plundered. We now know that the regime of so-

called market-based rates approved by FERC simply has been a way of permitting sellers to avoid just and reasonable requirements of the Federal Power Act. The Enron memos are a catalogue of the misrepresentations that may be used to defeat the just and reasonable requirement. They misrepresented load, they misrepresented power plant deliveries, they misrepresented power destinations, they misrepresented transmission line loadings. We now know they misrepresented the amount of power they got paid for. We now know that they misrepresented non-firm power as firm power, although the people who sold them that power did not engage in such misrepresentations.

The sellers protest that they are merely following the rules, although the panel before us admits that they were not. The Enron memos demonstrate that the FERC-enforced ISO tariffs were broken, even as loosely as those tariffs were written, and that the scofflaws were pursuing trading strategies designed to defeat the just and reasonable standard as a matter of corporate policy. Laws were broken and laws were bent.

My first few slides demonstrate the laws that I believe were broken.

If you go to slides 1 to 4, you will see Enron's unlawful behavior.

I believe that Enron's unlawful behavior consisted of fraud and misrepresentation, as outlined on slide 1; collusion and conspiracy, as outlined on slide 2; and FERC and ISO violations. Get Shorty is admitted by Enron to be unlawful under the FERC rules. Gaming, taking unfair advantage of ISO and PX tariff rules, violate the ISO market monitoring and information protocols, as I describe there. The anomalous market behavior of what are unusual trades and transactions in pricing and bidding patterns that are inconsistent with prevailing market supply conditions also violate the ISO rules. And I believe that these strategies and practices also are potential violations of the California Public Utilities Code, as I have listed.

But even more than that, Enron's behavior demonstrates an intent to manipulate and increase prices and costs. And if they intended and did so with other companies, that may well be sufficient for conspiracy and beyond. I am going to actually leave it to Senator Dunn to talk about the criminal implications of that.

I would note, however, that all of the panelists said, well, some of these strategies ended. Well, of course they did. On December 8th the ISO petitioned the FERC on an emergency basis to eliminate California's price caps and elimination occurred on December 8th. So no longer did they need to manipulate strategies through ricocheting or parking power out of state because the FERC was letting them charge any price they wanted.

They also very carefully stated that the strategies were no longer occurring in certain markets. Of course they were not, because those markets had been destroyed by bankruptcy. The Power Exchange went bankrupt in December and thereafter power was not traded on the Power Exchange between at some point in December and January. So, at that point, these strategies, the particularized strategies mentioned in the December memos, may not have been used, or they may not have been used to increase price, because after December 8th they could charge whatever price they wanted.

That does not mean that they did not use similar strategies to make sure that they could withhold supply or they could game the market to make sure that they got the kinds of laws in California they wanted.

I would note I believe that Mr. Sanders said that he informed the Enron General Counsel on November 20th of some of these strategies and his concerns about the strategies. If you will go to slides 6 and 7, I have just pulled representative samplings of what Enron told the FERC on November 22nd and December 4th. The General Counsel knew, according to Mr. Sanders, about these activities on November 20th. On November 22nd and December 4th, they filed these statements at the FERC: "At all times Enron complied with the market rules in effect. In the current California market, market participants are unable to explain or predict the incidence or severity of system congestion. Enron's rates are consistent with the market rules established under the ISO and the PX tariffs. The rates charged by Enron this summer in California and to our knowledge all other sellers are fully permissible and consistent with the ISO's and PX's market rules."

They knew those statements were not true when they filed them at FERC. FERC relied upon Enron's statements and other sellers' statements in the November 22nd and December 4th filings to file their order on December 15th which completely obliterated any semblance of rationality in California's market. By the way, California has not yet been able to challenge the December 15, 2000, order in any federal court because of administrative manipulations by the FERC to keep us at the administrative level and deny us a fair judicial hearing.

I would note on slides 8 and 9 specifically how FERC has denied us that hearing by manipulating their administrative process.

I also would note at this time California had issued subpoenas to all the sellers and, in November of 2000, I specifically went to FERC to ask for help to enforce the subpoenas. To this date, FERC has not responded to our requests and our motions to compel the documents we requested in September of 2000.

But I would like to just turn to one element of my testimony because I think it encapsulates in fact the market power that Enron had. I note in my testimony about a meeting that occurred in Los Angeles on January 13th of 2001. This was after the California PUC had increased rates on an emergency basis, a multi-billion dollar rate increase. Members of the Clinton Administration and all the sellers' representatives, as well as California elected leaders and California energy officials, gathered in Los Angeles to talk about how we were going to keep the lights on.

At that meeting Mr. Lay stated, and my contemporaneous notes quote him saying: "If there is not a plan that is resolved this weekend, the supplies will dry up. You saw that last Thursday." And, in fact, that last Thursday California had experienced a Stage 2 Emergency.

Keith Bailey, CEO of Williams, followed. Quoting from my notes: "If we do not have a deal/public statement re the law"—meaning if California does not agree to change its law to pay any price from the sellers.

Lay later in that meeting pressed again for legislative changes and he stated and my notes quote: "It gets more and more difficult every day starting Monday morning until the comprehensive solution happens and is shown." And, in fact, starting Tuesday morning California began to experience blackouts. On Wednesday, the Governor called a state of emergency, a bill was introduced in the legislature and passed and signed in 48 hours to have the state step in and buy power at any price that the generators and sellers were demanding. And only then did the California January blackouts stop.

I would just refer you to chart 13 in my presentation, which shows the blue are Stage 2 Emergencies. That is every day before January 16th. And the red are Stage 3 Emergencies. That is every day after January 16th except for, of course, those two yellow days when the law was being considered in California and California was blacked out. These sellers, especially Enron, knew what they were doing. They knew what they were doing when they filed at FERC, and FERC has ignored our pleas for 18 months, actually 20 months now, will not let us go to court, and, in the mean time, happily continues to grant market-based power authority to seller after seller. Charts 14 and 15 show the 48 sellers who have been granted market-based authority since the December Enron memos were written.

I would ask Congress to make FERC do its job. Keep the price caps and rational price controls that are on California's market until they can get to the bottom of this, and make sure that FERC allows the State of California to have the documents it obtains in real time so that we can also go after them.

Thank you.

[The prepared statement and slide presentation of Ms. Lynch follow:]

PREPARED STATEMENT OF LORETTA M. LYNCH, PRESIDENT, CALIFORNIA PUBLIC UTILITIES COMMISSION

Mr. Chairman, Senators, thank you for the opportunity to discuss the Enron memos and what must be done to stop the further plundering of the California economy. Thirteen months ago I testified before Mr. Burton's House Committee on Government Reform in April 2001. I said at that time in my prepared testimony:

> FERC's failure to enforce the law—to require that wholesale electric rates be just and reasonable—has created an untenable situation. California faces an unbounded wholesale price risk and a dysfunctional market, characterized by pervasive market power of the sellers to demand and receive unconscionable prices and profits. Under these circumstances, no one—not the utilities, not the banks, not the state, not the ratepayers—will accept and fund an unlimited risk. California is literally being plundered, with the full knowledge and consent of the FERC.

It took FERC another two months to impose west-wide market controls and returned to California to a semblance of normalcy with its June 19, 2001 order, an order that FERC announced will expire in just over four months on September 30, 2002. Senators, we are all at the beginning of understanding what really happened in California. You cannot permit FERC to let these basic consumer protections expire until a comprehensive scheme of enforcement of the just and reasonable electricity pricing requirements has not only been established but has also been proven to work.

With the publication of the Enron memos, none of us can hide from a basic truth: the California energy crisis has never been about supply or demand or any other set of economic fundamentals. It has been about a complete lack of appropriate enforcement, and lax or nonexistent federal regulation. The Enron memos describe

some of the means by which California was plundered. It is now past time to assess how devastating FERC's failure to enforce the law has been to California's economy and to California's families.

We now know that the regime of so-called "market-based rates" approved by FERC has been simply a way of permitting sellers to avoid the just and reasonable price requirements of the Federal Power Act. By refusing to state their prices in advance through a public filing at FERC, sellers are placed in a position to commit deception or fraud. The Enron memos are a catalog of the misrepresentations that may be used to defeat the just and reasonable legal requirement—misrepresent load, misrepresent powerplant deliveries, misrepresent power destinations, misrepresent transmission line loadings.

The new disclosures about the prevalence of "round-trip" trading among the affiliates of a handful of huge energy merchants in order to create false impressions of large volumes and high prices that drive indices are additional evidence that the market-based rate regime extracts unconscionable prices from California's consumers far in excess of what the just and reasonable standard would permit.

The sellers protest that they were merely following the rules. That lie can now be put to rest. The Enron memos demonstrate that the FERC-enforced ISO tariffs were broken, as loosely as those tariffs were written; that the scofflaws were pursuing "trading strategies" designed to defeat the just and reasonable standard as a matter of corporate policy. Laws were bent, to be certain. But laws were also broken, as slides 1–4 show.

FERC's Failure to Investigate or Act

These practices are not news to FERC. FERC was warned that these kinds of practices were occurring. California has been complaining to the FERC about just these kinds of behaviors, since at least September 2000. Governor Davis and I and key California legislative leaders called on FERC to investigate these kinds of behaviors as early as August and September of 2000 and the CPUC offered to partner with FERC in the investigation. FERC never responded. California has been complaining to both the Clinton and the Bush Administration FERC for over 20 months now about the kinds of practices detailed in the Enron memos to no avail. Slide 5 details FERC's inaction. The CPUC offered on numerous occasions in the Summer and Fall of 2000 to cooperate with the FERC staff in pursuing the investigation that led to the December 15, 2000 order. We were rebuffed. Indeed, subpoenas that we asked FERC to enforce in November 2000 are still unenforced. Our offers to the new FERC to jointly investigate California's market failures and seller behaviors have similarly not been accepted.

In order to maximize the value of these strategies to the sellers, price caps had to be eliminated without change to any other structural element of grid management, which FERC did on December 8, 2000. FERC took this, and its subsequent action on December 15, 2000, on the basis of explicit findings that the types of misrepresentations and malfeasance described in the memos were not taking place. Either the FERC was misled by seller interests in the course of its investigation or it deliberately ignored without comment evidence in its possession that illegal acts were possibly taking place. Enron did do its best to mislead the FERC in its filings during this period, as slides 6 and 7 demonstrate.

Instead of joining with California to get to the bottom of the market manipulation and fix the loose or nonexistent market rules, FERC has done its best to put off in depth investigations, refused to work with the state on investigating these problems jointly and by manipulating their own administrative processes, has refused to allow California to present its case to a neutral judge in a federal court.

FERC Fights Judicial Review of its California Orders

The attached timeline in slide 8 shows how it is that 18 months and many billions of dollars after FERC first decided the issues, California is still not able to obtain judicial review. Slide 8 is just one example of how California has been stymied in its efforts to challenge FERC's decisions that caused the California energy market to careen out of control. FERC began relaxing what little price cap controls California had in place with the publication of its draft ruling November 1, 2000. California immediately protested by objecting and filing administrative briefs in front of FERC as we were required to do.

To date, that draft ruling, the December 8th emergency action and FERC's December 15th complete elimination of price caps continue to be stuck in FERC. See Slide 9. FERC has opposed California's attempts to get California's complaints about FERC's lack of process, lack of evidence supporting the elimination of price caps and lack of evidence demonstrating that FERC's lax regulations would prevent market

power and gaming in front of any federal court through arcane procedural moves that use the FERC's rehearing process to defeat federal court jurisdiction.

Given this record of delay, Congress needs to ensure that the courts enforce the Federal Power Act's existing provision which provides that if FERC has not acted on a petition for rehearing within 30 days, it is deemed denied and the parties may proceed to the appellate court. FERC currently evades this provision by issuing non substantive "tolling" orders, hindering judicial review.

The Effects of FERC's Failure to Enforce—A Market Unbounded

It is critical to set the lack of FERC action in Fall 2000 and 2001 against the broader context of what was occurring in the CA market. Slide 10 compares natural gas prices nationally against those in CA. As is demonstrated, CA natural gas prices spiked to over eight times the price of natural gas nationally. The chart also shows California's attempts to stop the manipulation. Within a month after I was appointed President of the CA Commission the CPUC filed an action against El Paso and its subsidiaries for illegally manipulating California's natural gas markets. We knew then that El Paso had perfected using its affiliates and its market power to illegally create artificial shortages and to drive up the price of natural gas. FERC refused even to grant CA a hearing to present its evidence for over a year after the filing date—and throughout the huge run-up in natural gas prices during the winter of 2000–01.

But the natural gas facts turn much more sinister when overlaid against what was happening at FERC concerning electricity regulation. The sellers had been complaining for months by November 2000 that rising natural gas prices meant that the price caps would not allow them to function profitably. FERC took those assertions at face value. Natural gas prices spiked just before CA ISO Executive Director Terry Winter ran to the FERC on December 8th, 2000 claiming that CA's price caps must be eliminated. FERC relied on what we now know to be false shortages in early December, 2000, shortages Enron admits in its December 6th memo having partially caused, and on high natural gas prices, prices about which FERC had California's complaint on which it was sitting, to justify blowing out the only protection CA had against the gouging that was occurring. The Enron memos show us exactly why FERC's enabling actions were so devastating.

FERC failed to investigate in the early fall, failed to allow CA to present its evidence of natural gas manipulation, failed to accept CA's offers to work together; failed to enforce the CPUC's subpoenas for basic information from the sellers and their scheduling coordinator representatives, but saw fit in four hours to remove the price caps. And FERC continues to this day to fight California's efforts to challenge their actions in a neutral venue—a federal court.

Chart 12 shows what happened to wholesale electricity prices when FERC removed the price caps. California's prices spun out of control, quadrupling in a matter of days, and the utilities, which were bleeding up until that time, began to hemorrhage rapidly. California again and again called upon FERC to act. We at the PUC swung into action and began emergency rate relief proceedings the next week, culminating in a multi-billion dollar retail price increase on January 4th, 2001, within a month of FERC's elimination of wholesale prices.

Enron and the Sellers' Ability to Manipulate the Market to Influence Governmental Decisions

Emboldened by FERC's inaction, the sellers increased their audacious practices. The week after the PUC instituted emergency retail price increases, as prices rose and supplies tightened, stage two emergencies were called in CA on January 9th, 10th and 11th, although peak demand on those days only reached normal low midwinter levels. Meetings occurred in Washington D.C. on January 9th and 10th with California elected officials, energy officials, sellers and Clinton Administration officials at which no agreement was reached.

Another round of meetings was called, this time for Los Angeles. On Saturday, January 13th, 2001 we gathered in Governor Davis' offices to discuss the CA electricity crisis further. At that meeting, as the sellers pushed Governor Davis and legislative leaders to guarantee payment for power at any price and pushed to change CA law, my contemporaneous notes of that meeting reflect Ken Lay, CEO of Enron stating the following: "if there is *NOT* a plan that is resolved this weekend, the supplies will dry up. You saw that last Thursday." Keith Bailey, CEO of Williams followed: "If we don't have a deal/public statement re: the law." Lay was referencing the Stage Two power emergencies CA had just experienced.

Later in that meeting, as Lay pressed for legislative changes, he stated: "It gets more & more difficult every day starting Monday morning until the comprehensive solution happens & is shown." And lo and behold, that is exactly what happened.

Slide 13 graphically depicts what was occurring during these key meetings and during key governmental decisions. That next week, as the CA Legislature debated whether to change California law to allow the State to step in and buy outrageously-priced power for the utilities, California experienced Stage Three emergencies on Tuesday, January 16th, necessitating turning off interruptible customers and water project power; CA experienced a blackout of power on Wednesday January 17th, in hindsight as "motivation" for the CA elected officials to do what the sellers demanded. An emergency purchasing bill, SB 7x, was introduced on Thursday January 18th as CA experienced its second January blackout, back to back with the first. Within 48 hours after introduction, that bill was passed and signed, prompted in no small part by the back to back blackouts occurring during deliberations about this change in law.

The rest of that week, on January 19th through the 21st, CA experienced Stage Three emergencies and had to drop nonfirm electric load as the state began purchasing power at the exorbitant rates demanded by the sellers.

In retrospect and with the admissions in the Enron memos it is obvious that the sellers could and did hold CA hostage to their demands. Thus, the state's intervention into the power buying business was forged by a crisis of the sellers' own making. And FERC was nowhere to help.

During this time, FERC was busily granting market price authority for scores of the major power sellers, however. Slides 14–15 detail all the applications and re-applications for market-based pricing authority that FERC has granted since the December Enron memos were written. Those memos alone show the market was broken, that illegal and unethical market power abounded. FERC should have determined, on the basis of sound evidence, that the market was truly competitive—namely that it worked without gaming—before it granted any market based authority. Additional applications for market based pricing authority are still pending at FERC. In the face of the pervasive unethical and illegal behavior, admitted by Enron, FERC should revoke all market-based pricing authority and should grant no further market based pricing authority until it can assure this Congress and this nation that the market works to provide California with just and reasonable wholesale electricity rates as required by federal law.

Summary of Needed Action

FERC must assure this Congress and this nation that it can perform its job and get to the bottom of this pervasive fraud. Until it completes a thorough investigation, in which the evidence it obtains is open to the state of California and to the public, Congress should ensure that the following protections are taken (slide 16):

- The regime of market based rates as it presently functions at FERC must be fundamentally overhauled,
- West-wide market price caps, "must-offer" orders and anti-Enron pricing protections (collectively often called "market mitigation measures") must remain in place so that creative minds cannot find new forms of manipulation for taking the money of California businesses and families.
- FERC should be required to finalize its orders so that CA can finally have its day in court and Congress should require the courts to enforce the "deemed denied" provision to FERC's rehearing process;
- FERC must revoke the market based pricing authority that rests on false and fraudulent assumptions of competitive markets that simply do not exist in California.
- FERC must give Californians their money back—both for past market manipulation in 2000 and 2001 and for future excessive long term contract prices paid because California was forced to negotiate long term contracts at excessive prices just in order to keep the lights on last year.
- In those FERC refund proceedings, CA should have access to all the data and documents FERC obtains in its investigation into the sellers' activities.

Thank you for your courtesy.

SLIDE PRESENTATION

Testimony of

Loretta Lynch
President, CPUC

before the U.S. Senate Commerce Committee Hearing
May 15, 2002

California Public Utilities Commission

Enron's Unlawful Behavior

Fraud and Misrepresentations

- **Selling Non-Firm Energy as Firm Energy** – ISO pays for Ancillary Services that Enron claims it is providing, but does not in fact provide
- **Fat Boy or "Inc'ing" Load into the Real Time Market** – artificially increases the load on the schedule submitted to the ISO to be paid for real time energy deliveries
- **Death Star** – Enron is paid for relieving congestion without actually moving any energy or relieving any congestion
- **Load Shift** – by knowingly increasing congestion costs, Enron increases the costs to all market participants in the Real-time Market
- **Non-Firm Export** – Enron is paid to relieve congestion by scheduling an export of non-firm power in the opposite direction of a constrained transmission path – then cancels the export

Enron's Unlawful Behavior

Collusion and Conspiracy

- **Ricochet/MW Laundering** – Enron bought energy from the PX in the Day Ahead Market, sent it out of California to a willing partner, then buys it back to sell the energy at a higher price to the ISO real-time market.
- **Fat Boy or "Inc'ing" Load into the Real-Time Market** – Enron, on behalf of itself and clients including PowerEx and Puget Sound, "is able to submit a schedule incorporating generation and balance the schedule with "dummied-up" load from Enron Energy Services.

Enron's Unlawful Behavior

FERC and ISO Violations

- Get Shorty – is admitted by Enron to be unlawful "paper trading"
- Gaming – taking unfair advantage of ISO & PX tariff rules and procedures or transmission constraints
  (ISO Market Monitoring & Information Protocol (MMIP) § 2.1.3)
- Anomalous Market Behavior – Unusual trades or transactions, pricing & bidding patterns that are inconsistent with prevailing market supply conditions. *(MMIP, § 2.1.1 et seq.)*
- Potential Violations of California Public Utility Codes *§§ 2102-04, 7, 8, & 14*

Enron's Behavior Demonstrates Intent to Manipulate and Increase Prices/Costs

- Fat Boy
- Death Star
- Load Shift
- Ricochet/MW Laundering
- Selling Non-Firm Energy as Firm Energy

Investigation, Data and Refund Requests Go Unanswered

- Since **August 2000**, the CPUC has sought FERC investigation of and remedies for abuse of market power by Enron and other marketers.
- On **November 6, 2000**, the CPUC asked FERC to issue subpoenas to Enron and other marketers regarding abuse of the California markets. FERC has not responded.
- Since **August 2001**, the CPUC has been seeking refunds from Enron and others in the Pacific Northwest refund case.
- Since **October 2001**, the CPUC has sought FERC action to provide limits on Enron's Transwestern pipeline affiliate. FERC never responded.
- **October 2001**, CPUC filed opposition yet FERC recently issued a new rule terminating the requirement for both generators and marketers like Enron to file their contracts at FERC.
- On **December 2001**, CPUC asked FERC to limit the ability of Enron and others to engage in affiliate abuses, by FERC's affiliate standards rulemaking, which FERC commenced in September 2001. FERC has not yet curbed affiliate abuse.

Enron Doubletalk to FERC

In pleadings filed November 22 and December 4, 2001 at FERC, Enron and others misled FERC

- "Enron's rates . . . were consistent with the market rules established under the market rules under the ISO's and PX's Tariff."
- "At all times, Enron complied with the market rules in effect."
- In the "current California market . . . market participants are unable to explain or predict the incidence and severity of system congestion."
- "Without specific findings that specific sellers of electricity influenced prices this summer in California by withholding service and excluding competitors over a period of time, the Commission cannot conclude that such sellers exercised market power."

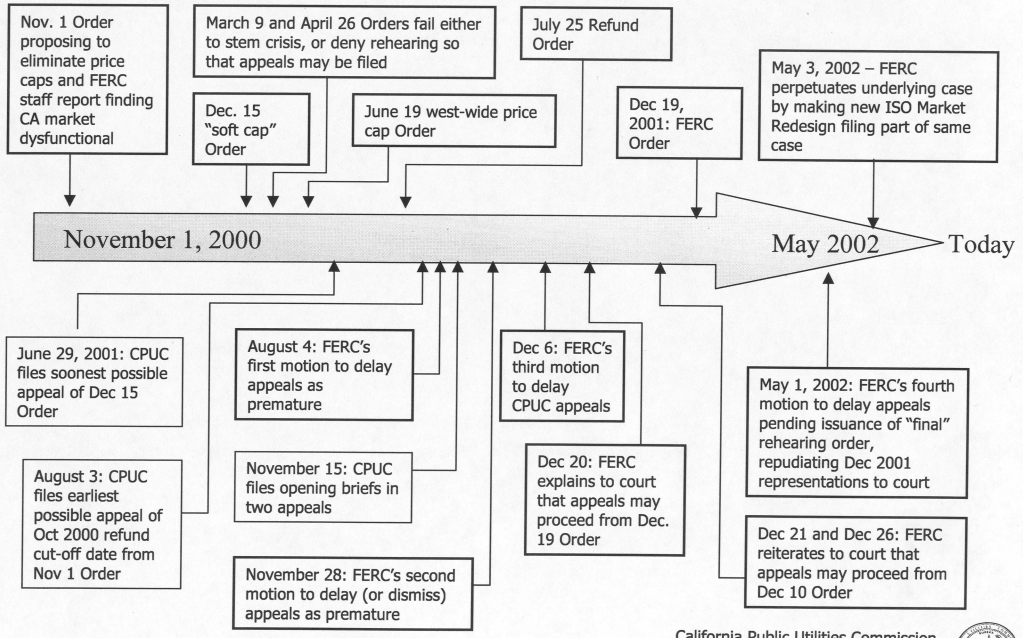
cont'd….

Enron Doubletalk to FERC (cont'd)

- "The rates charged by [Enron] this summer in California, and to our knowledge all other sellers, are fully permissible and consistent with the ISO's and PX's market rules."
- Enron "followed the market rules, charged the filed rates, and engaged in entirely rational economic behavior."
- "Generators and marketers have already begun shying away from the California market."

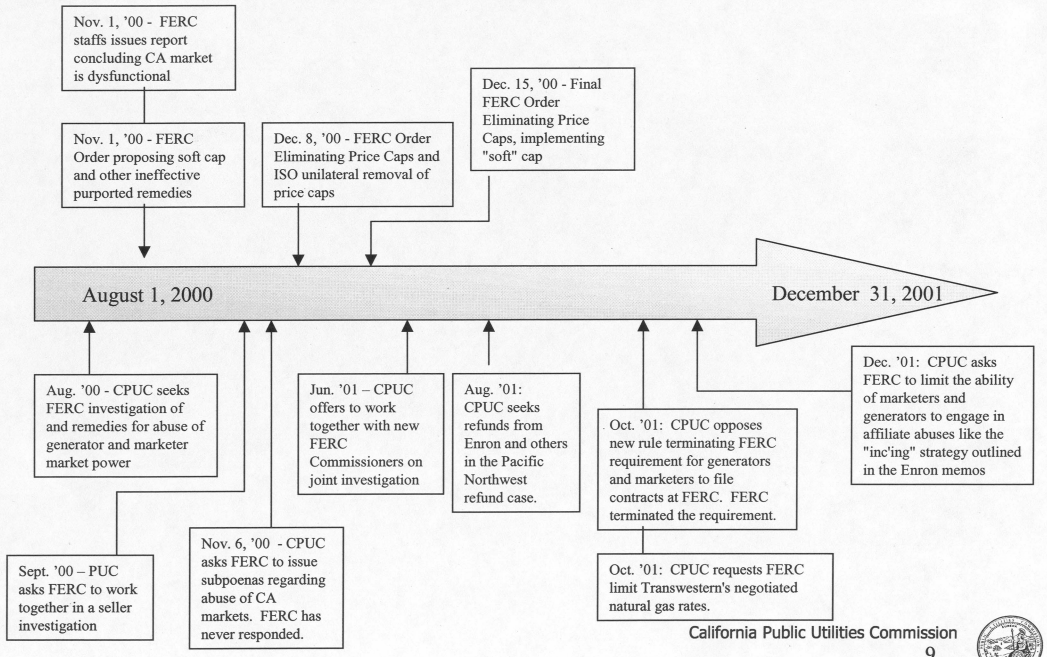
FERC's Rolling Barrier to Judicial Review

(FERC continues to bar California from challenging its 2000-01 Orders)

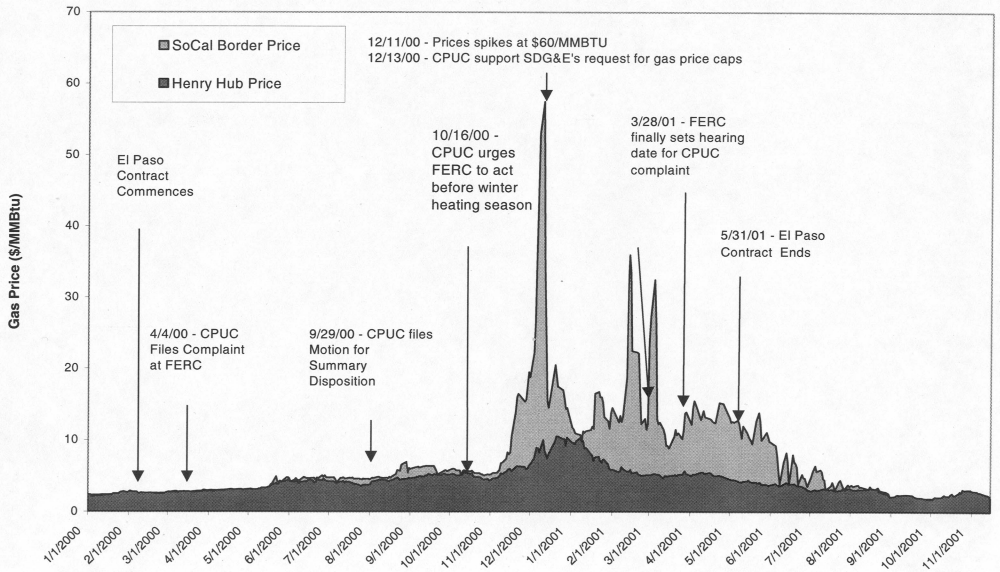


California Public Utilities Commission

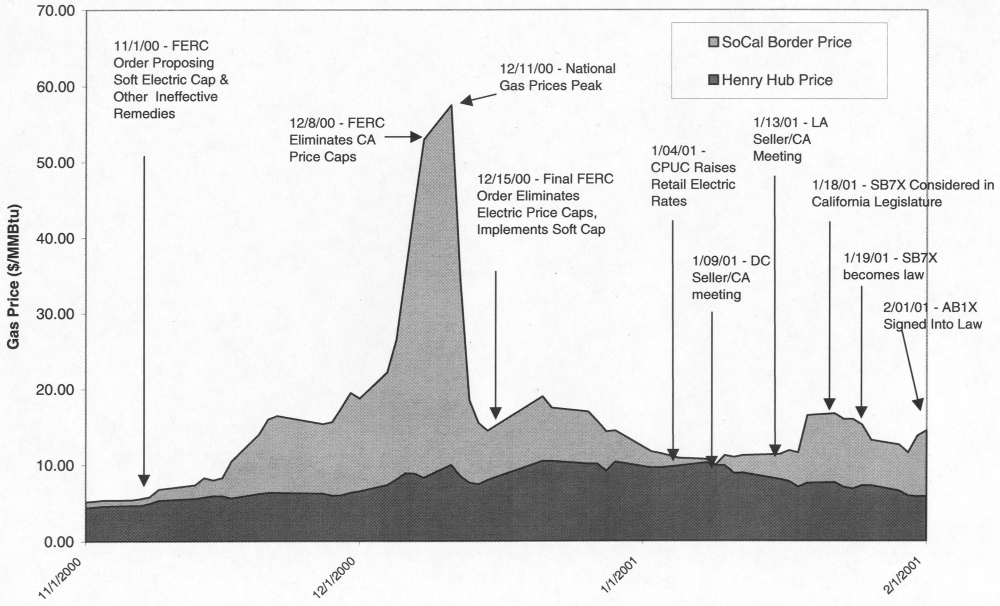
FERC Lack of Response to California's Unreasonable and Unjust Prices



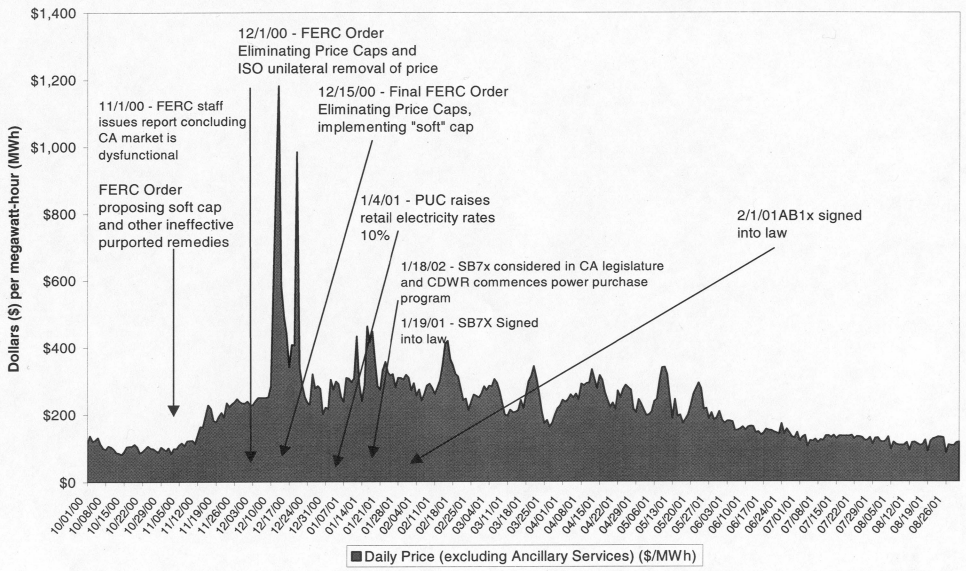
Southern California Border Gas Prices Increase Much More than Henry Hub Prices in 2000-2001 Due to El Paso Market Power

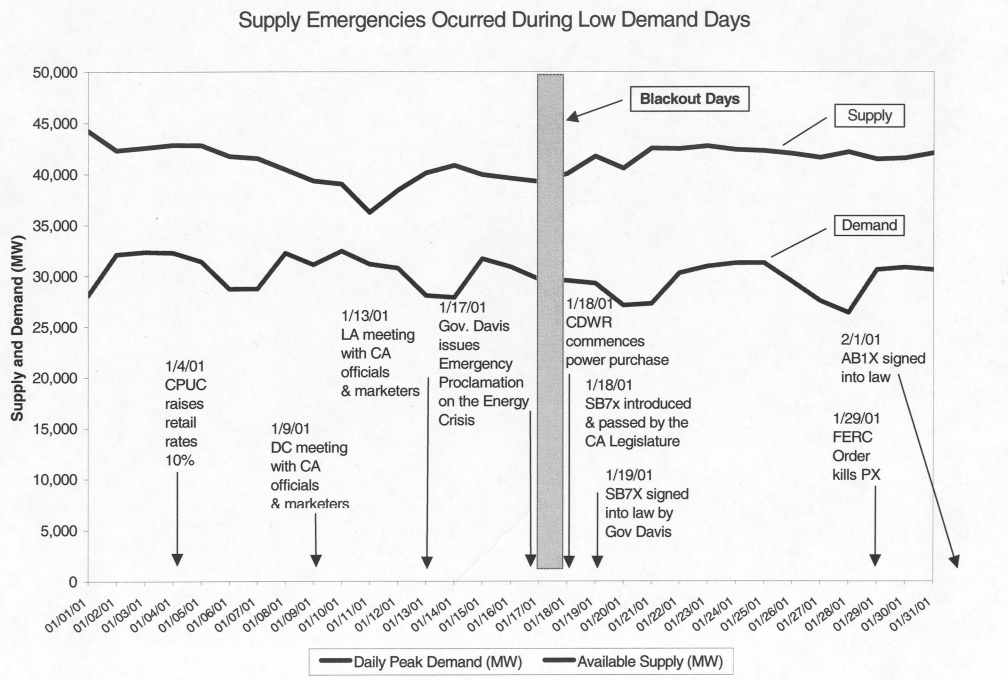


High Natural Gas Prices Impact FERC Electric Decisions



High Electricity Prices Occur Around Key Government Decisions





California Public Utilities Commission

FERC Continues to Encourage Market-Based Rates

Energy Companies Granted new Market-Based Tariffs post 12/06/2000

Source: FERC web site, Lexis

	Company	FERC Approval Date
1.	Duke Energy Mohave, LLC	18-May-01
2.	STI Capital Company	1/8/2001
3.	Cook Inlet Power, L.P.	1/9/2001
4.	Mountain View Power Partners, L.L.C	2/14/2001
5.	Attala Generating Co., L.L.C.	2/28/2001
6.	Mountain View Power Partners II, LP	4/26/2001
7.	Sempra Energy Resources	5/2/2001
8.	Sundance Energy	5/3/2001
9.	NEO California Power, L.L.C.	5/9/2001
10.	Enron Energy Services, Inc.	5/9/2001
11.	Idaho Power Company	5/9/2001
12.	Sierra Southwest Cooperative	5/13/2001
13.	Northwest Regional Power, L.L.C.	5/15/2001
14.	Celerity Energy Of New Mexico, LLC	5/15/2001
15.	Sierra Southwest Cooperative	5/31/2001
16.	Duke Energy Moapa,L.L.C.	6/6/2001
17.	San Manuel Power Company, L.L.C.	7/17/2001
18.	Sunrise Power Company, L.L.C.	7/25/2001
19.	Northern Lights Power Company	7/26/2001
20.	VIASYN, Inc.	7/26/2001
21.	Fountain Valley Power, L.L.C.	8/1/2001
22.	Sunrise Power Company, LLC	8/1/2001
23.	Pierce Power LLC	8/1/2001
24.	Haleywest L.L.C.	8/1/2001
25.	PPL Southwest Generation Holdings.	8/10/2001
26.	Huntington Beach Development, L.L.C.	8/17/2001
27.	Megawatt Marketing, LLC	8/20/2001
28.	Electric City Energy Producers, LLC	8/20/2001
29.	Huntington Beach Development, L.L.C	8/23/2001
30.	CalPeak Power - Midway LLC	9/12/2001

FERC Continues to Encourage Market-Based Rates

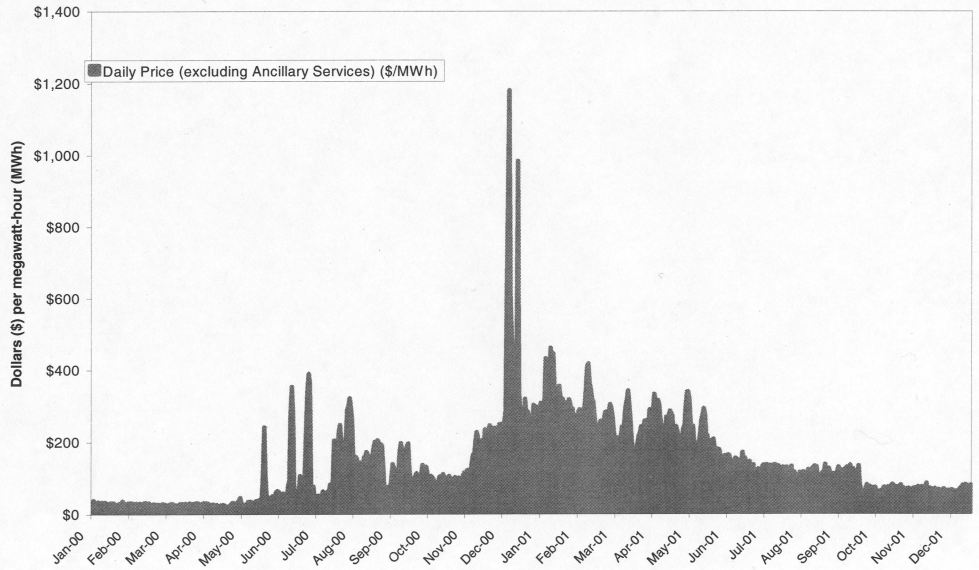
Energy Companies Granted new Market-Based Tariffs post 12/06/2000

Source: FERC web site, Lexis

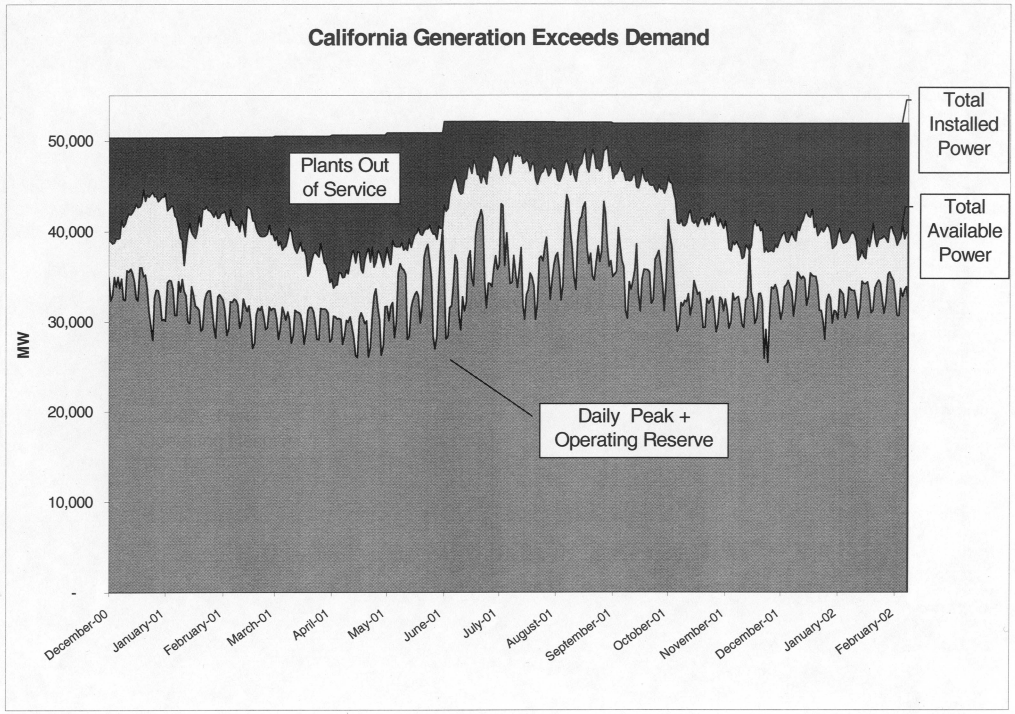
	Company	FERC Approval Date
31.	High Desert Power Project, LLC	9/18/2001
32.	California Electric Marketing	9/21/2001
33.	Plains End, L.L.C.	9/24/2001
34.	Exelon Energy Company	9/28/2001
35.	Pro-Energy Development, L.L.C.	10/11/2001
36.	Energy Transfer - Hanover Ventures	10/29/2001
37.	IDACORP Energy, LP	12/6/2001
38.	New Mexico Electric Marketing, LLC	12/10/2001
39.	Roseburg Forest Products Company	12/13/2001
40.	Hermiston Generating Company, L.P	12/14/2001
41.	GWF Energy LLC, Southern Company Services, Inc.	12/19/2001
42.	Attala Energy Company, LLC	12/20/2001
43.	Attala Energy Company, LLC	12/27/2001
44.	Condon Wind Power, LLC	12/27/2001
45.	South Point Energy Center, LLC	1/11/2002
46.	Colton Power, L.P.	1/31/2002
47.	UBS AG	3/12/2002
48.	Rail Energy of Montana, LLC	8/10/2002

Congress Should Require FERC to Act Immediately

- Require Maintenance of Current Price Caps thru 2003
- Require Maintenance of Current Must-Offer Orders thru 2003
- Revoke Market Based Wholesale Price Authority for Every Company Filing after December 2000
- Negate the Long Term Contracts Signed While the Gaming Was Occurring
- Order Refunds
  - Retrospectively - $8.9 billion
  - Prospectively - $21.0 billion
- Impose a "deemed denied" provision on FERC'S Rehearing Process and Require FERC to finalize its Orders
- Ensure FERC grants the states equal access to all investigation documents and data



California Public Utilities Commission


California Generation Exceeds Demand
MW
50,000
40,000
30,000
20,000
10,000
-
December-00
January-01
February-01
March-01
April-01
May-01
June-01
July-01
August-01
September-01
October-01
November-01
December-01
January-02
February-02
Plants Out of Service
Daily Peak + Operating Reserve
Total Installed Power
Total Available Power

Senator DORGAN. Ms. Lynch, thank you very much.

Next we will hear from State Senator Joseph Dunn. Senator Dunn, you have been with us before. Please proceed.

STATEMENT OF HON. JOSEPH DUNN, CALIFORNIA STATE SENATOR

Senator DUNN. Thank you, Mr. Chairman, fellow members, particularly our home state Senators, Senator Boxer. It is a privilege to be here. Also to thank California's Congressional Representatives who are here, as well, today. I appreciate their presence.

As most of you are aware, I chair the Senate Select Committee that has been investigating the energy crisis in California in the California State Legislature for over 14 months now. I proudly say that we are probably the one entity that has issued more subpoenas, taken more depositions, reviewed more documents, conducted more hearings than probably anybody in the country with respect to the energy crisis.

Senator DORGAN. Senator Dunn, how many people do you have working on this investigation?

Senator DUNN. It depends upon the particular event, Mr. Chairman, but probably somewhere between 10 to 12 full- and part-time combined, Mr. Chairman.

I am here to comment on two distinct issues. One of them is the issue of whether criminal violations have occurred; and second, I want to make some comments with respect to the December 8th issue. Before I do that, I want to make just some very brief preliminary comments if I may, Mr. Chairman.

I have been asked many times since Monday of last week when the documents by Enron were released what the significance of those documents are to our and other investigations. My answer has always been the same. The contents of the memorandums are no surprise. We have known about these strategies for a long time and, with all due respect to Commissioner Wood, so has FERC.

The significance is not its contents. The significance is that they are the first, in my view, honest admission by a market participant of the real root cause of the California energy crisis. I have referred to the Enron memos as the jailhouse confession of the crimes we have known were committed.

The release of those documents has allowed us to move past the excuses, past the excuses we have heard for over two years now that it is a shortage of electricity—not true—it is a sharp rise in demand—not true—bad deregulation process—not true—and even when Enron went bankrupt many of the other market participants said, well, the real root cause is Enron and it is a rogue player. Not true. All excuses, all lies.

In fact, in the last week since the release of the Enron documents, the dominos have begun to fall within the industry. You have already read the press accounts of other market participants admitting to certain manipulative behavior and I can assure this Committee that many more dominos will fall in the coming months.

But the memos show something else, a deliberate plan to attack California. Fat Boy, Death Star, Get Shorty, all show an intent well beyond anyone's imagination. It underscores what many of us

in California have said for a very long time: California should not have declared a state of emergency in January 2001; it should have declared a state of war, because that is, in fact, what we have been in in California.

Now let me go directly to the two points that I know the Committee is most interested in, the potential criminal conduct issue and the impact of December 8th because it is referenced in those Enron memoranda. So let me go to the one question. You have heard other lawyers dance around it, to be perfectly frank with you, and I will acknowledge that lawyers can have reasonably different opinions on the same set of facts and the application of the law.

But with respect to my opinion, based on the work that we have done thus far in our investigation committee, the question to me is whether the Enron documents released last week evidence criminal conduct, the answer is an unequivocal yes. Bear with me, Mr. Chairman. I am not going to talk about, as referenced before in the questioning, garden variety fraud. I am going to get to something that is uniquely Californian. There is an obscure penal code section in California, Penal Code section 395. It was enacted many, many, many years ago, not in any reference to the energy crisis in California.

It says very simply that it is illegal, it is a crime, to employ any fraudulent means to impact a market price. It is my view that every one of these acts of manipulation, every day, every instance they exercise these manipulative strategies, they engaged in a fraudulent practice for the purposes of impacting the market price.

Now, most people look at section 395 and dismiss it because the crime is a misdemeanor, and I suspect everybody here today would say, you know, with all due respect, Senator Dunn, no one really has any interest in pursuing a whole bunch of misdemeanors against these market participants. But that view forgets what that underlying repetitive criminal behavior lays the foundation for. So let me move to the more serious nature.

Those series of misdemeanors day in and day out, not only by Enron but by other market participants, along with the use of wire and mail services, including Internet services, serve as a basis for a violation in my opinion of a well-known criminal statute. It is called the Racketeering-Influenced Corrupt Organization Act, or RICO. That underlying series of misdemeanors in my view leads potentially to convictions under the RICO statutes.

Third, while we have believed for a long time that circumstantial evidence exists for potential antitrust or at the federal level Sherman Act claims, the memos provide in my opinion the first direct evidence of antitrust violations. Please remember that antitrust can be shown by direct collusion, i.e., the Fat Boy strategy, or other means, such as patterning their behavior after one another, called conscious parallelism. I believe that the evidence now exists to pursue such claims.

One final note on the violations of the law. The underlying section 395 sections noted above also may give rise in my view to a per se violation of the California Civil Unfair Business Practices Act, probably the one place California will see the reimbursements

it is entitled to, because I have no faith that they will occur at FERC.

With your indulgence, Mr. Chairman, just a few more comments. Let me turn to the December 8th issue. The Enron memos released last week reference December 6th, 7th, and 8th. Those were perhaps the most critical time periods, period, in the California energy crisis. I raise this issue because I believe the manipulative strategies referenced in those memorandums, which are not alone to Enron, were used not only for the purposes of extracting excess profits, they were also used for purposes of driving policy decisions in California. Allow me to explain.

I have referred to the day of December 8th as the palace coup, the day that the ISO management went around the ISO board, who was responsible for the direction the ISO will go, and made an emergency application to FERC to eliminate, as President Lynch indicated, the California price caps. However, if you look at the memorandum and other documents that we have reviewed, it appears that there may have been an intent in the works for several weeks before December 8th to create an artificial impression that there was a shortage of electricity that could only be alleviated by the removal of California's price caps.

The ISO CEO testified in his sworn deposition in front of our investigation committee that he made the decision to make that filing on December 7th. Yet, in reviewing some of the traders' logs of some of the market participants, we believe they were preparing for the removal of those price caps several days before that.

We implore this Committee and FERC to look deeply into the events surrounding December 8th, because we are fearful that there was a much grander conspiracy in play for the purposes of giving the industry what it sought, and that was the removal of the price caps that were in place via ISO with FERC approval. This includes looking into not only ISO and FERC, but the law firms that are associated with it, as well. In my written testimony, I reference as an example one of those law firms. And I implore this Committee to examine that aspect of it because they are probably outside the reach of our Committee.

Let me conclude. Where are we now with respect to our investigation committee? Following the release of those memos, seemingly almost in sync with FERC for the first time ever, we issued a set of written questions to each of the other market participants, yes or no questions, asking them to admit or deny whether they engaged in the same strategies outlined in the Enron memos.

Those responses were due yesterday. No one has responded. Tomorrow, back in the California State Senate we will have a compliance hearing, at which time if we do not receive satisfactory explanations as to why the answers have not been given, we will move forward with contempt charges against all the market participants that have failed to respond to those set of interrogatories.

In conclusion, I said it before when I was here last time, I will say it again: I do not have any problems with deregulation, but this deregulation was perhaps the greatest fraud ever perpetrated on the American consumer. I plead with you, as I did before, to use the full weight of your investigative powers to look at all aspects of this market. You will only get it via subpoena. That is the only

way it will come. And I think you will find yourself in the same position that we are now, concluding very reluctantly that, yes, there was anticompetitive behavior, yes, there was unethical behavior, and yes, there was illegal behavior.

We stand ready and willing to help this Committee in all of its endeavors in any way possible, and I end with the same request as President Lynch: In the meantime, to stop the damage while we can figure this all out and complete the investigation, we need those price caps extended beyond September and we need the market-based rate authority revoked until a real competitive market can be established.

Thank you, Mr. Chairman.

[The prepared statement of Senator Dunn follows:]

PREPARED STATEMENT OF HON. JOSEPH DUNN, CALIFORNIA STATE SENATOR

Good morning, Subcommittee Chairman Dorgan, Senator Boxer and members of the Committee on Commerce, Science and Transportation.

I am Joseph Dunn, a California state senator and chair of the state Senate Select Committee to Investigate Price Manipulation of the Wholesale Energy Market. I testified before your committee last month, and at that time I detailed my familiarity with the California market and the ongoing crisis in our energy markets. My committee's investigation has provided me with unique insight into Enron's role in the market's dysfunction and its arrogance toward California consumers, as well as that of other market participants. The committee is continuing its extensive investigation into all aspects of the energy crisis. We have held numerous hearings, taken countless depositions, conducted various interviews and meetings with experts and interested parties and reviewed millions of documents throughout the United States.

In light of the most recent disclosure of Enron's trading strategies in the California market, I appreciate the opportunity to testify again before this committee. The three memoranda released by Enron last week are the products of a dogged determination to get to the truth and to employ the powers of government—in this case the power of the California state legislature—to seek justice. The content however is no surprise. We and the FERC have known about the behavior for some time. Justice will not be fully served until the unlawful behavior outlined in the memoranda is stopped, is punished and measures are taken to ensure that the misconduct does not occur again.

Most significantly, these memoranda allow us to finally put aside the "evolution of excuses" we have faced since the opening bell of the energy crisis. Prices skyrocket and consumers are told they are suffering the short-term "pain" of deregulation. Prices remain high and generators falsely explain that California is a victim of its own demand—despite ranking 48th of the 50 states in per capita energy usage and a demand growth of just four percent year after year. Then we are told there is an outright shortage—a myth that persists today. Next they tell us that the crisis is the result of "bad market rules," the generators' and traders' way of justifying manipulative behavior. When Enron declared bankruptcy, we heard the refrain from other market participants that these were the acts of a "rogue company." It's time to stop listening to the excuses. The Enron memoranda and the recent admissions by other market participants reveal the truth about the cause of the energy crisis: certain market participants gamed the system to reap excess profits on the backs of Californians.

You should be aware that these documents were obtained due to the relentless pressure of our investigation, and others', and specifically because of the subpoena power invoked by, among others, our state legislature. I believe our committee stands alone in the duration and tenacity of our search for the truth. Although I have hope for the Federal Energy Regulatory Commission (FERC) under Chairman Wood's direction, Californians are deeply skeptical of the FERC's intentions. Despite protestations to the contrary, the FERC has known of the manipulative strategies since at least the beginning of 2000, if not earlier. This knowledge should buoy your resolve to investigate other market participants where warranted. Enron's admission about one aspect of its manipulation, "Inc-ing," is ample reason for alarm: "Although Enron may have been the first to use this strategy, others have picked up on it too." The evidence seems to show this is true for *all* of its strategies outlined in the memoranda.

Why did all that has happened occur? A likely answer lies in Enron's (and probably others') approach to risk management. As told to Congress in January 2002, by Professor Frank Partnoy:

> Enron's risk management manual stated the following: "Reported earnings follow the rules and principles of accounting. The results do not always create measures consistent with underlying economics. However, *corporate management's performance is generally measured by accounting income, not underlying economics. Risk management strategies are therefore directed at accounting rather than economic performance.*" This alarming statement is representative of the accounting-driven focus of U.S. managers generally, who all too frequently have little interest in maintaining controls to monitor their firm's economic realities.

I focus my testimony today on a specific discussion of the unlawful behavior I believe is demonstrated in these memoranda and a broader narrative of what makes them so troubling. I attempt to put these memoranda in context, for it is no coincidence that two of these memoranda are dated in early December 2000. You need to understand and question more than the content of the memoranda; you need to understand the timing of their creation and the timing of their release to the public. As of December 7, 2000, it appears from market participant documents that some of the market participants were experimenting with scenarios that could push the post cap price past *$3,000* per MWh.

I also admonish you not to be duped by the conveniently undated third memorandum released by Enron. After reading the damning laundry list of offenses contained in the first two memoranda, dated December 6, 2000 and December 8, 2000, counsel for Enron made a feeble attempt to put a positive spin on the manipulative strategies, presumably for the very occasion of their future discovery. They did so by attaching tempering monikers like "draft" and "preliminary" to the first two memoranda. Neither memorandum was identified as such and should not be considered as such. Do not fall for this attempt to diminish the adverse impact, prevalence or intention of these strategies. The undated memorandum was damage control. It should offend you that acts of plunder could be so glibly given names as they were so cavalierly given life.

Unlawful Conduct

Let me address the one question on everyone's mind: Do I believe the market participants engaged in illegal conduct? While reasonable attorneys may disagree on interpretations of the law, I believe the answer is an unequivocal "yes."

Antitrust Violations

These memoranda take us another step forward in making a case that Enron and others engaged in antitrust behavior in the California electricity market. This claim is not made lightly—our committee has focused on a "subset" of antitrust law, an anti-competitive market condition called market power, which I discussed with you last month. Market power is illegal in this market, and I believe many market participants have exercised it. Professor Wolak, testifying before you today, has also testified before our committee on this very point. I agree with him that the market is broken. These memoranda, however, may indicate why. Certainly, the memoranda seem to provide direct evidence that Enron and others were engaged in better-understood antitrust behavior—collusion.

The most direct evidence of collusion from the memoranda is: "In some cases, i.e, 'Fat Boy' Enron's traders have used these nicknames with traders from other companies to identify these strategies." In other words, the traders' collusive manipulation and coordination was so pervasive and advanced the parties actually developed signals in the form of nicknames to communicate among themselves about their unlawful acts.

In addition to the direct evidence of collusion, there is ample evidence the market participants violated antitrust laws through conscious parallelism. Conscious parallelism is a legal concept defined as the coordination of collusion without an actual (or explicit) agreement in which each party signals the others by their conscious parallel behavior. The above reference to the "Fat Boy" strategy is not only evidence of collusion, but is also an example of conscious parallelism.

Violations of California State Laws

California Business & Professions Code section 17200 prohibits unfair competition, which means and includes any unlawful, unfair or fraudulent business act or practice.

I believe there is little doubt that the strategies outlined in the memoranda constitute at a minimum, unfair business practices and acts. For example, one of the

strategies called "Get Shorty," and characterized as "paper trading," requires that "false information" be submitted to the California Independent System Operator (CAISO).

Enron's "Ricochet" strategy, known more commonly as megawatt laundering, is another example of potentially illegal conduct. "Enron buys energy from the PX in the Day Of market, and schedules it for export. The energy is sent out of California to another party, which charges a small fee per MW, and then Enron bought it back to sell the energy to the ISO real-time market."

This strategy requires complicity from the out-of-state party purchasing the energy—the entity "scheduled for export." In this case, Enron uses the out-of-state party as a virtual escrow account as a way to avoid price caps in the in-state market. This behavior implicates other companies and provides evidence that Enron's behavior rises to the level of fraudulent and anti-competitive behavior.

California Penal Code Section 395 also prohibits the conduct described in the memoranda. California Penal Code section 395 provides:

> Frauds Practiced To Affect The Market Price. Every person who willfully makes or publishes *any false statement, spreads any false rumor, or employs any other false or fraudulent means or device, with the intent to affect the market price* of any kind of property, is guilty of a misdemeanor. (Emphasis added).

The memoranda describe the "Load Shift" trading strategy in which Enron creates the appearance of artificial congestion by deliberately overstating its loads. Enron then reverts back to its true load and is paid congestion charges from the CAISO. The memoranda state: "One concern here is that by knowingly increasing the congestion costs, Enron is effectively increasing the costs to all market participants in the real time market." This amounts to an admission that Enron knows that it is affecting the price in the congestion market and that it deliberately overstated its load in order to drive up the congestion price. This load shift trading is an example of a violation of Penal Code section 395.

Enron's misbehavior in the market may also be a violation of Penal Code section 396, which prohibits excessive and unjustified price increases in essential goods and services during a declared state of emergency. On January 17, 2001, California Governor Gray Davis declared a state of emergency due to the energy crisis and electricity is clearly an "essential good." The memoranda acknowledge that the strategies Enron employed resulted in lower energy supplies in California and caused higher energy prices. The memoranda further admit that the strategies may have contributed to Stage 2 emergencies. Violations of Penal Code section 396 are also deemed violations of Business & Professions Code section 17200.

Finally, Penal Code section 182 provides that it is a felony to conspire to commit any crime. These memoranda indicate that persons from separate corporations may have conspired to commit fraud on the regulators, consumers and managers of the state's energy markets.

Commodities and RICO Violations

In addition to these instances of violations of California law, I believe that Enron and others broke federal law as well. As James Newsome, chairman of the Commodities Future Trading Commission, has testified before the Senate, while the bilateral and multilateral trading markets maintained by the energy traders were exempt from the registration provisions of federal law, they are not exempt from its anti-fraud and anti-manipulation provisions.

I am troubled by recent admissions by Reliant that it engaged in phantom trading practices intended to create false stock valuation, a violation for which Dynegy also stands accused. Reliant announced on Monday that it had engaged in transactions involving simultaneous purchases and sales with the same counterparty and the same price—so-called "round trip" trades. These transactions, involving more than 100 million megawatt hours and 45 billion cubic feet of gas over the last three years, increased Reliant's revenues by about 10 percent during that period. The company's CEO has blamed these violations on "misguided employees," but the problem is much more deeply rooted—industry players have admitted that "round-tripping" was a common practice among the major players. Though Dynegy has not admitted guilt, we believe its argument that the trades were intended to test a computer system is specious. To the extent that this practice falsely inflated corporate earnings, these companies are in violation of federal securities disclosure laws.

Put together, the evidence suggests that Enron and other market participants used the mail and wires to defraud the State of California and its consumers. Given this, I believe they may have violated the Racketeering Influence Corrupt Organizations Act, commonly referred to as RICO.

The CAISO Complicity

I have talked about the unlawful conduct we believe Enron and others engaged in. Now I address a troubling aspect of the memoranda. The date, December 6, 2000, of the first memorandum is not, in my mind, coincidental. It implicates the CAISO as a willing or, or at best, unwitting participant in the process.

I have previously detailed to the committee how Enron successfully lobbied for the market rules that allowed for later exploitation. What is important for you to understand, and to act upon, is that by the time these memoranda were written Enron was the market. It was the market regulator, a key market participant, a market speculator and, as the memoranda reveal beyond any doubt, a market manipulator.

Committee members and staff have struggled for months with the question of regulatory oversight during the energy crisis. We have asked many times, "Who was watching the store?" Others have recounted the shortcomings of our federal regulatory bodies, including the FERC, but I will focus on one of FERC's charges, the CAISO. I contend that CAISO management knew, or should have known, about the games Enron and others perpetrated on the market. Further, I believe CAISO management was either co-opted by Enron and the marketers participating in the California market, or it was incompetent in the handling of the manipulative strategies. Either way, CAISO failed in its duty to regulate the market.

I call CAISO a regulator very much against its will. CAISO officials object to the label—they argue that their duty is simply to "keep the lights on." By way of background, CAISO is a non-profit, public-benefit corporation charged with the neutral management of the state's electricity grid. In lay terms, CAISO was responsible for sending the proper amount of megawatts across the state's electric wires.

Inherent to this responsibility is the management of "load," or the demand of consumers. CAISO has the real-time duty of figuring out *exactly* how much electricity is needed, minute-to-minute. By design, the balancing of real-time load was CAISO's job—maybe shedding 50 megawatts in San Francisco when demand was less than anticipated, or finding 150 megawatts for San Diego when the load turned out to be greater than expected. The shedding and acquisition of load took place in a neutral auction market, called the imbalance energy market, run by CAISO. The auction was supposed to represent a small share of the state's overall need—somewhere in the neighborhood of five percent on a bad day.

But managing load made CAISO a de facto regulator, and despite its protests, it is impossible to deny. Its duty to regulate is the reason why it sought the ability to employ price caps, and it is the reason why it employs a staff of economists for its Department of Market Analysis (DMA), which is charged with monitoring the market to ensure there is no manipulation of load or of its neutral auction.

Given that CAISO was supposed to regulate the market, one might reasonably expect that it had been granted certain regulatory powers—perhaps to mete out discipline to participants it found guilty of market manipulation, or something more banal, like failing to fill out a form or failing to provide notification in a timely fashion.

Instead, its behavior is governed by a voluminous, complicated tariff subject to varied interpretations, which even the CEO, Terry Winter, testified he has never read. Penalizing bad behavior is apparently not part of the tariff, if not in theory, then certainly in practice. The tariff is a lengthy, complex legal document whose enforcement provisions are rarely used by the CAISO to protect consumers and ratepayers. It appears to me that the legal teams composed by every single market participant understand the nuances and use the tariff more adeptly, albeit in more self-interested ways, than CAISO. This should not be surprising in light of the fact that Mr. Winter reportedly views the market participants as CAISO's constituency as opposed to consumers and ratepayers.

The tariff, like speed limit signs, was intended to manage behavior. In both cases, behavior is only modified when there are penalties for violations. Radar guns make costly speeding tickets more likely, turning the decision to speed into a calculation of expense in a risk-reward equation. This is exactly the model that should have been employed by CAISO, only the radar gun, in this case a host of DMA reports of the exercise of market power, was consistently ignored by the "officer," CAISO management.

How did it get this bad? The energy crisis in California can be divided into two discrete periods, before and after December 8, 2000. Intending no disrespect, this is a date that will live in infamy for California consumers.

What Lead to the Crisis?

As noted in my prior testimony, symptoms of a pending crisis were noticed as early as May 1999, when Enron deliberately overscheduled hundreds of megawatts of electricity through a line equipped to handle a tiny fraction of that. It was an

admitted "test" of the system, Enron said, a loophole that exposed problems in one of the markets. But it was more than another strategy put to the test and given a Hollywood nickname—it was a watershed event that proved how ill equipped, or unwilling, the markets' protectors were to remedy market flaws and to punish bad actors.

I use this term, "protectors," quite intentionally. I use it to underscore the faith that consumers, small business owners, taxpayers and especially the poor, placed in the regulators' stewardship of a deregulated electricity market. This was no small task. It remains a job of extraordinary importance, one that requires untiring vigilance and unerring, unbending discipline. I can say without equivocation that not a single protector—no regulator, no market manager, no market monitor—did right by the California consumer or ratepayer. The energy crisis was not only a failure of the market participants to behave legally and ethically, but was also a failure of oversight and a failure of protection.

Not the least of these failures was that of CAISO. Though May 1999's "test" of the market took place on the watch of its sister market manager, the California Power Exchange (CalPX), CAISO was aware of the event and did little to protect consumers from similar practices to which it would later fall victim. Instead, both CalPX and CAISO kept their respective markets in check with price caps, the bane of free marketeers and a major taboo to the energy industry.

Caps had been in place almost since the beginning of the market. The first cap was quickly put in place in 1998 in a move that illustrates the reactive nature of CAISO. Shortly after the market opened, an "unnamed" generator submitted a $9,999.99/MWh bid, an anomalous event that rightfully raised red flags within CAISO. What is interesting about the bid is that its rather curious amount was limited only by a generator's misunderstanding of the CAISO computer system's capabilities—in other words, the generator did not believe the computer could handle a bid higher than $10,000. Caps remained through the end of 1999 and into 2000, when the issue became politicized.

The CAISO "stakeholder board," as it was then known, was a microcosm of differing viewpoints, as any stakeholder board would be. We have been told during numerous depositions that, despite these differences, the board was cohesive and "acted in the best interest" of the state.

Price cap votes (there were six in 2000) were always privately contentious. At first, the votes represented consensus opinions, and however acrimonious the behind-the-scenes discussions may have been, the board usually presented a united front on the issue. By summer 2000 this began to change as San Diego Gas & Electric (SDG&E) was the first to cross the still-deregulating market's expected finish line, as the utility became eligible to charge its customers the "true" price of electricity.

SDG&E's wholesale costs were passed on to an unsuspecting public that summer, inspiring a well-documented political firestorm that fractured the CAISO board. Coupled with the state's first rolling blackout in Northern California on June 14, the board's price cap decisions helped usher "CAISO" into the vernacular of the rate-paying public. Imagine how strange it must have seemed to the volunteer stakeholder appointee: their once-obscure board of an unknown corporation, which functioned to monitor something everyone took for granted, was suddenly a topic for watercooler discussions.

The board was the public face of CAISO, but not where its power was centered. Price cap decisions framed CAISO's public persona, and not surprisingly, the board voted with a shaky certitude to ratchet down price caps each time the issue was decided. Generators represented on the board, including an Enron representative and the president of the generators' trade association, who acted as Chair of the CAISO board, railed at their inability to win a majority and keep the caps from being lowered.

The generators argued throughout the summer and fall of 2000 that price caps limited future investment in the state and that the caps were fast approaching (and surpassing) the break-even point of generators. To drive this point home, each time the cap was lowered, power mysteriously grew more scarce. The relationship between availability and price was impressed upon fellow board member, CAISO CEO Terry Winter.

The price cap issue reached a fever pitch in October 2000, when a consumer-representative to the board introduced a proposal referred to as "load-differentiated price caps." Put simply, CAISO would set a fluctuating, maximum price for electricity as it related to demand, with a maximum price of $150; as demand fell, the price for each megawatt would fall in concert, and as load grew, the maximum price grew with it. The board tabled a vote on the proposal when it was first introduced,

to allow CAISO's staff to run a full work-up on the idea. On October 26, the CAISO board gave the nod to the proposal by the narrowest of margins.

Enter CAISO management and its self-proclaimed "constituents," Enron and the market participants. Like any corporation, CAISO was run by a board to which management was supposed to report. It was the custom that management would carry out the orders of the board after any change in direction or policy. This might require management to prepare legal filings, put in motion tariff amendments for review by the FERC or institute upgrades in software to accommodate such changes as load-differentiated price caps.

Not so this time—CAISO management declared mutiny. Not a single effort was undertaken to implement the board's load-differentiated price cap decision after it was made. No memorandum was written, no phone call made, no software ordered.

Instead, Enron, including Ken Lay himself, and every generator, appealed to the FERC in writing to intervene and to do away with the most recent price cap. Each and every letter was dated October 31, 2000. The very next day, November 1, 2000, in a now-infamous missive that revealed its allegiance, the FERC overturned the CAISO board's decision, reinstated a previous price cap threshold of $250 and ordered the stakeholder board reconstituted.

It was an unmitigated victory for Ken Lay, Enron and other market participants. But it only solved part of the problem—they next set their sights on price caps of any kind.

We asked Mr. Winter if he heard rumblings of the October 31 letters. He told us he had not. We asked him if he recognized that the generators seemed to be withholding supply because of a disagreement with their compensation. Sort of, he said. He said he had asked the generators to bid more capacity into the market, but the requests got no results. The only solution, he felt, was to increase the compensation for each megawatt.

The problem grew worse between the FERC ruling on November 1 and early December. The market grew thinner. Fewer megawatts were available to light the state's lights. Outages soared. Did Mr. Winter form a task force to determine why supply was not being bid into the market? No. Did CAISO investigate the outages? No. Mr. Winter had reached the conclusion that the only way to increase supply was to pay more for each megawatt. Not coincidentally, this was also the opinion of Enron and the generators.

Where were the megawatts? The memoranda disclosed last week by Enron prove what many have long known—they were being intentionally laundered out of state to avoid the caps. We asked Mr. Winter about this laundering, and he told us he had only heard rumors of the practice, and said, "Well, I don't like to use that term." Enron also preferred not to be so crass, which is why it gave the practice a nickname—"Ricochet." He knew the megawatts were being withheld, but instead of punishing the traders and generators who withheld them, he decided to reward them with more money.

The December Crisis

As stated above, other documents suggest market participants were preparing for the removal of price caps prior to the CAISO's December 8, 2000 emergency petition.

On December 6, CAISO declared a Stage 2 emergency, a public declaration that electric reserves had fallen below five percent. Enron claims its manipulation of the market may have caused this shortage, though that was never investigated by CAISO. Instead, Mr. Winter instructed lawyers at Swidler Berlin Sheriff & Friedman, LLP, CAISO's outside counsel, to begin preparing a FERC filing that would eliminate the $250 price cap. He did so in direct contravention of the known will of the board and without consulting the board or the governor. He told our committee that the governor "had no concept" of the problems faced by CAISO staff, but more troubling was his unilateral decision to go against the board. His rationale for not seeking approval from the board was based on his understanding that the board would not grant approval for such a filing. "I had already made up my mind what I was going to do, so if [the board] said no . . . I would have gone ahead . . ."

According to Mr. Winter, the "decision to make the filing" began on December 7. Just a few hours later, a draft was given to CAISO management, and less than 24 hours later, a 48-page filing was delivered to the FERC at 4:20 p.m. on Friday, December 8, 2000, in Washington, D.C. The state was in the midst of another Stage 2 emergency and rumored to be headed for blackouts that weekend. The Enron memoranda states that one of the trading strategies "may have contributed to California's declaration of a Stage 2 emergency." Mr. Winter claims he had a very brief conversation on Friday with FERC Chairman James Hoecker, alerting him of a forthcoming filing, but that his conversation was the *only* preparation CAISO under-

took to make the FERC aware of its filing. Despite the lack of preparation, approximately two hours after the filing, the FERC issued a ruling granting CAISO's request to remove price caps. The December 8 palace coup was complete.

This explanation of events is incredible. It is difficult to believe that such a long, detailed filing was not already underway prior to December 7, that FERC would or could act so quickly and that this was the only solution to a patently artificial crisis. At no time has FERC acted as quickly on any request that would negatively impact the industry.

We have heard every manner of explanation for the price of electricity during December 2000, most notably the price of natural gas during this time and the price of NOx credits. We have found these explanations to lack merit for a host of reasons, including a spike in the price of electricity during January 2001, subsequent to the leveling of natural gas prices. Moreover, Enron's short-term exposure in the natural gas market leads us, and others, to believe that it was positioning itself to manipulate the shortages it was helping to create.

In a two-day period in the week following the November 1 FERC ruling, Enron's open position in the U.S. natural gas market went from a short position of more than 33 Bcf to a long position of more than 168 Bcf. By December 4, Enron was long almost twice that amount, 304 Bcf, a staggering amount that most certainly contributed to the price of natural gas so far above national averages. This data demonstrates Enron's motive and ability to pressure regulators for the removal of price caps, while the protectors stood by and let it happen.

The Lawyers Involvement

Our committee has asked the familiar question of each of the participants in the December 8 filing: "What did you know and when did you know it?" We believe that the answer to this may be found in the relationship between CAISO and the Swidler Berlin law firm. Swidler Berlin is an influential law firm that has been described, among other things, as a "FERC law firm." It is easy to understand why, since the firm has employed a number of former FERC commissioners, including former Commissioner Hoecker. My committee does not have the power to make Swidler Berlin cooperate in any meaningful way, but your committee does. I believe there are a number of questions you should ask of Swidler Berlin.

When did CAISO first request Swidler Berlin to begin work on the December 8, 2000 FERC filing? We have been told the first time Swidler was informed of the intent to make such a filing was December 7. FERC's absurd *ex parte* rules allow energy companies, and their law firms, to contact FERC staff and commissioners before filings are "officially" handed over the desk. This practice is rightfully prohibited in the criminal and civil justice system as potentially prejudicial—it is tantamount to influencing a judge about the character of a witness prior to the witness being called to the stand. If Mr. Winter is to be believed, however, the FERC was prepared to rule on a 50-page filing in a matter of minutes, with only a brief and unspecific phone conversation.

Additionally, the firm represents former Enron executives subpoenaed by our committee. We have also learned that Swidler Berlin is counsel to a trade association that represents a substantial number of the market participants in California. Despite this, CAISO maintains an employee in the Swidler Berlin office in Washington, D.C.—an employee who answers the phone, "Hello, California ISO . . ." This relationship raises serious concerns of conflict of interest.

This brings us to the question of the timing of Enron's first two memoranda. It is our belief that these memoranda were prepared in anticipation of the actions by CAISO management and the FERC to eliminate price caps in the California market. I believe that Enron's legal counsel commissioned a "study" of Enron's trading practices. With an expected "deadline" on or near December 8 to blow out the price caps, Enron counsel needed to become more familiar with these practices, if for none other than the "public relations" reasons cited in the December 6 and 8 memoranda. Whether or not Mr. Winter knew that this was the goal of such strategies is unimportant. Neither he nor anyone else on his management team took the necessary steps to prevent this from happening, or for that matter, to investigate its likelihood. Nor did he take any steps to implement the October 26 load-differentiated price cap. We consider this a failure of CAISO and of the FERC to ferret out, punish and prevent these practices. Enron used the market to siphon money from consumers and it used CAISO management to ensure that the market operated to allow this to continue to happen.

Just as Enron's current board of directors has waived its privilege for these documents, I believe the current CAISO board should waive any claims of privilege over many documents, including all documents relevant to the December 8 filing. If it

can be demonstrated that there was a plan to have caps removed, I believe Enron will not be the lone company implicated.

Conclusion

Does the market participants' conduct suggest unlawful behavior? Were the strategies outlined in the Enron memoranda used not only for the purpose of generating huge profits, but also to impact critical policy decisions? We believe the answer to these questions is "yes."

We suspect other market participants have knowledge of Enron's strategies, even if they themselves did not participate in such a manner. This committee has the power to discover the truth. I urge you to subpoena the executives and CEOs, the company presidents, the board chairmen, march them before your committee, and require them to testify under oath. Many companies serve California, but you could begin your queries with only a handful: Duke, Dynegy, Williams, and Reliant. Ask them to swear that their companies did not engage in these or other manipulative strategies and that they knew nothing of such practices. I am reminded of tobacco company executives raising their right hands in front of a similar congressional body. Getting these statements on the record in such a setting will go a long way to finding the truth.

My wish is that FERC's requests for admission are not a carefully crafted ploy for market participants to avoid such charges, but an earnest attempt to bring more light to the market, past and present.

Without it, we are forced to wait for the next bankruptcy, the next scandal. Regulators should not passively observe the next scar upon the national economy. Rather, we strongly urge the United States Senate and the FERC to leave in place the June 19, 2001 price cap order, to revoke market-based rate authority until a functioning competitive market is established and to focus vigorously your investigations on the privilege logs of each of the market participants and the role of legal counsel in the market participants' conduct.

Senator DORGAN. Senator Dunn, thank you very much. Again, you have appeared before this Committee prior to this and we appreciate your testimony.

I must be absent for about 40 to 45 minutes for another schedule and Senator Hollings, the Chairman of the full Committee, will be here and Senator Boxer. Next we'll have Mr. David Freeman, Chairman of the California Power Authority, who also has appeared previously before this Committee. Mr. Freeman, welcome and thank you very much for being here.

STATEMENT OF S. DAVID FREEMAN, CHAIRMAN, CALIFORNIA POWER AUTHORITY

Mr. FREEMAN. Thank you, sir.

The CHAIRMAN. That is why I was staying, Mr. Chairman, to hear this fellow.

Senator DORGAN. I have heard Mr. Freeman before. I regret that I am going to miss your testimony, but I have read your testimony.

Mr. FREEMAN. I take great personal pleasure in appearing before Chairman Hollings. I worked for him in the seventies and, to refresh his recollection, remember Kenny Boy was lobbying for deregulation of natural gas back then. So you and I have an inkling of his capabilities.

The CHAIRMAN. And he left Nebraska holding the bag, if I remember. Go ahead.

Mr. FREEMAN. That is correct.

Well, before I deal with the testimony of hear no evil, see no evil, there is no evil, which was the panel that preceded us, I have a few things that I would like to say out of my prepared testimony which I submit for the record.

I had a personal conversation with Ken Lay in the latter part of the year 2000 when I was head of the L.A. Department of Water and Power and he was trying to persuade me that we did not need price caps. And I argued with him for 45 minutes over the phone, and he did not persuade me. At the end he said: Well, Dave, I do not care what you crazy people in California do; I have got folks down here that will figure out how to make money.

I did not realize exactly what he was talking about until these memos came out. Indeed, he did have people down there that could figure out how to make money, and they made a whole lot of money.

I want to remind the Committee that it was Enron that was the leading lobbyist to fashion the rules and put the loopholes into the California system which they slid through. This was not any one-shot proposition on their part. They have been at this a long, long time, and they developed a system that they were able to manipulate.

Now, about a year ago, Governor Davis and the California delegation were trying to tell the world this was happening, but the folks at the White House were not listening and the folks at FERC were not listening. Well, now that we have the confession, I trust that the whole world is listening. And we have a simple message: We want our money back. We want our money back.

There are four ways in which FERC needs to take action. One, they need to order the refunds. We did not know the extent of this when we filed. We only asked for $9 billion. We are probably entitled to close to $30 billion. But that proceeding is dragging over there at FERC. And they admitted that we are entitled to refunds, but we have not gotten any.

We need just and reasonable rates for these long-term contracts that we negotiated while the market was dysfunctional. It is up to FERC to accelerate that proceeding and give us just and reasonable rates.

They have got to continue the mitigation that they put in, which your chart shows helped us. The Federal Power Act, Mr. Chairman, does not expire on September 30th and there is no West Coast exception to the Act. They are duty-bound as a matter of law to continue the mitigation that they have in place.

Then of course, the investigations must go on with great vigor.

Now, there is a lesson that I think we need to learn from this, and it is sort of fundamental. It has been expressed before. Electricity is different. The reason they could do these sham transactions is no one has ever seen a kilowatt-hour. They can move it anywhere they want to and lie about it, but you cannot prove they did not. You cannot do without it for even a nanosecond, and it is just not subject to the ups and downs of the market. It is a public good that cannot be allowed to be abused by private companies.

I have a new version of Murphy's Law that I want to offer to the Committee: Any system that can be gamed will be gamed at the worst possible time. It is the gaming practices that they did not discover that probably have gotten us as much as the vivid names that they have. The market approach to electricity is inherently gamable and we just cannot allow a system where a company can operate in secret and has no responsibility for power supply.

We need to go back to companies that own power plants and sell electricity from power plants with real power that goes to real customers. There is no place in the electric power business for a company like Enron that really just owned an electronic telephone book and manipulated the market to jack the price up.

With this confession, some people are saying that Governor Davis and the California delegation is vindicated. Well, Mr. Chairman, there is no vindication until we get our money back. Now that the whole world is watching, I think that the burden is on the Federal Energy Regulatory Commission to move ahead, let the refunds take place, let the contracts be brought down to a just and reasonable rate, and let the mitigation continue and the investigations begin.

Now, what we heard this morning from these witnesses is that they knew about these practices back in October, did not do anything but write what they thought was a cover-yourselves memo, and then did not tell Mr. Skilling about it until the next June, and only because he was coming to California to get a pie thrown in his face.

Now, these folks have no moral compass. This company had no moral compass. They were all obviously hired just to help cover it up. We heard it this morning. The real concern is that those prices stayed jacked up for the next six months. That is when they took us to the cleaners after these guys supposedly stopped—they did not stop anything except defending lawsuits, and all the practices that occurred that have not been identified probably even make the ones that they have identified look small in comparison.

The arrogance of saying they stopped this when they bankrupted the Power Exchange has got to be galling to those of us in California. They wipe out the only open market where there was any record. That was killed. And then they make a killing off of us for the next six months.

I have heard a lot of testimony in my life, and I am sure this Committee has heard a lot more. That was some of the—I think it could be described only as hear no evil, see no evil, and there is no evil. But there is plenty of evil, and we want our money back.

Thank you.

[The prepared statement of Mr. Freeman follows:]

PREPARED STATEMENT OF S. DAVID FREEMAN, CHAIRMAN, CALIFORNIA POWER AUTHORITY

It is a pleasure to be back to testify before this committee today. Two weeks ago, I was only able to speculate as to Enron's invisible role in the rip-off of California consumers. Now we have a confession by Enron that it did in fact game the system.

A fundamental point I would like to repeat from my previous testimony is that Enron was the leading advocate for the most extreme deregulation in California at every step in the Road and thus helped create the loopholes to manipulate the market. Enron successfully lobbied for the loosest rules and then stretched them to create a volatile market that helped to bring them profits while gouging the consumers of California to the tune of billions of dollars.

Allow me to share from my previous testimony the recollection of a long phone argument I had with Ken Lay in 2000 on the subject of price caps. I rejected his arguments and he said to me gleefully that no matter what we "crazy people in California" did that he had people working for him at Enron that could figure out a way to make money. I now realize just how true he was. Fat Boy, Death Star and the others were strategies that made Enron a whole lot of money.

For a long time last year we in California felt that Governor Davis and our delegation were not being heard in claiming that Enron and the generators were manip-

ulating the market and cheating us out of billions of dollars. But now that Enron has confessed, we repeat that claim in a voice that I trust will now be heard:

We want our money back!

Now that the whole world, and that must include the FERC, realizes we were overcharged as no one in the history of electricity has been overcharged, we insist on the simple justice required under the law. To be specific, the FERC must:

(1) Order refunds of $9 billion or more
(2) Fix just and reasonable rates for our long-term contracts
(3) Continue to mitigate the Western market
(4) Investigate all the gougers

(1) Refunds

Fortunately a process is underway at FERC which has acknowledged that California consumers are entitled to refunds. But the process is moving at a snail's pace. In light of the recent evidence that confirms California's claims, all the prior rulings need to be reviewed. The Commission needs to take charge and order the refunds at once.

(2) Long-term contracts

The long-term contracts California entered into of necessity under a manipulated, dysfunctional market need to be reformed to a just and reasonable level, and done so promptly. The process is, to FERC's credit, underway. The Commission needs to let the generators know that FERC will insist on the just and reasonable rate standard. It is the law and needs to be enforced. FERC needs to assure that the process does not just drag on because every day that is delayed means more dollars of overcharge.

(3) Market mitigation

Continuing the mitigation measures to assure the continuous flow of power from the generators at controlled prices is absolutely essential. The present plan to cease those measures on September 30, 2002, cannot be reconciled with the FERC's duty to assure just and reasonable rates at wholesale. The Federal Power Act does not cease in September, nor is there a California exemption from its mandate that the rates *shall* be just and reasonable.

(4) Price gouging investigation

Of course the FERC must now investigate all the generators with renewed vigor. There is every reason to believe that the practices so colorfully described by Enron were and are widespread. They need to be exposed.

Let me say that we hope and expect FERC to do their duty. Governor Davis and the rest of us have been favorably impressed by FERC President Pat Wood, Nora Brownell, and Bill Massey. They instituted the mitigation measures last summer that helped California tame the market. But it happened only after a horrible year before the new majority was appointed and in which the State suffered the largest transfer of money out of consumers' pockets in utility history.

There is one fundamental lesson we must learn from this experience: electricity is really different from everything else. It cannot be stored, it cannot be seen, and we cannot do without it, which makes opportunities to take advantage of a deregulated market endless. It is a public good that must be protected from private abuse.

If Murphy's Law were written for a market approach to electricity, then the law would state "any system that can be gamed, will be gamed, and at the worst possible time." And a market approach for electricity is inherently gameable.

Never again can we allow private interests to create artificial or even real shortages and to be in control. Enron stood for secrecy and a lack of responsibility. In electric power, we must have openness and companies that are responsible for keeping the lights on

We need to go back to companies that own power plants with clear responsibilities for selling real power under long-term contracts. There is no place for companies like Enron that own the equivalent of an electronic telephone book and game the system to extract an unnecessary middleman's profits. Companies with power plants can compete for contracts to provide the bulk of our power at reasonable prices that reflect costs.

People say that Governor Davis has been vindicated by the Enron confession. But real vindication will only come if those that manipulated us are made to pay back the overcharges and trim back the contracts signed when they had us over a barrel. We deserve no less, and the whole world will now be watching whose side FERC is on.

Now let the refunds, contract reforms and investigations begin.

The CHAIRMAN [presiding]. Thank you very much, Mr. Freeman.

Our next witness is Dr. Frank Wolak of Stanford University. Dr. Wolak.

STATEMENT OF FRANK A. WOLAK, PH.D., PROFESSOR OF ECONOMICS, STANFORD UNIVERSITY

Dr. WOLAK. Thank you. Thank you for the opportunity to be here today. I will focus on four issues. The first is what new information about the causes of the California crisis is revealed by the Enron memos. The second is I would like to draw the distinction between unilateral exercise of market power and market manipulation and the critical role that the exercise of market power played in the California electricity crisis. The third is to clarify how these two concepts fit into FERC's statutory mandate to set just and reasonable wholesale prices. And finally, to propose a long-term market monitoring program that would guarantee that FERC would fulfill its statutory mandate to protect consumers from unjust and unreasonable wholesale prices going forward.

The Enron memos reveal one important fact about the behavior of electricity suppliers that was strongly disputed by many observers and that is that sellers want to make as much money as possible and will use all available strategies to achieve this goal. Although some of the strategies outlined in the memo may be violations of California market rules or illegal under state or U.S. antitrust law, it is extremely difficult to tell for sure because of the incomplete and sometimes inconsistent descriptions given.

However, the vast majority of the remaining strategies are simply arbitrage strategies that were known to members of the independent market monitoring committees, as well as other market participants well before the summer of 2000. Power markets are not fundamentally different from common stock, commodity, and foreign exchange markets. Traders in financial markets constantly attempt to earn profits from arbitraging differences in prices for the same product over time, space, and maturity.

For example, if the price of gold in San Francisco is significantly less than the price in New York, traders will buy gold they have no intention of consuming in San Francisco and sell it in New York until the price difference is less than the cost of transporting the gold between the two locations. Because one kilowatt-hour of electricity consumes the same amount of energy regardless of which firm produces it and the cost of transporting power over very long distances is low, we would expect there is many opportunities for power traders to earn profits from arbitraging very small price differences across locations, space, and time in the transmission network.

There are explanations involving attempts to arbitrage price differences over time and location in the ancillary services and congestion management markets that can be constructed for the vast majority of the strategies described in the memos. However, it is important to emphasize four points in this regard.

The first is that versions of most of these strategies exist in wholesale electricity markets operating in the Eastern U.S., as well.

Second, none of these strategies involve zero risk on the part of the trader executing them.

Third, all the arbitrage strategies described in the Enron memos were available to all buyers and sellers in the California market and likely were pursued by those traders in the California market.

Finally, like all arbitrage strategies, their profitability most likely declined as more market participants gained experience participating in the California market.

This logic implies that the strategies described in the Enron memos are at best a small part of the cause of the California electricity crisis. Of the more than $10 billion of refunds California's ISO has calculated are due to California consumers from unjust and unreasonable prices over the period of the crisis, the strategies outlined in this memo in my view account for less than a half a billion dollars when aggregated over the California market participants, and that is a very conservative estimate.

The major cause of the California crisis, however, was the unilateral exercise of market power by suppliers to the California market. A firm exercises its unilateral market power by withdrawing generating capacity from the market either by bidding extremely high prices or refusing to sell its capacity at any price. The goal of both of these strategies is to create an artificial scarcity of energy in order to drive up the market price.

There are a growing number of studies by independent market monitoring committees, in particular the one that I chair, as well as the ISO's department of market analysis and many other independent entities, that have shown that this unilateral exercise of market power was the cause of the unjust and unreasonable rates in California during the period of the crisis.

However, at this point, it is important to emphasize that it is not illegal under U.S. antitrust law for a firm to exercise its unilateral market power. Moreover, all privately owned firms in all markets continually attempt to exercise all available unilateral market power. Their shareholders' demand to earn the highest possible returns on their investment forces the firm to engage in this.

However, the competitiveness of the market suppliers sell into and the responsiveness of consumer demand to price increases determines the amount of unilateral market power that firms are ultimately able to exercise. Unfortunately, electricity markets are extremely susceptible to the exercise of market power. The demand at any hour of the day is virtually insensitive to the hourly price. It is very costly to store electricity. Its production is subject to extreme capacity constraints.

All these factors imply that a single firm owning 5 to 10 percent of the generating capacity in the market can under a range of demand levels increase the price of electricity substantially by withholding only a very small fraction of its capacity from the market.

Now I would like to make the distinction between the unilateral exercise of market power and market manipulation. To reiterate, unilateral exercise of market power is simply equivalent to a firm using all legal means to serve its fiduciary responsibility to its

shareholders to earn the highest return possible on their investment. Market manipulation, on the other hand, does not have a generally agreed upon definition. However, most would agree that market manipulation implies an intent to harm competition or market efficiency and certainly implies bad behavior on the part of the manipulator.

However, it is virtually impossible to tell intent from a firm's actions. Unless the market participant tells us their goal is to harm competition or market efficiency, we cannot tell.

Fortunately, the designers of the Federal Power Act understood the problem of distinguishing market manipulation from unilateral exercise of market power. They also recognized the extreme susceptibility of electricity markets to the unilateral exercise of market power and the tremendous harm that consumers could endure if this resulted. The Federal Power Act requires FERC to ensure that wholesale electricity prices paid by consumers are just and reasonable. The Federal Power Act does not require that FERC show that wholesale prices are the result of market manipulation in order for them to be unjust and unreasonable. Market prices simply have to reflect the exercise of significant market power for them to be unjust and unreasonable.

Consequently, it is unnecessary to prove market manipulation by suppliers to the California market in order for California to receive refunds for unjust and unreasonable rates during the period June 2000 to June 2001 and for the forward contracts negotiated during the spring and winter of 2001. Whether any portion of this unilateral exercise of market power was in fact market manipulation is irrelevant. In either case, the Federal Power Act states it is illegal for FERC to allow consumers to pay unjust and unreasonable rates.

I will now finish up by briefly describing a market monitoring program that will guarantee that FERC fulfills its statutory mandate to protect consumers from unjust and unreasonable wholesale prices so that a California electricity crisis will not occur in another electricity market at some future date. First, FERC must set a clear standard for unjust and unreasonable prices that, if violated, automatically triggers regulatory intervention. As Chairman of the Market Surveillance Committee of the California ISO, I find it wholly unacceptable that, despite the fact that competitive electricity markets have been in operation in the U.S. for almost four years, FERC has yet to set a standard for what constitutes unjust and unreasonable prices. This makes it impossible for California's independent market monitoring committees and the ISO's own department of market analysis, however vigilant they are, to find any evidence that wholesale prices are unjust and unreasonable and therefore illegal under the Federal Power Act.

The California ISO in its Market Design 2002 filing with FERC has proposed a version of this market monitoring and regulatory intervention protocol. This market design details a 12-month market performance index automatic intervention trigger and the required regulatory intervention by FERC and is discussed in detail in this filing. I strongly encourage Congress to require FERC to implement a version of this market monitoring protocol to avoid another California disaster.

Thank you for your time.
[The prepared statement of Dr. Wolak follows:]

PREPARED STATEMENT OF FRANK A. WOLAK, PH.D., PROFESSOR OF ECONOMICS, STANFORD UNIVERSITY

Members of the Committee, I am pleased to submit this written statement on Enron's role

California electricity crisis in the light of recently disclosed documents describing the strategies Enron's traders used in the California market. I am a Professor of Economics at Stanford University. I began my work on energy and environmental issues at the Los Alamos National Laboratory (LANL) in 1980. The following year I entered graduate school at Harvard University, where I received an S.M. in Applied Mathematics and Ph.D. in Economics. For the past fifteen years, I have been engaged on a research program studying privatization, competition, and regulation in network industries such as electricity and natural gas. A major focus of my work is the empirical analysis of market power and, more generally, market design issues in newly restructured electricity markets. I have studied the design and operation of the PJM (The Pennsylvania, New Jersey, and Maryland Interconnection), New York, New England and California electricity markets, as well as virtually all restructured electricity markets currently operating around the world. Since April 1, 1998, I have been the Chairman of the Market Surveillance Committee (MSC) for the Independent System Operator (ISO) of California electricity industry.

Market Surveillance Committee

To provide further background on my expertise on the California electricity market, I will describe the role of the Market Surveillance Committee of the California Independent System Operator and the activities that I have undertaken as its Chairman. The MSC is an independent committee charged with monitoring the California electricity market for the exercise of market power and for market design flaws which may enhance the ability of market participants to exercise market power. The MSC was required by the Federal Energy Regulatory Commission (FERC) as part of the market monitoring protocols of the California ISO. Because the California ISO had a board of governors composed of employees from firms participating in the California market, as well as stakeholders from state agencies and regulatory bodies, FERC mandated the formation of an independent market monitoring entity to prepare and file with FERC periodic reports on the performance of the market. In this capacity I have written or co-authored more than ten reports on aspects of the design and performance of the California electricity markets during my four years as Chairman of the MSC. In preparing these MSC reports I have analyzed confidential data made available by the ISO on bidding, scheduling and production by all generation unit owners selling into the California market. In addition, the MSC has worked closely with the Department of Market Analysis and management at the ISO in preparing these reports. These reports, along with other papers I have written on competitive electricity markets, are listed at the end of my testimony.

My testimony focuses on four issues. The first is the what new information about the causes of the California electricity crisis is revealed by the recently released memos describing the strategies pursued by Enron's traders in California. The second is to describe the distinction between the unilateral exercise of market power and market manipulation, and the role that the unilateral exercise of market power played in the California electricity crisis. The third is to clarify the role these two concepts play in the Federal Regulatory Commission's (FERC) statutory mandate to set just and reasonable wholesale electricity prices. The fourth is to propose a long-term market performance measure and market monitoring protocol that FERC should adopt to fulfill its statutory mandate to protect consumers from unjust and unreasonable wholesale electricity prices.

Enron Memos and Causes of California Electricity Crisis

The Enron memos reveal one an important fact about the behavior of electricity suppliers that was strongly disputed by many observers of competitive electricity markets but is a maintained assumption for economists studying these markets. That is, sellers intend to make as much money as possible and will use all available strategies to achieve this goal.

Although some of the strategies outlined in the Enron memos may be violations of market rules or illegal under US anti-trust law, it is difficult to tell for sure because of the incomplete and sometimes inconsistent descriptions given in the memos. However, the vast majority of the strategies described in sufficient detail

to understand them are standard arbitrage strategies that were known to the independent market monitoring committees for California ISO and Power Exchange well before the summer of 2000.

Power markets are not fundamentally different from common stock, commodity, and foreign exchange markets. Traders in financial markets constantly attempt to earn profits from arbitraging differences in the prices for same product across time, space and maturity. For example, if the price of gold in London is sufficiently less than the price in New York, then traders will buy gold in London and sell it in New York until this price difference is less than or equal to cost of transporting gold between these two locations. Because 1 kilowatt-hour (KWh) of electricity contains the same amount of energy regardless of which firm produces it and the cost of transporting electricity over very long distances is extremely low, we would expect that there are many opportunities for power traders to earn profits from arbitraging small differences in electricity prices across locations in the transmission network.

All electricity markets have a number of forward markets where power suppliers can sell energy in advance of actual delivery of the electricity to the transmission network. For example, before January of 2001 in the California market, power delivered to the grid during each hour of the day could have been sold in the Power Exchange (PX) day-ahead market, the PX day-of market, a variety of forward bilateral markets, or the California ISO's real-time market. These opportunities to buy and sell electricity in various markets in advance of delivery offer power suppliers ample opportunity to arbitrage price differences across these markets. For example, if a power supplier thought the price in the ISO's real-time market was going to be higher than PX's day-ahead price, then it could buy power that it had no intention of consuming in the PX market and sell it in the ISO's real-time market. This is one explanation for the "Inc-ing Load Into the Real-Time Market" strategy described in the Enron memos.

Similar explanations involving attempts to arbitrage price differences over time and location in California's energy, ancillary services and congestion management markets can be constructed for the vast majority of the other strategies described in the Enron memos. It is important to emphasize three other points about these strategies. First, versions of most of these strategies exist in the wholesale electricity markets operating in the eastern US. Second, none of these strategies involved zero risk on the part of the trader executing them. For example, a trader would lose money from buying energy in the day-ahead market and selling it in the real-time market if contrary to the trader's expectations, the price in the ISO's real-time market was less than the price in the PX's day-ahead market, a circumstance which often occurred in the California market. Third, all of the arbitrage strategies described in the Enron memos were available to all buyers and sellers in the California market. Like all arbitrage strategies, as more market participants gained experience participating in the California market, their profitability most likely declined.

An argument can even be made that many of these strategies enhanced the efficiency of the California electricity market. Taking an analogy from the gold market, because gold traders are constantly looking to exploit profitable arbitrage opportunities due to geographic price differences, consumers in any location be assured of getting the best possible price for gold in their own location.

The above logic implies that the strategies described in the Enron memos are, at best, a small part of the cause of the California electricity crisis. Of the more than $10 billion of refunds that the California ISO has calculated are owed to California consumers from paying unjust and reasonable wholesale electricity prices over the period June 2000 to June 2001, the strategies outlined in these memos, at most, account for $500 million when aggregated over all California market participants.

Market Power, Market Manipulation and the California Crisis

The major cause of the California electricity crisis was the unilateral exercise of market power by suppliers to the California ISO control area. A firm exercises its unilateral market power by withdrawing generating capacity from the market either by bidding extremely high prices for some or all of its capacity or by refusing to make a portion of its capacity available to the market at any price. The goal of both of these strategies is to create an artificial scarcity of energy in order to drive up the market price.

The extent to which firms find the unilateral exercise of market power profitable depends on the impact their capacity withholding has on the market price. For example, if a generator withholding 5 percent of its capacity from the market manages to increase the market-clearing price by 50% (not an unusual tradeoff in the California market during the period June 2000 to June 2001), this small amount of withholding is extremely profitable for the firm pursuing this strategy. Studies by

the independent market monitoring committees for the California market, the ISO's Department of Market Analysis and other independent researchers have shown that the unilateral exercise of market power was the cause of the unjust and unreasonable electricity prices that occurred during the period June 2000 to June 2001.

It is important to emphasize that it not illegal under US antitrust law for a firm to exercise its unilateral market power. Markets not dominated by a small number of firms face sufficient competition to discipline the unilateral attempts of these firms to raise market prices. Even in a market with a large number of firms, each one will still attempt to exercise all of its available unilateral market power. However, in a workably competitive market, each firm will find it unilaterally profitable to withhold very little supply from the market because the price increase it achieves from withholding very little supply from the market is very close to the price increase it achieves from withholding a significant amount. This logic implies that the firm's unilateral profit-maximizing strategy leads it to exercise very little market power.

All privately-owned firms in all markets continually attempt to exercise all available unilateral market power. Their shareholders' demands to earn the highest possible returns on their investment require the firm to do it. However, the competitiveness of the market suppliers sell into and the responsiveness of consumer demand to price increases determines the amount of unilateral market power that firms are ultimately able to exercise.

Wholesale electricity markets are extremely susceptible to the unilateral exercise of market power. The aggregate demand for electricity in any hour of the day is virtually insensitive to the hourly wholesale price. Electricity is very costly to store and its production is subject to extreme capacity constraints. A 500 megawatt (MW) generating unit can't produce much more than 500 MW-hours (MWh) in a single hour. All of these factors imply that, a single firm owning 5 to 10 percent of the generating capacity in the market can, under a range of demand levels, increase the price of electricity substantially by withholding a very small fraction of its capacity from the market.

The incentives for capacity withholding from the spot electricity market are even greater the larger is the fraction of the firm's capacity that receives this elevated spot price. In addition, the larger the fraction of demand that must be purchased on the spot market the greater the consumer harm that occurs as result this elevated spot price.

This logic illustrates three important points. First, because of the characteristics of the electricity production process and how it is priced to final consumers, this market is extremely susceptible to the unilateral exercise of market power. Second, because price can increase substantially as result of the unilateral exercise of market power by firms in a wholesale electricity market, consumers can experience significant harm in a very short time. Finally, the incentive to exercise market power and the extent of consumer harm that it can cause is greater the larger is the fraction of demand that is served from the spot market.

Now I would like to make the distinction between the unilateral exercise of market power and market manipulation. As discussed above, the unilateral exercise of market power is equivalent to the firm using all legal means to serve its fiduciary responsibility to its shareholders to earn the highest return possible on their investment. Market manipulation does not have a generally agreed upon definition. However, most would agree than market manipulation implies intent to harm competition or market efficiency and certainly implies "bad" behavior on the part of the manipulator. However, it is virtually impossible to infer intent from a firm's actions. Returning to my earlier example, how do we know if the intent of a power supplier in buying power in the day-ahead market and selling it the real-time market was to harm competitors, and not just attempt to serve its fiduciary responsibility to its shareholders? Unless the market participant tells us their goal is harm competition or market efficiency we cannot tell.

FERC's Statutory Responsibility Under the Federal Power Act

The designers of the Federal Power Act understood this problem of distinguishing market manipulation from the unilateral exercise of market power. They also recognized the extreme susceptibility of electricity markets to the unilateral exercise of market power and the tremendous consumers harm that could occur if it happened. The Federal Power Act, the enabling legislation for the Federal Power Administration (the predecessor to FERC) requires that FERC ensure that wholesale electricity prices paid by consumers are just and reasonable. The Federal Power Act does not require that FERC show that wholesale prices are the result of market manipulation in order for them to be unjust and unreasonable. Market prices that reflect the exercise of sufficient unilateral market power are also unjust and unreasonable. As

discussed above, because of a number of features of wholesale electricity markets, a small amount of withholding of generating capacity by a few electricity suppliers can result in price that reflect the exercise of significant market power under system conditions such as those that occurred during the period June 2000 to June 2001.

Consequently, it is unnecessary to prove market manipulation by suppliers to the California market in order for California to receive refunds for unjust and unreasonable prices during the period June 2000 to June 2001 and for the forward contracts negotiated during the winter and spring of 2001. As discussed above, there is definitive evidence from a variety of sources that significant unilateral market power was exercised in California during the period June 2000 to June 2001 and that this led to the unjust and unreasonable wholesale electricity prices that existed during that period and were expected to exist for next 18 months to 2 years. Whether a portion of this unilateral exercise of market power was in fact market manipulation is irrelevant. In either case, the Federal Power Act states that it is illegal for FERC to allow consumers to pay unjust and unreasonable wholesale electricity prices. Moreover, both FERC and California agree that prices during the period June 2000 to June 2001 were unjust and unreasonable.

Protecting Consumers from Unjust and Unreasonable Prices

I now describe a market monitoring protocol that will guarantee that FERC fulfills its statutory mandate under the Federal Power Act to protect consumers from unjust and unreasonable wholesale electricity prices, so that a "California electricity crisis" will not occur in another electricity market at some future data. First, FERC must set a clear standard for unjust and unreasonable prices, that if violated automatically triggers regulatory intervention by FERC. This would require specifying a level, a duration, and geographic scope for what constitutes unjust and unreasonable prices. Despite the fact that competitive electricity markets have been in operation in the US for more than four years, FERC has yet to define a standard for what constitutes unjust and unreasonable prices. This makes it impossible for California's independent market monitoring committees and the ISO's own Department of Market Analysis to find any evidence that wholesale prices are unjust and unreasonable and therefore illegal under the Federal Power Act.

All market participants should be able to compute this index of market performance using publicly available data. It is also important that the regulatory intervention that would result if this standard were violated is spelled out in detail and viewed as sufficiently undesirable to the power suppliers so that they have a strong incentive to work to fix market design flaws and other market inefficiencies before they develop into problems that can result in the significant consumer harm that would trigger this intervention. This would create a self-regulating market, rather than one that requires day-to-day intervention by the ISO, state agencies and often FERC that detracts from long-run market efficiency.

The California ISO, in its Market Design 2002 filing with FERC, has proposed a version of this market monitoring and regulatory intervention protocol. The details of the 12-month market performance index, automatic intervention trigger, and the required regulatory intervention by FERC are discussed in detail in this filing. The April 22, 2002 opinion of the Market Surveillance Committee strongly endorses this concept and discusses several important aspects of its implementation.

This 12-month market performance index approach to defining a standard for unjust and unreasonable wholesale electricity prices requiring regulatory intervention by FERC does not distinguish between unjust and unreasonable prices due to the unilateral exercise of market power or market manipulation. Regardless of the cause, consumers are protected from the unjust and unreasonable prices, and intervention to correct the cause of these unjust and unreasonable rates is pre-specified. Consequently, FERC and all of the stakeholders in the California market can immediately stop attempting to find "bad" behavior California market and instead focus on the far more productive goal fulfilling FERC's statutory mandate of protecting consumers.

Market Surveillance Committee Reports/Opinions

"ISO Market Surveillance Committee Opinion on Firm Transmission Rights Proposals," May 22, 1998.

"Preliminary Report on the Operation of the Ancillary Services Markets of the California Independent System Operator (ISO)," August 19, 1998.

"Report on the Redesign of the Markets for Ancillary Services and Real-Time Energy," March 25, 1999.

"Reliability Must-Run Contracts for the California Electricity Market," April 2, 1999.
"Report on the Redesign of the California Real-Time Energy and Ancillary Services Markets," October 18, 1999.
"The Competitiveness of the California Energy and Ancillary Services Markets," March 9, 2000.
Comments on 'Comprehensive Congestion Management Reform—Zonal-Forward Market—White Paper' by California ISO," April 24, 2000.
"Opinion on the California ISO's Proposal for Interim Locational Market Power Mitigation ('Interim LMPM')," June 13, 2000.
"Recent Events in the California Electricity Industry and the Level of Price Caps on the ISO's Energy and Ancillary Services Markets," July 6, 2000.
"Market Surveillance Committee Opinion on the ISO's Proposal For Congestion Management Reform," July 31, 2000.
"Designing the Market for Local Reliability Service," August 3, 2000.
"An Analysis of the June 2000 Price Spikes in the California ISO's Energy and Ancillary Services Markets," September 6, 2000.
"Long-Term Price Cap Policy," September 20, 2000.
"Analysis of 'Order Proposing Remedies for California Wholesale Electric Markets (Issued November 1, 2000),'" December 1, 2000.
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Comments on "Staff Recommendation on Prospective Market Monitoring and Mitigation for the California Wholesale Electricity Market," March 22, 2001.
Comments on "Market Design 2002 Project: Preliminary Draft Comprehensive Design Proposal," February 20, 2002.
Comments on "Market Design 2002 Project: Preliminary Draft Comprehensive Design Proposal," April 22, 2002.

Other Papers and Presentations on Electricity Markets

AVAILABLE FROM: HTTP://WWW.STANFORD.EDU/WOLAK.

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The Time Series Behavior of Market Prices and Output in the England and Wales Electricity Market, mimeo, October 1996 (with R. H. Patrick).
Estimating the Customer-Level Demand for Electricity Under Real-Time Market Prices, mimeo, August 1997, (with R.H. Patrick).
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Measuring Market Inefficiencies in California's Restructured Electricity Market, September 2002 (with Severin Borenstein and James Bushnell).
An Empirical Analysis of the Impact of Hedge Contracts on Bidding Behavior in a Competitive Electricity Market, International Economic Journal, Summer 2000, 1–40.
Identification and Estimation of Cost Functions Using Observed Bid Data: An Application to Electricity, August 2000.
"Ten Myths About Competitive Electricity Markets: Lessons for Designing Congestion Management Protocols," May 2001.
"Will FERC See the Light on the Law? (Los Angeles Times, 4/30/01).
"Want 10,000 megawatts? Use Variable Power Pricing" (San Jose Mercury News, May 4, 2001).
"A Comprehensive Market Power Mitigation Plan for the California Electricity Market" April 24, 2001.

The CHAIRMAN. Dr. Wolak, you say it is hard to tell unless they tell you that that is what they are going to do. But, of course, they just about told us with that memo, is that not correct?

Dr. WOLAK. Well, I certainly think that that is one thing that the memo definitely gives that it did not give—what Senator Dunn said, that it certainly demonstrates clear intent. You no longer

have to say you are not trying to exercise market power. The memo certainly makes that clear.

The CHAIRMAN. I am going to yield my time to the others who have been intimate to this hearing and to the Enron procedures. But Mr. Freeman, let me ask this. When you talk about the daily price and the next day price, that system was set up in California—let me qualify you. You used to head up the TVA and have been an expert in energy for 30, 40 years now. What I am trying to get at is how in the world did California set this thing up where you could game inherently, the market was inherently gamable, as you have attested to?

Mr. FREEMAN. It is my testimony, with the benefit of hindsight, you know, the word "competition" as you know is very seductive. When Pete Wilson was the Governor of California some years ago, California went for this deregulation scheme. But my testimony, and I think the testimony of just about everybody in California, is that deregulation for electricity is just inherently gamable.

They have got 100 people on the floor down there in Houston for every one person we can hire, and they can dream up an almost endless number of schemes because no one has ever seen a kilowatt-hour. They can move it to Kansas and back and you cannot tell they are lying or they did not move it at all. They claim transactions between each other.

The reason they did not want to tell you about the booking scheme is that sometimes it is a legitimate transaction, but they did a lot of it when there was no transactions at all and they pretended that power was sold and resold to make their volumes look higher when nothing happened at all.

The fertile minds of the gamers will always be one game ahead of people trying to stop it. That is why Sam Rayburn and the Congress in 1935 had the wisdom to say the rates for electricity shall, shall be just and reasonable. The FERC has no authority to allow a dysfunctional market to continue. They have a duty to fix a price that reflects real competition, which is costs and a reasonable profit.

Finally, to his credit, President Wood and Nora Brownell and Mr. Massey came in in June of 2001 and put some kind of a ceiling in there. We are hoping that with all this attention now they will not end that September 30th. We are scared to death that right now their controls expire on September 30th and we are afraid of an October surprise. It is an election year in California, and we want to see those controls stay in place because the law demands it.

Now, between the time that these fellows that testified this morning first found out about this back in October of 2000, and in June when they told Mr. Skilling about it, was a 7- or 8-month period where everybody on the West Coast got taken to the cleaners. I mean to the tune of billions and billions of dollars, all the way from the State of Washington, through Oregon, through California. To suggest that there was any vigilance, that there was any morality, that there was any concern in that Enron Corporation when they testified this morning that there were people that knew about this back in October—and the irony of it is that they admitted that they did not tell Mr. Skilling, never told Mr. Lay about it. There was no sense of outrage. There was no sense of concern.

These are people with no moral compass. It does not matter, Mr. Wolak, whether somebody who is picking my pocket did it out of market power or out of manipulation. I could care less what word you want to use. They did it and it was an outrage, and it was unjust and unreasonable, and we are here saying we want our money back.

The CHAIRMAN. You talk about gamable and the crowd down in Houston. Is it not your testimony—I heard you; I want to be correct—you said one of the principal lobbyists was Mr. Kenneth Lay for this gamable system in California?

Mr. FREEMAN. Oh, yes. He was in California from the year one and at every step of the way, whether it was the rules that the ISO put in place or the Power Exchange. All of these rules, the lobbying was led by Enron.

The CHAIRMAN. I remember his wife appearing on my TV at home saying that he did not know what was going on.

Mr. FREEMAN. Well, he may not have known exactly what was going on in Houston because he spent a lot of time in California.

The CHAIRMAN. Let me yield to Senator Wyden.

Senator WYDEN. Thank you. Thank you for being willing to come back a second time.

The witnesses earlier, a big part of what they were asserting as their defense is that California knew about all these kinds of things that were going on, that California knew about what certainly people in my part of the world think is pretty questionable: to take power that is non-firm and sell it as firm.

Did California know about all these sleazy practices, as we heard the witnesses earlier say?

Senator DUNN. Senator, let me take a shot at that one since I started my testimony with the relatively bold statement that we have known about these strategies, albeit not their nicknames. We have known about the strategies themselves or at least some of them for a long period of time, and so has FERC.

Now, why did California not act in response to these strategies when they were picked up some time ago? I believe the best suited California entity, which is actually a FERC creation, that was in a position to respond was the California ISO. We deposed the CEO of the California ISO, a man by the name of Terry Winter. Let me tell you what he said specifically with respect to the strategy relating to what we call megawatt laundering. That is shipping megawatts out of the state at least in theory, bringing them back in the state for the purposes of avoiding the then-existing price caps that were installed by the California ISO with FERC approval.

Mr. Winter indicated—now, he is the CEO of the ISO. He indicated yes, he was aware of the conduct, but he really did not like the term "megawatt laundering." When pressed about what he did about those strategies, the best he could come up with: Well, we tried to tinker with the rules a little here and a little there.

But what is most telling, Senator, at least in my view, is what Mr. Winter did in that critical time period referenced in the Enron memos of December 6th, 7th, and 8th, 2000. We are now faced with an unbelievable situation which I believe when ultimately the full truth comes out will end up to be a manufactured situation for pur-

poses of blowing out the then-existing California price caps. The CEO of ISO is now faced with Stage 2 and 3 Emergencies. In other words, in lay terms, the lights are about to go out in California, as Senator Boxer indicated before.

Instead of commencing an emergency investigation into the behavior of the market participants that were refusing to sell into the market because of the price caps, he instead decided to go to FERC and ask for elimination of the price caps so the market participants could make more money. We asked him: Did you make any phone calls to market participants about why they were withholding? No. Did you commence an investigation? No. Did you review documents? No. Did you consider it may have been the result of the manipulative strategies you already admitted were in existence? No.

All he did was march to the tune, in my view, of the industry's drums. I want to underscore this because what led to, in my view, the strategy to blow out the California price caps was a vote by the California ISO board in late October 2000 when they instituted what is technically called the load-differentiated price cap. Some folks refer to it as the $100 price cap.

When that vote was taken in late October, the activity within the industry went into overdrive to eliminate those price caps through a variety of different maneuvers. What did Terry Winter do as the CEO of the ISO board when his board voted to institute load-differentiated price caps? Nothing. Nothing. He did not order new software, he did not start an investigation or an examination of how to implement those new price caps. Nothing.

Senator WYDEN. What is striking is that, again, if you just look at what is on the record, Mr. Sanders said, for example, today that he had not been involved in any destruction of documents and he knew of nobody who had been involved in destroying documents. I went back and looked at the testimony you gave when you came before the Committee earlier. You pointed specifically to your concern about destruction of documents.

I think it is helpful to have your reaction to the comments that we heard earlier. There are a number of areas that I asked about, particularly those affecting the Pacific Northwest, that just do not pass the smell test. I mean, to say that you can sell non-firm power as firm power is not being straight with people and at a minimum you ought to be disclosing that.

Mr. FREEMAN. Senator Wyden, could I comment?

Senator WYDEN. Sure.

Mr. FREEMAN. I ran the Tennessee Valley Authority. We sold power under interruptible rates. Even though we had plenty of power, we interrupted each customer each year so that they would know that it was interruptible rate. The idea of pretending that you are not going to interrupt someone—I mean, you give people a lower rate for the right to interrupt, and that right certainly in a crisis is likely to be exercised.

So I do not think your words were too strong at all in describing that.

If I could add a bit to Senator Dunn's comment. Mr. Winter testified in public that the reason he did not go to the Governor and brief him before he went to FERC to eliminate the caps is that he knew that the Governor would disagree with him and would not let

him do it. This ISO is completely out of control in terms of the state government.

Senator WYDEN. I share your concern about the California ISO and, obviously, all of the activities in California have ramifications for my part of the country because it is an integrated market. What I have been trying to do through all of these hearings essentially is to point out how Enron has essentially been running a West Coast protection racket, essentially structuring these deals so as to bilk people all up and down the West Coast. You have helped to confirm our concerns.

Just one other question for you, Mr. Freeman, if I might, again to look at the implications for the entire West. California has got long-term power contracts that are currently above market rates. It is my sense that the spiking of prices in the spot markets had a direct impact on long-term contracts, again not just in California, but all up and down the West Coast.

Mr. FREEMAN. There is absolutely no doubt about it. I did the negotiating for California and they had us over a barrel. I mean, we had a choice of continuing paying 30, 35 cents a kilowatt-hour in the spot market or accepting long-term contracts at 7 cents or 6 cents, which compared to what we were paying looked pretty good, but comparing to a just and reasonable rate for long-term power is way too high.

That is the reason that we are before FERC under section 206 requesting that these contracts be trimmed down to a just and reasonable level. And we have renegotiated some of the contracts, but the rest of them are there. The spot market, the dysfunctional market, was the proximate cause of our having to pay over market for the long-term contracts. I am sure it is true in Oregon and true in Washington. It was all the same market.

Senator WYDEN. I have one last question, but I think, Ms. Lynch, did you want to comment on that, as well?

Ms. LYNCH. I just wanted to note that FERC knows it, too, that there is a relationship between long-term prices and short-term prices. In its December 15th, 2000, order that gave the sellers the ability to run amok in California, they drop a footnote and say: Well, there is a relationship between out of control short-term prices and long-term prices. However, when the California Public Utilities Commission sued on those long-term contracts, saying that we have overpaid over $21 billion, FERC instituted a new evidentiary standard and said we not only have to prove the prices are unjust and unreasonable, we also have to prove that they are against public interest.

So once we meet one evidentiary threshold, they raise the bar—all in the service of the sellers.

Senator WYDEN. My last question. We are at a critical time now with respect to energy legislation in the Congress. We have a House-Senate conference. We have the good fortune to have a strong advocate of the consumer in Senator Hollings who will be in the room when we are working on these provisions. I want to get your thoughts on the three areas that I think are key in terms of consumer protection. One is the transparency provisions, the openness requirements, because I think that would have made a real difference here.

Second are tougher penalties, because it is clear that there really is not the deterrent that is needed in order to send a message with respect to this wrongdoing.

Third is the ratepayer advocate that would get to the Department of Justice, so that instead of having all this dawdling at FERC that we have seen, that we would have a chance to have a tough enforcement office at Justice.

I would be interested in your thoughts with respect to those provisions and whether there are any others. My reason for asking is that this is extraordinarily timely because in the next few weeks I think decisions are going to be made with respect to whether we are going to get consumer protections that can prevent this from happening again.

Ms. LYNCH. I believe all three provisions are necessary, but not sufficient to fix the California market because of the extent of the gaming and the illegal activity. I also believe that Senator Feinstein's derivative amendment, which narrowly failed, needs to be reconsidered by this Congress. The only way you are going to actually be able to know what is happening is to have public access to the information and reports that are under penalty of perjury.

But, in addition, do not preempt the states any further. Please do not give additional state authority away to a do-nothing, know-nothing FERC. I am glad that they have finally issued their own subpoenas in May of 2002. I am sad that they never helped us enforce our subpoenas that we issued in September of 2000.

The problem is, even with a smoking gun, they are going to go slow. So please do not curtail the states' authority to fix their own markets in favor of a very distant and very lax FERC.

Senator WYDEN. Before we get Senator Dunn and Mr. Freeman, please know that I am strongly in support of those, as well. With Senator Cantwell, I am one of the original sponsors of Senator Feinstein's derivatives legislation. It seems to me if you are going to trade and sell pork bellies in this country with a degree of openness, you certainly ought to do it for energy, as well. I think we are going to have that legislation. It will not be in the conference because, as you know, we were not successful on the floor. But just know we are going to come back very, very aggressively on behalf of that legislation and stay at it. As far as the preemption, I share your view on it as well.

Senator Dunn.

Senator DUNN. Thank you, Senator. The only thing I would add to President Lynch's comments is we need at this time, in my view, to revoke the market-based rate authority. That is the goose that laid the golden egg for the industry. Yet, to obtain market-based rate authority, as I believe Professor Wolak indicated before, you as an industry player, you as a market participant, were required to come to the FERC and prove you do not have market power.

We had one of the FERC lawyers testify before our Committee last year. He came and we explored the issue of defining market power and he expressed the view that the definition of market power at FERC is deliberately vague. I am adding a little to his testimony, taking a little liberties, and my apologies to Mr. Pease for doing so. But in essence that is how we interpreted his testimony.

When we asked why the Commission was not pursuing the exercise of market power, which almost every economist acknowledges is prevalent in that market, and thus revoking the market-based rate authority due to that, his answer was: I do not know, Senator; you are going to have to ask the commissioners themselves—who have refused to appear before our Committee.

I believe the revocation of the market-based rate authority is necessary until we have more definitive rules, as suggested by Professor Wolak.

Senator WYDEN. Mr. Freeman, then Mr. Wolak.

Mr. FREEMAN. I agree with the testimony of my colleagues here. I would want to stress this issue of FERC making market-based rates. It seems to me that either you need an amendment to the Act that forbids market rates or at the very least an amendment or maybe just language in the Committee report that says that FERC got it backward last time, they went to market-based rates without knowing whether there was a competitive market, and that there has to be a hearing on the record with a finding that the market is in fact competitive before they can permit market-based rates. Because, otherwise, what happened in California will happen again.

I think that is fundamental. They are now just wedded to this market deregulation scheme and, frankly, they are trying to do it with transmission, which is their next step. I think the Congress needs to tell them to stop. The Federal Power Act worked rather well for 40 or 50 years, rates have to be just and reasonable, and they cannot let anybody go to a market approach without first making a finding on the record that that market approach will come up with just and reasonable rates. Whether that would require an amendment to the Act or whether just strong language in the Committee report would do it, but that, I think, is absolutely essential to put a stop to this.

Senator WYDEN. Dr. Wolak.

Dr. WOLAK. I just want to followup on one of the points Senator Dunn made. The way that the FERC market-based rate authority works is that you as a generator make a filing to FERC with the various concentration measures and the like to demonstrate to FERC's satisfaction, which is very clearly a very low hurdle, that you do not have the ability to exercise market power. But then once you get market-based rate authority, you can exercise all the market power you want, because it is only the prices that reflect the exercise of market power that are illegal. But FERC has not said that exercising market power is illegal, nor have they defined what exercising market power is.

As almost any, I think, economist will also tell you, it is virtually impossible to tell prospectively whether or not a market is going to be workably competitive or not. That is why I guess the thing that I would add to this, to your list, is this sort of market performance index, where what you are doing is you are monitoring on an ongoing basis market prices relative to some competitive benchmark, and to the extent that those prices get grossly out of whack with that, what we think should be coming from a competitive market, then automatic intervention is triggered, so that effectively you

cannot have another California crisis. FERC is compelled to act, rather than have the discretion.

The first step in that process is for them to set a standard for what constitutes a just and reasonable price, lay out a methodology for that to be the case, and allow this index to be computed by all market participants.

Then the other is to make the intervention be something I think Senator Dunn alluded to, which is everybody returns to cost of service if this index is exceeded until the appropriate sorts of mitigation measures are put in place. This will make the market self-regulating. One of the things that happened in California that we learned during the 2001 runup is essentially at each step of the way market participants found that the amount of money that was available to take from California just kept getting bigger and bigger and there was no one telling them that they could not take more, and so they did.

Senator WYDEN. Thank you, Mr. Chairman.

Senator DUNN. May I add one thing, Mr. Chairman, very quickly? My apologies.

The CHAIRMAN. Go ahead.

Senator DUNN. Please remember the core reason that California went down the deregulation route is not, as some have accused in my view, that we were duped. We really had the best of intentions as policymakers in California. We wanted one simple thing as policymakers. We wanted to deliver lower rates to our constituents. That was at the heart of it. We were promised that if we adopted deregulation that, in fact, the benefits of free competition would deliver better service at lower costs to our constituents.

What we failed to take into account with that promise is that the move for deregulation was led by the industry. Tell me, why would any CEO of any generator or trader advocate for deregulation if they thought it would lower the income to that particular company and thereby benefit to stockholders? They would not. But the promise to each and every one of us is: Adopt our scheme and you will see lower prices. Not true.

The CHAIRMAN. Senator Boxer.

Senator BOXER. You did not know what the word "scheme" meant, right?

Senator DUNN. Correct, Senator.

Senator BOXER. Look what Jeffrey Skilling told you. He said under deregulation California would save about $8.9 billion per year. You should have quizzed him right then. We did not even spend $8.9 billion per year.

Senator DUNN. Can I add to that, Senator?

Senator BOXER. Yes, you can add to it.

Senator DUNN. That is part of a quote, because what he did is going on in that testimony and tell us Californians what we could get for $8.9 billion.

Senator BOXER. Oh, I understand. I am just saying, hey, they were behind it, that is it. We know it. And we know when California's problem was solved they went bankrupt, Professor Wolak. That is the truth.

Look what he said. Look what Skilling said about it when asked about it. He said to *The San Diego Union-Tribune,* describing the

company's condition when they were going broke: "Enron, he said, faced terrible problems because California's electricity crisis had been solved." I mean, this is an amazing story of greed and a complete lack of morality, as Mr. Freeman said.

I would ask to put Governor Gray Davis' statement in the record at this point.

The CHAIRMAN. It will be included.

[The prepared statement of Governor Davis follows:]

PREPARED STATEMENT OF GOVERNOR GRAY DAVIS, STATE OF CALIFORNIA

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

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

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

We have been saying as much since 2000. We have been accused of blaming others for problems of our own making. We have been told repeatedly to "trust the market." But FERC's revelation last week of Enron's confession to abusive, manipulative and possibly illegal electricity trading practices bear out what California has been saying. There is reason to believe that other traders engaged in similar practices. Also, the SEC announced it was investigating a practice by Dynegy and CMS Energy called "round trip" or "wash" trades—a kind of financial shell game where companies traded equal amounts of energy to inflate their trading volumes. Reliant Energy admitted it also engaged in "wash" trades. Now we learn that Enron has admitted to overstating the value of its assets by up to $24 billion.

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

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

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

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

According to the Enron memo, the only downside as one trading strategy was described was a "public relations risk arising from the fact that such exports may have

contributed to California's declaration of a Stage 2 emergency yesterday." The Enron memos allege that others in the industry engaged in these practices—FERC should follow up thoroughly. Asking other traders and sellers to admit to whether they engaged in similar practices as FERC did on May 8 is a good start but it is not enough. We believe and have submitted to FERC evidence of other abusive practices, such as withholding of power. FERC must thoroughly investigate and remedy any and all market abuses.

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

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

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

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

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

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

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

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

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

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

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

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

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

Thank you.

Senator BOXER. He talks about the refunds and the renegotiation.

But, I have to say, Professor, that when you started your presentation, I used to be—I was an economics major in college. I started to sweat. It brought back the memory.

But the thing I take away from your presentation is FERC has to act on unjust and unreasonable, bottom line, period. It does not matter if there was illegalities. You do not know; you are not a lawyer. But FERC must act on unjust and unreasonable prices. And by doing nothing it is an affirmative decision.

Mr. Chairman, if I have to make that point a hundred times, I will, because that is the bottom line. That is their job. Even our professor comes together with our panel on that very important point.

Ms. Lynch, I think you have a way of—all our panelists do—of painting the picture very clearly. So, I have summed up what I think you have said here. I am going to put it in my own words, because I believe this, and I want to know if you agree with me and if not, could you make me—because I want to explain it clearly.

Enron held Californians' electricity supply hostage for astronomical, non-regulated gouging prices, and they were able to do it for so long because of their relationship with FERC, the only entity who could have stopped them.

Ms. LYNCH. I think that is absolutely right.

Senator BOXER. Well, that is our story, one sentence. Clearly, others may have been part of this, but we know they took the lead from testimony of Senator Dunn, Mr. Freeman, just explaining how involved they were. This is the issue, and the reason that I felt like I wanted to make a citizen's arrest before, but held myself back, is because we could have been spared all this.

Then Senator Dunn explains how the ISO did not work on behalf of consumers like they should have. The PUC did, Senator. The PUC wrote to FERC, Mr. Chairman, August 2000. PUC sought a FERC investigation and remedies for abuse of market power by Enron and other marketers. So when people say California did not speak up, that is not true.

On November 6, 2000, the PUC asked the FERC to issue subpoenas to Enron and other marketers regarding abuses in the California market. FERC has not responded. Finally, in light of the smoking guns memos we now know what was going on, and now FERC has issued affidavits.

So let us not say that California was not saying help us. I have not gone through what Senator Feinstein and I were doing and Congresswoman Eshoo, Congressmen Farr, and Miller. I mean, I could name the whole delegation, going at FERC for help.

I just have to say again, doing nothing is an affirmative decision. Does anyone disagree with that on the panel? FERC doing nothing is an affirmative policy. Yes?

Senator DUNN. Senator, if I can add one more credit to those, such as the PUC, that were consistently barraging FERC with this information back to 2000, and that is an individual I think most of the Congressional delegation and you, Senator Boxer, know. That is State Senator Steve Pease, because he was writing to FERC in late 1999, early 2000, complaining from the get-go of this market and laying out in great detail.

Senator BOXER. Well, he had a lot at stake, did he not?

Senator DUNN. He did indeed.

Senator BOXER. He should have done that, and I am proud of him for doing that because a lot of people in his situation would not have done it.

I do not want to start naming Members of Congress and Members of the Senate because I have got to get through. Loretta, did you want to add something?

Ms. LYNCH. I would just note that FERC did less than nothing. They affirmatively put barriers in our way in the investigation.

Senator BOXER. Important, so I am going to amend that. They did nothing and, worse, they stopped the California PUC in every way that they could from pursuing legal action; is that correct?

Ms. LYNCH. Well, they did not help us and then they changed the rules, which would make it more difficult for us to pursue.

Senator BOXER. They made it very difficult for the California PUC to pursue justice. Is that correct?

Ms. LYNCH. Yes. Then because we have to sue at FERC first, they have wrapped our legal suits up in procedural maneuvers for 20 months or 18 months such that we cannot get to court. In fact, as late as May 2002, FERC has moved to delay our appeals in the Ninth Circuit, repudiating their representations that we could go forward.

This is our appeal of their December 8th action blowing out the price caps and their December 15th action opening this door to the sellers.

Senator BOXER. So not only did they do nothing to protect consumers for us as we were begging them to do, they stopped you, made it very difficult, effectively stopped you. They effectively stopped you from having justice done in helping our consumers. My concern, Mr. Chairman—and that is why I asked FERC, did you meet with the people from Enron? Oh, yes, we got the information; they wined and dined them 25 times. There is too much coziness here and I do not have confidence because of the ties of this administration to Enron.

When we talk to Mr. Wood, I hope he is going to reassure me. I heard there was a meeting this morning and I have some quotes from Commissioner Massey which are hopeful. But let there be no mistake about it from this hearing, the people from California want redress. I think Mr. Freeman said it in the most straightforward way: We want our money back. But more than that, we want our refunds, but we want to make sure we can renegotiate those long-term contracts.

Mr. Chairman, they were made under duress, under stress, under a phony market that was riddled with schemes. Why it would take FERC this long is beyond me. This is not fair, to have the people of California hang out like this to dry, to have a state deficit which I understand Senator Dunn believes is all, if not almost all, related to what it has cost us.

So, Mr. Chairman, I want to really thank you. Hearing, learning about these schemes, connecting the dots, hearing Loretta Lynch say she was back in August 2000 asking for investigations, not having gotten those investigations—now, I want to make it clear that Bill Clinton was President and that the FERC under Bill Clinton did find unjust and unreasonable prices, and they did have some must-sell orders.

Under Bush we finally got something good eight months too late, after we were broke, and our Republican business people in the state said to the Bush Administration: You have got to step in here. You know, our friends from Washington State lost their whole aluminum industry, that is what they told me, because of the high cost of energy.

So I just want to thank the panel very much.

Is Mr. Wood here now? Is he? He is here, good. So I do not want to take up anything else. But I have one question for you, Loretta Lynch. You showed us that the order that FERC issued that enables these companies to go at market-based pricing—does that just affect California or does that affect other states that have deregulation?

Ms. LYNCH. We focused on the California market-based rates, but I believe that they are broader than California.

Senator BOXER. So it is possible if this thing goes awry that other states could have the same thing happen or close to the same thing? It is possible?

Ms. LYNCH. Oh, it is more than possible. We have 138 days until the Death Star comes back to California. On October 1st, Get Shorty, Fat Boy, Ricochet, and Death Star are going to occur again in California. I wouldsubmit that 138 days is way too short to first, get to the bottom of this and figure out exactly how they gamed us, and also create a system where they cannot game us, and hopefully this time test it instead of making sure that Californians are guinea pigs in the test.

Senator BOXER. That is right. But I am saying it could happen to other states that have deregulation.

Ms. LYNCH. It will. I mean, if California's market spins out of control on October 1st, so will the West.

Senator BOXER. Mr. Freeman, can I submit for the record what this means, "How long can we not disclose bookouts?" Do you understand that?

Mr. FREEMAN. Yes, I understand that some of those transactions were make-believe, where they pretended to sell power to each other and did not. Other transactions, when there is a legitimate swap and you net it out, is perfect accounting. But they just did not want to report them. They did not want to make that distinction, and they jacked up the revenues that they supposedly made by having numbers that were unreal.

So this is all part of the gaming.

Senator BOXER. So they were trying to cover up the gaming by saying "How long can we not disclose bookouts." It is interesting that you knew it, but none of the attorneys that are paid I-do-not-know-what an hour were unable to answer that question. I find that astounding. But, then again, you are just a country boy, right?

Mr. FREEMAN. That is not much credit to me if you find it astounding.

But, while I am speaking, could I help us clarify our opinion of the FERC commissioners. Chairman Hendrie was the guy that really socked it to us. He is a Clinton appointee.

Senator BOXER. That is not the right name.

Mr. FREEMAN. Hecker.

Senator BOXER. Hecker.

Mr. FREEMAN. Before him there was——

Senator BOXER. There is some guy named Hendrie out there wondering, what did I do?

Mr. FREEMAN. But basically they said that if California just quadrupled its rates everything would be fine. They wanted us to have a depression rather than a recession, and they did nothing during this period of grand larceny.

You know, we had an 18-minute gap under Watergate. The witnesses this morning testified to an 8-month gap between the time that they discovered this stuff back in October until June when they told Mr. Skilling about it, only because they figured he might hear about it in California.

But it was when President Pat Wood came on board that we finally got some relief, and we want to give him public credit. He did the right thing then. We have every hope and reason to believe that with this new information he will now do the things that FERC needs to do and do them promptly.

Senator BOXER. I am forever hopeful that FERC will do the right thing. They have done a couple of right things. It took them too long to act the first time, way too long to act while this larceny went on. I do not like what PUC Chair Lynch tells me about them getting in the way of California finding justice. So those things are not happy for me.

But I hope today that my problems will be resolved, that Mr. Wood will say, in light of this we are going to see those refunds, we are going to see the renegotiation, we are going to redo those caps because it is a dysfunctional market. If I hear that, I will be the happiest person in the Capitol. If I do, I will call you all. The call will be on me personally.

So, I want to thank all of you. I do not know if anyone else has any, but I am done. Thank you.

The CHAIRMAN. Thank you very much. Senator Dorgan takes over.

Senator DORGAN. Mr. Chairman, thank you very much.

Let us excuse these witnesses. Thank you very much for testifying once again today and contributing to this hearing.

The CHAIRMAN. It was outstanding, I can tell you that.

Senator DORGAN. Next we will have the testimony of Mr. Pat Wood, Chairman of the Federal Energy Regulatory Commission. Mr. Wood, would you please come forward and take a seat at the witness table, please.

We are going to be in recess for two minutes.

[Brief recess.]

Senator DORGAN. The Committee will come to order and we will ask that the door be closed. We next will hear from Mr. Patrick Wood, Chairman of the Federal Energy Regulatory Commission. Mr. Wood, thank you for joining us. I believe you have a statement. Your entire statement will be made part of the record and you may summarize.

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

Mr. WOOD. Thank you, Mr. Dorgan, Mr. Chairman, Senator Boxer. It is a pleasure to be here. Not a pleasure; it is a hard time

to be here, quite frankly. I have heard Senator Boxer's comments on the pain and I received your letter last week, ma'am, about the budget issues your state has to face and how this could be part of the mix. So I understand that, and we want to, to kind of cut to the chase, we want to get these issues resolved, to try to resolve what happened in the past as fairly and equitably as possible to all concerned, to talk about how to make the future better, not just for California—but for all the other states that deal with changes in their energy markets. It is such a critical commodity to all Americans that it cannot be treated cavalierly, and please know that it is not.

In fact, one of the principal reasons that I accepted the President's request to serve on the FERC about this time last year was to restore confidence in how the energy markets are working around the nation. The events in the Western markets, which you are very apprised of, in mid to late 2000 not only disrupted life out there, but made it very uncertain across the entire country about what is the future going to be like. Customers were nervous about the California experience, can it happen here. Even in very regulated states, the same concerns were happening about, "Will we have sufficient power infrastructure to meet the needs of our growing economy?" So please know that the ripple in the pond did not just stop at the California border. It went across the entire country.

I had spent the prior six years of my professional career as a retail regulator in the State of Texas for telecom and the electric industry, and nothing, as I think my friend Loretta Lynch can tell you, brings home the job as clearly of what we need to do here than having served as a retail regulator at the state, where you see up and close personal the issues related to, of all your decisions relating to utility rates, service complaints, area codes, competitor issues, low income programs, renewable energy portfolios, and the like.

The sort of behavior indicated in the Enron memos that I understand you visited with the authors of this morning is not what I have in mind when I talk about the benefits of competition in the nation's energy markets. One of the things that states needed when I was there was knowledge that FERC and the FCC, depending on which issue we were dealing with, would be supportive partners with the states as the states move forward to change the way that they are regulating these businesses.

Market oversight is a great big part of that supportive partner relationship and it is one of the principal goals that I have set for the Commission from the day that I took over as Chairman last September. Building upon the front-line market monitoring units that we have at the California ISO and at the existing three ISO's here in the eastern markets, FERC has to have a better resource structure to address the needs of not only the regulators, but the customers in these different markets, as well as oversee the broader picture of energy infrastructure and balanced market rules.

While there have been enforcement and hot line and market surveillance functions in our agency to date, I do not believe that they have had the mandate to pursue their job, the resources, or the visibility, to successfully oversee the markets in the nation. This is changing.

Right before I took over as Chairman in December, Senator Domenici of New Mexico called and, based on some testimony I had made before the Senate Energy Committee in July of last year, asked if we needed more resources, and I said, yes, sir, we do; I need to be able to go out and hire some hot dogs to really oversee these markets, to lure them away from the private sector and to come work at the FERC, give some years to public service. I am pleased that the Congress did, after going through conference committee, add another $3 million to our budget, not ten as requested, but five of the high-paid positions, and that in the subsequent budget that has been before the Congress this year that has been added to a full 50 additional people to staff that effort.

We are reallocating resources within the agency to do it anyway. It is too important not to be done. But the greater ability I have to get that done with the resources—and please know that we have asked for it and I would love to be back up here to follow that all the way through later this year.

But in any event, by the end of the year the full Commission agreed that market oversight is one of the three principal functions of what we do: infrastructure; balanced rules; and protection of customers through oversight. That third goal again was elevated to priority with the other two and we created the Office of Market Oversight and Investigation in January of this year, posted for the Director shortly thereafter, filled it with a well-credentialed and good leader, William Hederman, in late March, and they are staffing this process as we speak with auditors, investigators, data guys, engineers, economists, attorneys, analysts.

We are doing not only the Office of Market Oversight and Investigation, but the actual investigation itself into the Western market. I committed on behalf of my colleagues to the Senate Energy Committee Members in January that we would look into market manipulation in the West and report back by this summer. We formally opened a docket. That is the docket from which the memoranda that you visited about earlier came. It is an unusual docket in that generally our investigations are private, they are not known. But because of my public commitment to the Committee to do those, we have made a web site available with all the public documents that come from the Commission.

There are a number of confidential documents that were filed under seal and those will be kept that way. But the ones that we can make available we will and do.

So I see my time has run out, but we have done a number of other things to make sure that the markets do catch this type of behavior before it happens, and where it does happen that we have sufficient ability to identify where it has happened and award the appropriate punishment to people who do not follow this.

Finally, why we are doing this, why are we going through this transition of something that was working in most people's minds pretty well? I think if you look at your own PG&E in California, the embedded retail rate for the post-restructuring was $65 a megawatt-hour for the generation component. Competitive markets—I just pulled the strips today to look at before I came here—competitive markets in California today are $29 at wholesale, $21

on off-peak. A longer-term contract which carries through the summer is around $39.

That is why we are doing this. There are significant savings from a well-functioning competitive wholesale market that customers ought to be able to put into their pockets. We saw this happen in the natural gas industry when FERC led an administrative effort with Congress making other changes to the statutes to open up the gas markets, and tens of billions of dollars have stayed in gas customers' pockets because of those efforts to make sure that a competitive wholesale market worked and worked well. So that is why we are in here fighting through these hard issues, and it would be very easy to retreat back into what we perceive worked well when in fact it was an expensive experience for customers and continues to be so today.

So that is why we are here. We want markets that work for customers. When they play by the rules, market participants ought to get their fair reward. But, when they do not play by the rules, they ought to get their fair punishment. That is what I want our Commission to be about. We have got some changes to make, and please know, as the Committee that looks after consumer interests in the country, that the new FERC is committed to that and will follow through, not only in California, but everywhere, to make sure that that happens.

I look forward to any of your questions or advice.

[The prepared statement of Chairman Wood follows:]

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

I. Introduction and Summary

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to testify concerning the developments and new evidence regarding Enron's role in manipulating western state electricity markets, focusing on California's electricity price increases and power shortage between May 2000 and June 2001.

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

Let's confront the key issues head-on. Did California experience severe electric market problems? Clearly, yes. Were these problems the result of market manipulation? We are currently investigating that issue. Many observers agree that these problems stemmed in part from the poor design of the California electricity market and the lack of adequate reserves and demand response relative to growing electricity demand. Those conditions made it possible for Enron (apparently)—and possibly other market participants—to exploit, profit from, and possibly exacerbate the magnitude of California's problems. Did FERC respond properly to help California

deal with these problems? Yes. It is clear that FERC took action to address problems in California and western markets, which became apparent in May 2000, by instituting a fact-finding investigation into the nation's electric bulk power markets on July 26, 2000, and has been dealing with those issues extensively ever since. Since I joined the Commission in June 2001, we have addressed California and western states issues in almost every single open meeting and have dealt with each issue using the best information and evidence available to us under the guidance and limits of the law.

In the eleven months since I joined FERC, the nation has continued to reap the continuing benefits of wholesale electric and natural gas competition. The billions of dollars invested in efficient, economical, independent generation and gas pipelines and production over the past decade have caused wholesale electric prices across the nation to drop by 59 percent, while weighted average prices in California have dropped from almost $140 to about $25 per megawatt-hour. Approximately 41,000 new megawatts of electric generation capacity have been built across the country—but only 2,922 megawatts have come on-line in California. Since I arrived in Washington, FERC has issued over 60 orders on issues relating to California and the western states electric market and instituted numerous proceedings relating to the California and western electric market. And to ensure adequate market oversight for all wholesale electric markets in the future, FERC has formed and is now staffing a new Office of Market Oversight and Investigation.

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

II. The Commission's Western Markets Investigation

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

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

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

comply with the March 5, 2002, information request, particularly with respect to providing affiliate sales data.

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

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

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

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

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

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

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

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

III. Other FERC Investigations Relating to California and the West

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

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

IV. The Commission's Actions To Mitigate Market Manipulation or Failures in California and the West

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

- Strategies that involved "inc-ing load"—artificially increasing load on schedules, dispatching generation in excess of actual load, and getting paid for the excess generation at the market clearing price;
- Strategies that exploited the congestion management system by relieving real or artificial congestion;
- Strategies that exploited the California v. Western price differential (e.g., megawatt laundering); and,
- Strategies that involve misrepresentation (paper trading of ancillary services when the company doesn't actually have the services to sell, submitting false information about the identity of the plants providing the services, and selling non-firm energy as firm to the PX).

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

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

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

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

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

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

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

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

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

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

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

Although we have not completed our fact-finding investigation with respect to sellers in California and the western electric markets, as a general matter it is clear that regulators must have two essential tools to prevent or mitigate significant misbehavior. First, the market regulator must have adequate monitoring and oversight capabilities, and a good understanding of market activities and patterns, to identify when and whether misrepresentation and manipulation is occurring. Second, regulators must have meaningful penalty authority, to ensure that market participants do not jeopardize reliability or manipulate market outcomes. FERC is working to develop and improve its understanding of markets and market manipulation through the new Office of Market Oversight and Investigation and its on-going cooperation with the CAISOs' Market Monitoring Units and other federal agencies. But it is clear that the Commission's penalty and enforcement authorities are limited and need to be expanded if they are to serve as effective deterrents to market misbehavior. I will discuss this issue further below.

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

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

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

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

V. Interaction Between the Commission and the CAISO

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

and developments in the California market. The other is the independence of the CAISO itself.

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

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

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

VI. CAISO's Comprehensive Market Redesign Plan

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

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

VII. Will Market Design Alone Save California?

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

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

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

- California has built little new generation—only 3,055 megawatts of new generation have come on line since 2000, so there is now a total of 50,345 MW in-state to serve a peak demand of 54,255 MW projected for 2002. Power plant developers have announced the cancellation of 17 plants previously proposed to be built in California, for 1,296 MW, over the past year alone; Attachment B, a map of new and cancelled power plants across the western states since the year 2000, shows that many proposed plants have been cancelled. Although the CAISO itself has stated that "the capacity reserve margin . . . should be 14% to 19% of the annual peak load to promote a workably competitive market outcome" ("Preliminary Study of Reserve Margin Requirements Necessary to Promote Workable Competition", Anjali Sheffrin, Market Analysis, CAISO, November 19, 2001), California remains dependent on out-of-state imports for a significant share of its load, and on unpredictable hydroelectric generation for 15% of its supply. In the year 2000, California's reserve margin was only 2%; for the summer of 2002, the CAISO predicts a reserve margin of 8.4% at expected peak.
- California has built no new bulk transmission, either to link the north and south portions of the state grid or to improve its import capabilities from out-of-state generators. Recently, the Western Area Power Administration, PG&E and TransElect filed a proposal to upgrade California's Path 15 line.
- The ability of individual customers to receive price signals and adjust their energy demands accordingly remains limited. California has done much to reduce peak customer loads, but more demand response is needed across the western states, as a crucial check on the ability of suppliers to exercise market power by raising prices.

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

VIII. Making Markets Work for the Long Term

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

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

Standard Market Design

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

Regional Transmission Organizations (RTOs)

As long as they are properly structured and truly independent, RTOs will provide significant benefits to electric utility customers across the nation by eliminating obstacles to competition and making markets more efficient. RTOs facilitate wholesale competition and, where states choose to pursue it, retail competition. Even in the absence of retail competition, electricity customers benefit from increased competition in wholesale markets because it reduces bulk power prices and improves reliability. First, RTOs should eliminate "pancaking" of transmission rates, that raises the cost of moving power across multiple utility systems. Second, RTOs that have the proper tools can better manage transmission congestion, reduce the instances when power flows on transmission lines must be decreased to prevent overloads, and effectively solve short-term reliability problems. I believe that RTOs (and independent transmission companies operating under an RTO umbrella) will attract the capital and expertise needed to expand the grid and serve the generation capacity necessary for growing, competitive electricity markets. Third, RTOs should ensure that vertically-integrated transmission-owning utilities do not discriminate in favor of their own generation over another seller's generation. Fourth, RTOs can facilitate transmission planning across a multi-state region and, by operating the grid as efficiently as possible, should provide assurance to state siting authorities that new transmission facilities are proposed only when truly needed.

Infrastructure

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

Market Monitoring and Mitigation

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

IX. Legislative Actions That Could Help FERC Deal With Market Power

A. Earlier Refund Effective Date

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

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

B. Increased Civil and/or Criminal Penalty Authority

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

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

C. Encouraging Construction of Needed Energy Infrastructure

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

X. FERC Employee Contacts With Enron Between May, 2000 and August, 2001

The Subcommittee's letter of invitation asked about Enron's contacts with FERC between May 2000 and June 2001. Over this period, FERC employees report 367 meetings with Enron-affiliated personnel—including those representing FERC-regulated facilities and energy marketing activities across a number of Enron subsidiaries and affiliates as well as corporate representatives and electricity marketers and traders. During Enron Corporation's existence, FERC has had jurisdiction over 37 Enron affiliates (some of which may no longer be in existence). These affiliates have included electric generators, qualifying facilities, power marketers, one traditional electric utility (which owns FERC-regulated hydroelectric facilities), on-shore interstate natural gas pipelines, off-shore natural gas pipelines, intrastate natural gas pipelines (which engaged in FERC-jurisdictional activities), crude-oil pipelines and petroleum products pipelines (FERC sets transportation rates for oil pipelines under the Interstate Commerce Act).

There were actually fewer meetings than the number above implies because each of these reported contacts represents a single FERC staffer at a meeting or event, and there was often more than one staffer at a meeting (thus one meeting may be reported numerous times). In addition, fewer staffers worked on Enron issues than the number implies because individual staffers attended numerous meetings over the course of the 14 month period. Numerous non-meeting "communications" were exchanged between FERC staff and Enron or Enron-affiliated companies over this time period. However, "communications" is interpreted broadly to include formal submittals of filings to the Commission and its staff, concerning Enron's or its affiliates' regulated activities before the agency.

It is normal and necessary for the agency to have frequent contacts with a regulated entity such as Enron and its affiliates, since they control pipelines, hydroelectric projects and interstate transportation facilities under FERC jurisdiction. During the relevant time frame, Enron and its affiliated companies would have dealt with FERC as an applicant in some cases, as an intervener in others, and as an interested and affected industry member in broader policy matters. FERC meets with and communicates with members of industry and interest groups every day, as a necessary and integral part of our regulatory life and responsibilities—for perspective, the Commission receives on average 70,000 filings a year. Thus, it would not be uncommon for employees to have had contact with Enron (and its affiliated companies) in (among other things): audits, technical conferences, settlement conferences, pre-hearing conferences, alternative dispute resolutions sessions, pre- and post-license and certificate site inspections, environmental scoping meetings, field inspections, pre-filing conferences, field compliance inspections, planning seminars,

facility tours, archeological surveys, periodic environmental inspections, annual project inspections, outreach programs, rulemaking conferences, fact-finding excursions, restructuring conferences to implement Order No. 637 (natural gas), joint industry meetings to review accounting issues, joint FERC-industry meetings to implement the Gas Industry Standards Board protocols, and industry demonstrations of new technologies.

Such contacts are appropriate and valuable when conducted within the agency's regulatory procedures. Since I was not present at the Commission during most of the period in question, I cannot personally speak to whether Enron or its affiliates attempted to influence FERC's decision-making with respect to wholesale electric markets. But based on my experience, I do not believe that Enron's scope of contacts with our employees or managers have been inappropriate given the breadth of its regulated interests, nor that Enron or any of its affiliates has had any undue influence on the decision-making process at the Commission. The Commission has had strict ex parte rules for many years and I have made it clear to staff at all levels that these must be rigorously followed at all times.

XI. Conclusion

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

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

Attachment

Commission Staff Summary of Recent Commission Actions Concerning Western Markets

November 2000

- November 1: *San Diego Gas & Elec. Co. (Complainant) v. Sellers of Energy and Ancillary Services into Markets Operated by CaISO and CalPX*, 93 FERC ¶ 61,121 (order proposing remedies for California crisis on complaint of SDG&E)("November 1 Order")
- November 9: Public Conference re FERC-proposed remedies held in Washington (see 93 FERC ¶ 61,122)
- November 22: *California Power Exchange Corp.*, 93 FERC ¶ 61,199 (order accepting amendments to streamline and clarify several provisions of the PX tariff)
- November 22: *Pacific Gas & Elec. Co.*, 93 FERC ¶ 61,207 (order suspending PG&E transmission rate increase proposal)

December 2000

- December 8:

  San Diego Gas & Elec. Co., 93 FERC ¶ 61,238 (order waiving operating efficiency and other regulatory requirements governing "QFs" and other small power producers to boost power output in California)

  California ISO Corp., 93 FERC ¶ 61,239 (order authorizing ISO tariff amendments to: (1) convert existing $250/MWh hard cap on bids in the real-time market into a $250/MWh breakpoint; (2) impose a penalty on generators who fail to comply with an ISO emergency order to provide power; and (3) assess costs against parties that underschedule demand or fail to deliver power.
- December 13: *California Power Exchange Corp.*, 93 FERC ¶ 61,260 (order accepting settlement re PX dispute resolution procedures)
- December 15: *San Diego Gas & Elec. Co. (Complainant) v. Sellers of Energy and Ancillary Services into Markets Operated by CaISO and CalPX*, 93 FERC ¶ 61,294 (Order adopting remedial measures to reduce reliance on volatile spot markets, including: (1) eliminating requirement that investor-owned utilities sell all their generation into the PX markets; (2) requiring 95 percent of demand to be scheduled in advance and establishing a benchmark for long-term con-

tracts; and (3) imposing an interim $150/MWh soft cap or "breakpoint" on spot markets pending development of longer term price mitigation plan) ("December 15 Order")

- December 22: Commission issues data request in response to December 7 SDG&E complaint re natural gas prices
- December 29:

  Southern California Edison Co., 93 FERC ¶ 61,320 (order analyzing and accepting SoCal Edison rates for scheduling and dispatching)

  Pacific Gas & Elec. Co., 93 FERC ¶ 61,322 (order rejecting PG&E filing regarding its scheduling on the ISO)

  San Diego Gas & Elec. Co., 93 FERC ¶ 61,333 (order accepting SDG&E rate filing re so-called "RMR" generating units-units that must run to assure system reliability)

  Southern California Edison Co., 93 FERC ¶ 61,334 (order accepting RMR tariff for SoCal Edison)

  California ISO Corp., 93 FERC ¶ 61,337 (order accepting ISO grid mgmt charges)

January 2001

- January 23: FERC staff conducts technical conference with industry representatives re prospective spot market monitoring and mitigation plan
- January 29: *San Diego Gas & Elec. Co.*, 94 FERC ¶ 61,085 (order finding Cal PX in violation of December 15, 2000 order for failing to implement $150/MWh breakpoint)

February 2001

- February 7: *Pacific Gas & Elec. Co.*, 94 FERC ¶ 61,093 (order accepting settlement re PG&E transmission rates)
- February 14: *California ISO Corp.*, 94 FERC ¶ 61,132 (order rejecting ISO and PX tariff amendments relaxing creditworthiness standards for PG&E and SoCal Edison as applied to transactions affecting third-party suppliers)
- February 15: FERC staff meets with PX regarding requirements for implementing $150/MWh breakpoint
- February 21:

  California ISO Corp., 94 FERC ¶ 61,141 (order accepting amended Transmission Control Agreement among ISO and transmission owners and addressing complaints by City of Vernon regarding conditions of becoming participating transmission owner)

  California ISO Corp., 94 FERC ¶ 61,148 (order denying rehearing of October 2000 order relating to ISO's Transmission Access Charge)

  Pacific Gas & Elec. Co., 94 FERC ¶ 61,154 (order denying intervention and rehearing of January 12 order authorizing PG&E Corporation intra-corporate reorganization)
- February 23: *San Diego Gas & Elec. Co.*, 94 FERC ¶ 61,200 (order on rehearing of December 29 order re reassignment of RMR costs)
- February 28: Former FERC Chairman testifies before the House Energy and Commerce Subcommittee on Energy and Air Quality concerning rising natural gas prices, the squeeze on natural gas supplies, and the role of natural gas in developing a national energy policy.

March 2001

- March 9:

  San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by CaISO and CalPX, 94 FERC ¶ 61,245 (Order directing refunds or further justification for charges)

  "Staff Recommendation on Prospective Market Monitoring and Mitigation for the California Wholesale Electric Power Market" (Docket Nos. EL 00–95–012, *et al.*)

San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by CaISO and CalPX, 94 FERC ¶61,243 (Order dismissing rehearing request of 1/8/01 order)

- March 14:

Order Removing Obstacles to Increased Electric Generation and Natural Gas Supply in the Western United States and Requesting Comments on Further Actions to Increase Energy Supply and Decrease Energy Consumption, (Docket No. EL 01–47–000) (order includes: (1) requirement that ISO and western transmission owners file list of grid enhancements that can be implemented in short term; (2) extension of waiver of QF regulations through December 31, 2001; (3) authorization for western businesses with back-up generators and customers who reduce their consumption to sell wholesale power at market-based rates; and (4) solicitation of comment on additional proposals)

Cities of Anaheim, et al. v. ISO, 94 FERC ¶61,268 (order dismissing in part and granting in part complaint alleging that certain cities are being charged inappropriate costs when ISO allocates the cost of power obtained through emergency orders to generators)

AES Southland, Inc., Williams Energy Trading & Marketing Co., 94 FERC ¶61, 248 (order directing parties to explain why they should not be found in violation of the Federal Power Act for engaging in actions that inflated electric power prices)

- March 15: Chairman testifies before the Senate Committee on Energy and Natural Resources
- March 16: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by CaISO and CalPX*, 94 FERC ¶62,245 (notice re proxy market clearing price and refunds for February transactions)
- March 20: The Commissioners testify before the House Committee on Energy and Commerce, Subcommittee on Energy and Air Quality
- March 28: *CPUC v. El Paso Natural Gas Co., et al.,* 94 FERC ¶61,338 (order dismissing portion of complaint alleging affiliate abuse but ordering public hearing on whether El Paso exercised market power to drive up natural gas prices)

April 2001

- April 6:

San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, 95 FERC ¶61,021 (Order dismissing rehearing, accepting compliance filing, and directing the recalculation of lower wholesale rates)

Pacific Gas and Electric Co., et al., 95 FERC ¶61,020 (Order on complaints concerning use of chargebacks and liquidation of collateral)

Kern River Gas Transmission Co., 95 FERC ¶61,022 (Order issuing certificate for facilities to transport natural gas from Wyoming to California)

California Independent System Operator Corporation, 95 FERC ¶61,024 (Order granting motion of generators to compel ISO to comply with creditworthiness requirements)

California Independent System Operator Corporation, 95 FERC ¶61,026 (Order granting clarification in part and denying rehearing of order on PX tariff creditworthiness amendment)

Southern California Edison Co and Pacific Gas and Electric Co, 95 FERC ¶61,025 (Order deferring action on request for suspension of underscheduling penalty and issuing request for information)

- April 10: Commission convenes Western Energy Issues Conference in Boise, Idaho
- April 10–12: The Chairman and General Counsel testify before the House Committee on Government Reform regarding wholesale electricity prices in California and the West
- April 16: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX* (unpublished notice of proxy price for March wholesale transactions in Docket No. EL00–95–028, *et al.*)

- April 18: *Public Utilities Commission of the State of California v. El Paso Natural Gas Co., et al.*, 95 FERC ¶ 61,089 (Order on rehearing regarding allegations of affiliate abuse and market power by gas pipeline)
- April 26:

  San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, 95 FERC ¶ 61,115 (Order establishing prospective mitigation and monitoring plan for the California wholesale electric markets and establishing an investigation of public utility rates in wholesale Western energy markets)

  Avista Corporation, et al., 95 FERC ¶ 61,114 (Order granting, with modification, RTO west petition for declaratory order and granting Transconnect petition for declaratory order)
- April 27:

  Commission notices initiation of investigation of rates in the WSCC (Docket No. EL01–68–000)
- April 30: *AES Southland, Inc. and Williams Energy Marketing & Trading Co.*, 95 FERC ¶ 61,167 (Order approving stipulation and consent agreement with respect to issues raised in the 3/14 show cause order)

May 2001

- May 1:

  The Commissioners testify before the House Subcommittee on Energy and Air Quality to discuss the proposed Electricity Emergency Relief Act

  The Director of Markets, Tariffs and Rates issues a letter to the ISO, PG&E, SDG&E, and SoCal Edison offering staff's assistance to complete RTO filings
- May 2: The Commission institutes a proceeding under FPA § 210(d) in Docket No. EL01–72–000 to consider whether it may need to order interconnection or transmission services to alleviate generation capacity shortages in California
- May 3: The Commissioners submit a written statement at the Senate Committee on Energy and Natural Resources oversight hearing called to review the Commission's April 26, 2001 mitigation order.
- May 7: *El Paso Natural Gas Co.*, 95 FERC ¶ 61,176 (Order issuing a certificate permitting increased pipeline capacity to California by converting an oil pipeline to gas service)
- May 9: Director of OMTR issues a letter to Southern California Air Quality Management District requesting information on its NO_x Emission Program
- May 14:

  Cities of Anaheim, et al. v. Cal ISO, 95 FERC ¶ 61,197 (Order on rehearing concerning complaint about OOM costs)

  Edison Mission Energy, 95 FERC ¶ 61,198 (Order approving corporate reorganization)

  San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, 95 FERC ¶ 62,125 (notice of proxy price for April wholesale transactions in Docket No. EL00–95–033, *et al.*)
- May 16:

  Removing Obstacles To Increased Electric Generation And Natural Gas Supply In The Western United States, 95 FERC ¶ 61,225 (Further order on removing obstacles to increased energy supply and reduced demand in the Western United States and dismissing petition for rehearing)

  San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, 95 FERC ¶ 61,226 (Order granting motions for emergency relief by QFs in part and establishing further procedures)

  California Independent System Operator Corporation, 95 FERC ¶ 61,199 (Order accepting in part and rejecting in part ISO Tariff Amendment No. 38)
- May 18: *Reporting of Natural Gas Sales to the California Market*, 95 FERC ¶ 61,262 (Order proposing reporting requirements on natural gas sales to California markets and requesting comments)

- May 22: *San Diego Gas & Electric Co., et al.*, 95 FERC ¶ 61,264 (Order requesting comments on whether the Commission should reimpose the maximum rate ceiling on short-term capacity release transactions into California)
- May 24: Commission convenes a technical conference regarding pipeline capacity into and adequacy within California (Docket No. PL01–4–000)
- May 25: *San Diego Gas & Electric Co., et al.*, 95 FERC ¶ 61,275 (Order providing clarification and preliminary guidance on implementation of mitigation and monitoring plan)
- May 31:

  Strategic Energy LLC v. Cal ISO, 95 FERC ¶ 61,312 (Order rejecting as premature complaint that ISO overcharged for power being bought out-of-market)

  CPUC v. El Paso Natural Gas Company, et al., 95 FERC ¶ 63,020 (Chief Judge's Report to the Commission, request to waive initial decision date and request for guidance)

June 2001

- June 4: *Cogeneration Council of California, et al.* (Notice of intent not to act re two petitions for enforcement filed pursuant to PURPA § 210(h) in Docket Nos. EL01–64–000 and EL01–67–000)
- June 11: *CPUC v. El Paso Natural Gas Co., et al.*, 95 FERC ¶ 61,368 (Order granting in part rehearing of 3/28/01 order and setting for hearing the allegations of affiliate abuse raised by complainants)
- June 13:

  California Independent System Operator Corporation, 95 FERC ¶ 61,391 (Order denying rehearing of order granting motion of generators to compel ISO to comply with creditworthiness requirements)

  California Independent System Operator Corporation, 95 FERC ¶ 61,390 (Order accepting ISO tariff amendments to conform with FERC formatting requirements)
- June 15:

  San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, et al. (unpublished notice of proxy price for May wholesale transactions in Docket No. EL00–95–037, *et al.*)
- June 19:

  San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, et al., 95 FERC ¶ 61,418 (Order on rehearing of monitoring and mitigation plan for the California wholesale electric markets, establishing West-wide mitigation, and establishing a settlement conference)

  The Commissioners and the General Counsel testify before the Senate Committee on Energy and Natural Resources concerning the June 19, 2001 Westwide mitigation order.
- June 20: The Commissioners testify before the Senate Committee on Governmental Affairs on the role of the Commission in its restructuring of the energy industries and its implications for other states and regions.
- June 22: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, et al.*, 95 FERC ¶ 61,425 (Order clarifying settlement conference procedures established in June 19 order)
- June 25—July 9: Settlement conference convened regarding refunds/offsets of past accounts, etc.
- June 26: *Calpine Corporation, et al.*, 95 FERC ¶ 61,430 (notice of intent not to act re two petitions for enforcement filed pursuant to PURPA §210(h) in Docket Nos. EL01–71–000 and EL01–77–000)

July 2001

- July 6: *Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California v. California* ISO, *et al.*, 96 FERC ¶ 61,024 (Order establishing settlement proceedings in Docket Nos. EL00–111–000 and EL01–84–000)

- July 11: *Universal Studios, Inc. v. Southern California Edison*, 96 FERC ¶ 61,043 (Order dismissing complaint re penalties Universal was charged for failing to interrupt its service under its interruptible service contract)
- July 12:

  San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, et al., 96 FERC ¶ 63,007 (Report and Recommendation of Chief ALJ and Certification of the Record following settlement proceeding)

  San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, et al., 96 FERC ¶ 61,051 (Order denying rehearing of 5/25/01 order which clarified 4/26/01 price mitigation order)
- July 16: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, et al.*, 96 FERC ¶ 61,088 (Order deferring action on rehearing requests of the 5/16/01 order concerning QF issues and on the issues that arise under FPA § 210)
- July 25:

  San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, et al., 96 FERC ¶ 61,120 (Order establishing the scope of and methodology for calculating refunds for past periods in California spot markets, initiating evidentiary hearing, and instituting preliminary evidentiary hearing for Pacific Northwest)

  San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, et al., 96 FERC ¶ 61,117 (Order granting Mirant's emergency motion for clarification of the must-offer requirement in the 4/26 and 6/19 price mitigation orders)

  Reporting of Natural Gas Sales to the California Market, 96 FERC ¶ 61,119 (Order imposing reporting requirements on natural gas sales to California markets)

August 2001

- August 2: The General Counsel and the OMTR Deputy Director testify before the House Government Reform Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs concerning market monitoring.
- August 7: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, et al.* (Order of Chief Judge Adopting Protective Order)
- August 10: *Automated Power Exchange, Inc.*, 96 FERC ¶ 61,199 (Letter Order re APX's role in the refund hearing)
- August 13: *CAlifornians for Renewable Energy*, 96 FERC ¶ 61,203 (Letter Order re intervention of CARE in EL00–95 proceeding)
- August 14: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, et al.*, 96 FERC ¶ 63,021 (Order and Report to the Commission granting late interventions and adopting trial schedule)
- August 29: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, et al.*, 96 FERC ¶ 63,030 (Chief Judge's Report to the Commission and order convening prehearing conference)

September 2001

- September 6: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, et al.*, 96 FERC ¶ 63,035 (Judge's Report to the Commission adopting a revised trial schedule)
- September 7: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX*, 96 FERC ¶ 61,254 (Order rejects wholesalers' cost justifications for sales in excess of the mitigated price)
- September 12: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, et al.*, 96 FERC ¶ 61,267 (Order rejects request for rehearing concerning creditworthiness)

- September 24: *Puget Sound Energy, Inc. v. All Jurisdictional Sellers of Energy and/or Capacity Markets into Pacific Northwest*, 96 FERC ¶ 63,044 (Presiding Judge's Recommendations and proposed findings of fact)
- September 26: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, et al.*, 96 FERC ¶ 63,048 (Judge's Report to the Commission adopting a revised trial schedule)
- September 27: *Western Systems Coordinating Council, et al.*, 96 FERC ¶ 61,348 (order granting request to transfer certain functions to Western Electricity Coordinating Council)
- September 28: Notice of Technical Conference issued concerning the Western states electric and gas infrastructure

October 2001

- October 5: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, et al.*, 97 FERC ¶ 61,012 (Order rejecting wholesalers' cost justifications for sales in excess of the mitigated price)
- October 9:

  CPUC v. El Paso Natural Gas Co., et al., 97 FERC ¶ 63,004 (Initial Decision of Chief Judge finding no evidence of the exercise of market power)

  Issuance of solicitation for audit proposals concerning operational audit of Cal ISO (Docket No. PA02–1–000)
- October 11: *Removing Obstacles to Increased Electric Generation and Natural Gas Supply in the Western United States*, 97 FERC ¶ 61,024 (order on rehearing of 7/27/01 order)
- October 12: Notice of Technical Conference issued concerning West-wide price mitigation for the winter season
- October 16: The Chairman testifies before the House Government Reform Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs concerning natural gas capacity, infrastructure constraints, and the promotion of healthy natural gas markets, especially in California.
- October 17: Issuance of letter order accepting for filing Duke Energy Oakland's revised reliability-must run service agreements (Docket No. ER01–3034–000)
- October 18: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, et al.*, 97 FERC ¶ 61,061 (Order clarifies earlier order concerning wholesalers' cost justifications for sales in excess of the mitigated price)
- October 24: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, et al.*, 97 FERC ¶ 61,066 (Order addresses the Cal ISO's outage coordination procedures)
- October 26: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, et al.*, 97 FERC ¶ 63,011 (Judge's Report to the Commission advising of the impact of an offer of settlement on refunds)
- October 29: Technical Conference held concerning West-wide price mitigation for the winter season (EL01–68–000)

November 2001

- November 2: Technical Conference held in Seattle concerning Western states' electric and gas infrastructure (PL01–7–000)
- November 7: *California Independent System Operator Corporation*, 97 FERC ¶ 61,151 (Order directing the ISO to comply with the Commission's past creditworthiness orders and rejecting Amendment No. 40)
- November 16: *CPUC v. El Paso Natural Gas Co., et al.*, 97 FERC ¶ 61,191 (order granting motion to compel return of protected material and requiring Southern California Edison to show cause why protective order has not been violated)
- November 20: *Reliant Energy Power Generation, Inc.*, 97 FERC ¶ 61,215 (Order directs the ISO to operate in accordance with the terms of its Tariff to ensure that all market participants are treated in a non-discriminatory manner)

December 2001

- December 10: Letter issued requesting views of Northwest state commissioners on RTOs
- December 19: *Investigation of Wholesale Rates of Public Utility Sellers of Energy and Ancillary Services in the Western Systems Coordinating Council*, 97 FERC ¶ 61,294 (Order requires the ISO to temporarily recalculate the price mitigation for spot market transactions under certain conditions)

  San Diego Gas & Electric Co., et al., 97 FERC ¶ 61,275 (Order generally reaffirms key earlier decisions on pricing and price mitigation measures and addressed a number of wide-ranging issues related to California and the Western energy markets)

  San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services, et al., 97 FERC ¶ 61,293 (Order accepts in part and rejects in part three ISO compliance filings submitted in 2001 concerning the minimum load costs that generators can recover in complying with the must-offer requirement; the declaration of system emergencies; elimination of the penalty for failure to report a forced outage or to respond to a dispatch request; and the requirement to submit cost justification only in cases where bids above the mitigated market clearing price are accepted)

  San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX, 97 FERC ¶ 61,290 (Order rejects wholesalers' cost justifications for sales in excess of the mitigated price)

  San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX et al., 97 FERC ¶ 61,301 (Judge's Report concerning the scope of the evidentiary hearing)

  Mirant Delta LLC and Mirant Potrero LLC, 97 FERC ¶ 61,284 (order conditionally accepting and suspending revised RMR agreements)

  Duke Energy Oakland LLC, 97 FERC 61,283 (order conditionally accepting and suspending revised RMR agreements)

  Pacific Gas and Electric Co., 97 FERC ¶ 61,291 (order conditionally accepting and suspending revised RMR agreements)

  Geysers Power Company, 97 FERC ¶ 61,295 (order conditionally accepting and suspending revised RMR agreements)

  Geysers Power Company, 97 FERC ¶ 61,299 (order accepting and suspending and setting for hearing and ADR revised RMR agreements)
- December 27: *CPUC v. El Paso Natural Gas Co., et al.*, 97 FERC ¶ 61,380 (order remanding proceeding for limited supplemental hearing regarding available capacity)

January 2002

- January 4: *Ramco, Inc.*, 98 FERC ¶ 61,004 (Letter order rejects RAMCO's cost justification filing as unsupported)
- January 9: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX*, 98 FERC ¶ 63,003 (Judge's Report to the Commission adopting a revised trial schedule)
- January 11: *Williams Energy Marketing & Trading*, 98 FERC ¶ 61,013 (order conditionally accepting and suspending revised RMR agreement)
- January 16: *Geysers Power Company*, 98 FERC ¶ 61,031 (order conditionally accepting and suspending revised RMR agreement)
- January 25:

  Issuance of Operational Audit Report of Cal ISO (Docket No. PA20–1–000)

  California Independent System Operator Corp., 98 FERC ¶ 61,047 (order establishing schedule for submission of pleadings regarding arbitrator's award)
- January 29: The Chairman testifies before the Senate Committee on Energy and Natural Resources concerning Enron.
- January 30: *Ramco, Inc.*, 98 FERC ¶ 61,057 (Letter order rejects RAMCO's cost justification filing as unsupported)

Dynegy Power Marketing, Inc., 98 FERC ¶61,074 (order granting complaint in part and dismissing in part)

- January 31: *California Power Exchange Corp.*, 98 FERC ¶61,097 (order granting petition for declaratory order in part)

February 2002

- February 1: *Geysers Power Company*, 98 FERC ¶61,114 (order granting rehearing of 10/17/01 order)

  Duke Energy South Bay, 98 FERC ¶61,110 (order conditionally accepting and suspending revised RMR agreement)

- February 13: *Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, 98 FERC ¶61,165 (order directing staff investigation)

  San Diego Gas & Electric Co., 98 FERC ¶61,128 (letter order accepting for filing proposed revenue requirement)

  Pacific Gas and Electric Co., 98 FERC ¶61,132 (letter order accepting for filing revised RMR agreement)

- February 13: The Chairman testifies before the House Energy and Commerce Subcommittee on Energy and Air Quality concerning the effect of the Enron bankruptcy on energy markets.
- February 15: Staff issues data request issued to Enron regarding its power supply contracts
- February 22: The Chairman testifies before the House Government Reform Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs concerning electricity market design in California.
- February 26: *California Independent System Operator Corp.*, 98 FERC ¶61,187 (order accepting in part and rejecting in part Tariff Amendment No. 41)
- February 27: *CPUC v. El Paso Natural Gas Co., et al.*, 98 FERC ¶61,210 (order denying rehearing of 12/27/01 order)

  San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX et al., 98 FERC ¶61,202 (order accepting compliance filing re outage coordination and directing further compliance filing

  San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX et al., 98 FERC ¶61,204 (order denying rehearing of 10/23/01 outage coordination order)

March 2002

- March 1: *NEO California Power LLC v. Cal ISO*, 98 FERC ¶61,228 (order directing Cal ISO to file status report on payments)
- March 5: Staff issues letter directing all sellers to report on transactions in WSCC for years 2000 and 2001
- March 7: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX*, 98 FERC ¶61,254 (Order suspends implementation of the Cal ISO re-running its past market clearing prices)
- March 15: Staff issues subpoena duces tecum to Enron directing the production of documents
- March 27: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX*, 98 FERC ¶61,335 (order clarifying creditworthiness requirement, denying rehearing in part, and rejecting compliance filings)

  San Diego Gas & Electric Company, 98 FERC ¶61,332 (order granting in part and denying in part petition for declaratory order)

  California Independent System Operator Corp. 98 FERC 61,327 (order accepting in part and rejecting in part tariff amendment and dismissing complaint)

- March 29: Notice of Technical Conference issued regarding meeting convened by staff to facilitate discussion between the Cal ISO, market participants, state agencies and others on development of a revised market design for the Cal ISO

April 2002

- April 1: *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by Cal ISO and CalPX et al.*, 99 FERC ¶61,008 (order denying rehearing of 12/19/01 cost justification order)
- April 4–5: Technical Conference held in San Francisco concerning the development of a revised market design for the Cal ISO
- April 16: Public conference to take comments on staff's recommended basis for assigning capacity and receipt points on El Paso system held in Washington, DC

  Nevada Power Company and Sierra Pacific Power Company v. Duke Energy Trading and Marketing, et al., 99 FERC ¶61,047 (order setting for hearing complaints filed by the Nevada Companies, Southern California Water Company and PUD No. 1 Snohomish County, Washington alleging excessive long-term power contracts)
- April 25: *Public Utilities Commission of the State of California v. Sellers of Long Term Contracts to the California Dep't of Water Resources, et al.*, 99 FERC ¶61,087 (order setting complaints for hearing)
- April 26: *Geysers Power Company*, 98 FERC ¶61,114 (order denying rehearing of 1/16/01 order)

May 2002

- May 9–10: Technical Conference held in San Francisco concerning the development of a revised market design for the Cal ISO

Staff Investigations

The Commission's staff has completed or initiated a number of public investigations, audits, and studies of matters relating to events in California, including the following:

- An audit of generation outages (report issued February 2, 2001)
- An analysis of the effect of a western region-wide price cap (released in early February 2001)
- An analysis of causes of high prices in Pacific Northwest and California (released in early February 2001)
- January 31, 2002: *Commission Staff Report to Congress on the Economic Impacts on Western Utilities and Ratepayers of Price Caps on Spot Market Sales*, (Report concludes that a wide variety of factors other than the price cap, such as conservation efforts, a downturn in the regional economy, and adequate supply given low demand, affected sales prices in both the spot and non-spot markets).
- Ongoing receipt and review of outage incident reports from generators within 24 hours of the beginning or conclusion of a unit's outage.
- Ongoing study of whether there have been any changes in operational patterns of generation plants owned by major independent marketers from patterns observed when they were owned by IOUs.

Court Cases (Decided and Pending) Concerning the Commission's Restructuring, Monitoring, and Mitigation of Western Energy Markets

Decided

In re: California Power Exchange, Corp., et al., 9th Cir. Nos. 01–70031, et al., 4/11/01, 245 F.3d 1110 (denying petitions for writ of mandamus to stay 12/15/01 mitigation order and to direct retroactive refunds).

In re: John L. Burton, et al. v. FERC, 9th Cir. No. 01–70812, 5/29/01, unpublished (denying petition for writ of mandamus directing price caps and return to cost-based pricing).

In re: Southern California Edison Co., D.C. Cir. No. 00–1543, 1/5/01, unpublished (denying petition for writ of mandamus directing cost-based pricing).

Western Power Trading Forum and Coalition of New Market Participants v. FERC, D.C. Cir. No. 99–1532, 4/10/01, 245 F.3d 798 (dismissing challenge to Commission's approval of governance over the California ISO).

Public Utilities Commission of the State of California v. FERC, D.C. Cir. No. 00–1203, 7/6/01, 254 F.3d 250 (denying challenge to Commission's allowing the California ISO to pass through the costs of reliability must-run contracts in its rates).

El Segundo Power, L.L.C. v. FERC, D.C. Cir. No. 00–1093, 5/22/01, unpublished (denying challenge to Commission's refusal to order the California ISO to refund to generators the differential between the capped price and the bid price for ancillary services).

California Municipal Utilities Assoc., et al. v. FERC, D.C. Cir. Nos. 01–1156, et al., 7/31/01, unpublished (dismissing challenge to 12/15/01 order on remedies for the California wholesale electricity market).

Pending

El Paso Merchant Energy and El Paso Natural Gas Co. v. FERC, D.C. Cir. Nos. 01–1286, 01–1287, 01–1443, 01–1444, 02–1140, 02–1142 (challenge to orders setting for hearing issues in CPUC complaint regarding possible affiliate abuse, anticompetitive conduct, and withholding of pipeline capacity into California gas market).

Amoco Production Co., et al. v. FERC, D.C. Cir. Nos. 01–1523, 01–1524 (challenge to orders certificating expansion of pipeline to allow for additional transportation capacity into California).

Cal. Dept. Of Water Resources v. FERC, D.C. Cir. No. 01–1234 (challenge to requirement that DWR, if it becomes a member of the California ISO and assigns its transmission contracts to the ISO, must design its transmission revenue requirements and establish a transmission revenue balancing account like any other ISO member).

California Independent System Operator v. FERC, D.C. Cir. No. 01–1343 (challenge to Commission order requiring California ISO to comply with earlier creditworthiness order).

Public Utilities Commission of the State of California v. FERC, D.C. Cir. No. 02–1108 (review of long-term power purchase agreements filed (or not needed to be filed) under blanket market-based sales tariffs).

State of California, ex rel. Bill Lockyer, et al. v. FERC, 9th Cir. Nos. 02–70336, et al. (challenge to orders authorizing intra-corporate reorganization of PG&E).

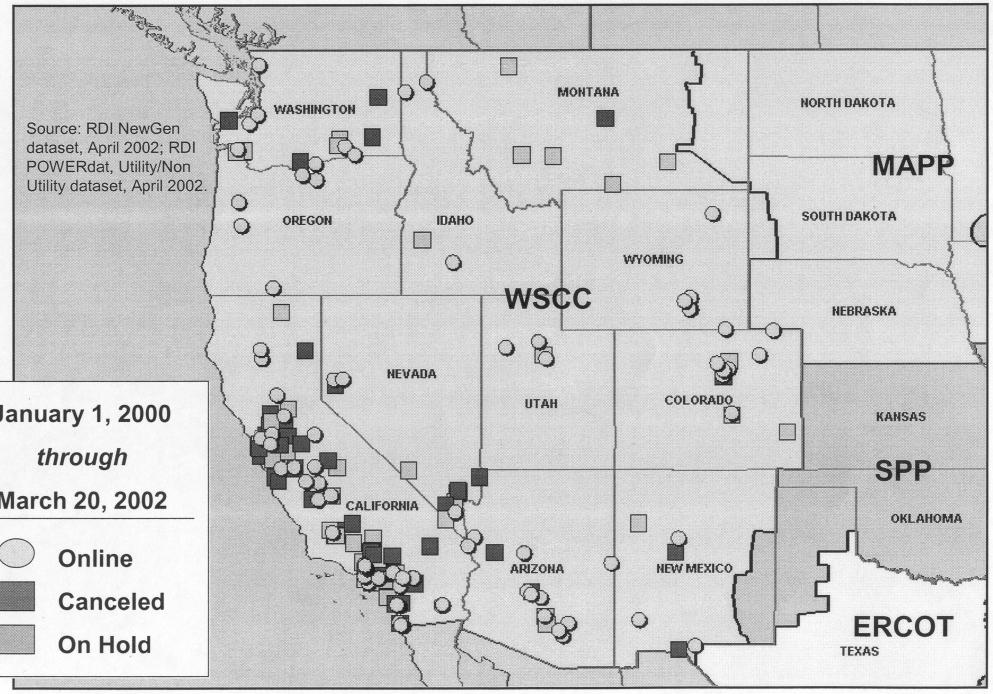
Turlock Irrigation District, et al. v. FERC, D.C. Cir. Nos. 01–1289, et al.

Public Utilities Commission of the State of California, et al. v. FERC, 9th Cir. Nos. 01–71051, et al. (over 50 petitions for review of the Commission's 4/26/01, 6/19/01, 7/25/01, and 12/19/01 orders establishing comprehensive market restructuring, monitoring and mitigation of Western energy markets).

Pacific Gas & Elec. Co., et al. v. FERC, D.C. Cir. No. 01–1187, et al. (review of transmission revenue requirements of California ISO members that do not own transmission).

Western Region (WSCC) Electric Generating Plants

Map of Plants Coming Online, On Hold, or Canceled From January 1, 2000 through March 20, 2002



Western Region (WSCC) Electric Generating Plants

Table of Plants Online, On Hold, or Canceled
From January 1, 2000 through March 20, 2002

		California	Rest of WSCC	Total
Online	Number of Plants	38	52	90
	Number of Units	66	104	170
	Nameplate Capacity MW	2,948	5,695	8,642
Canceled	Number of Plants	44	14	58
	Number of Units	48	18	66
	Nameplate Capacity MW	7,596	4,616	12,212
On Hold	Number of Plants	27	25	52
	Number of Units	34	32	66
	Nameplate Capacity MW	6,573	11,867	18,441

Senator DORGAN. Chairman Wood, thank you very much. I must tell you that last evening I spent a lot of time late into the night reading all of these documents. By the time I went to bed, I was so angry with FERC that it was hard for me to describe. It is a good thing you were not close.

I understand you were not there during much of this period, but still in all I get so upset with people who come to government really not interested in fulfilling their roles to be protective of the public's interest. That is what I think happened at FERC. I have accused FERC during the year and a half or so while we were having hearings of doing its best imitation of a potted plant, just sitting there doing nothing while people were dramatically injured.

I do not know why that happened, but I want to ask you some questions about why it happened. I recall during this period, when we were having hearings on the Energy Committee, on which I serve, *The New York Times* broke a story. This was in May of last year. Mr. Ebert, your predecessor, Washington's top electric regulator, said he had barely settled into his new job when he had an unsettling telephone conversation with Kenneth Lay, the head of the nation's largest energy trader, the Enron Corporation.

Mr. Ebert—this is in *The New York Times*—said that Mr. Lay, a close friend of President Bush's, offered him a deal. If he changed his views on electricity deregulation, Enron would continue to support him in his job. Mr. Ebert recalled that Mr. Lay prodded him to back a national push for retail competition and a faster pace in opening up access and so on.

Mr. Ebert said he refused the offer. "I was offended," he said. The fact is Mr. Ebert was replaced, as you know. You are from Texas. You came to replace him.

You ultimately, over a period of time, put on some price caps in California. I understand, as a result of that, you got put on an OMB watch list. I do not know if that is true or not, but one of my colleagues who served with me in the House did something they did not like and OMB got him fired, I understand you are on a watch list. So you might want to walk slowly.

Senator BOXER. Do not tell him that.

Senator DORGAN. I am not suggesting he should act slowly. I am just suggesting he be observant of his surroundings.

Let us talk about your agency and why it refused to act when it should have. Is it an agency that is incapable, incompetent, or corrupt? During this time when people were thieving Californians—and that is exactly what they were doing—what happened at FERC to persuade them to do nothing? Because the California agencies were busy as the dickens trying to figure out how to deal with this, and the Federal regulators, who were the only ones who had the capability to deal with it, did nothing.

Was that a deliberate strategy and, if so, where did it come from?

Mr. WOOD. I do not believe it was deliberate, sir. In fact, I think there was some activity going on. I think, in retrospect, it was not sufficient. When the June 2000 price spike happened in San Diego and it appeared that it was sustained, FERC did begin an effort to analyze the bulk power markets. I have actually re-read the report yesterday on a plane. That came out on November 1 of 2000. It did analyze it in sufficient detail and actually a number of the

items that were brought forth in the Enron memo also were discussed here as far as market issues that presented gaming opportunities.

Names of people who gamed were not attached to that, but the behaviors were, and FERC six weeks later on December 15th of 2000 did put forth an order that in fact—after a bunch of people responded to this report and said, you are going the right direction, just hurry and get there—brought to an end a number of the behaviors in the Enron——

Senator DORGAN. So you say FERC knew this was going on?

Mr. WOOD. I would say that FERC knew that these types of gaming opportunities existed.

Senator DORGAN. But did they know it was happening?

Mr. WOOD. From reading this document and from what I have been able to understand, it is not clear, sir.

Senator DORGAN. Well, it needs to be clear. Either they are incompetent or unwilling to take effective action. If this was going on and the California people knew it and the Oregon people knew it and everyone else had the suspicion that it was going on, and you were the only people that had the capability and the tools to get to the bottom of it and you are saying you do not know whether you knew it was going on, there is something wrong here.

Mr. WOOD. What I am saying, sir, is I do not know that we knew that particular identified people were engaging in this activity that we had evidence for, as we do now. But we knew that these opportunities existed and were being manipulated, yes. I would say that the answer to that is yes from reading this report. It is clear that the FERC at that time knew——

Senator DORGAN. So if FERC knew that these markets were being manipulated, why did they not hit the emergency brake immediately and put caps on wholesale prices?

Mr. WOOD. Well, I think what they did in December was an attempt to do that. Again, sir, please recognize I was not there. It was not after some thought that we did the caps. It was my very first vote.

Senator DORGAN. Well, you are right, but you were still running that agency and the bowels of that agency are still attached to the neck.

Mr. WOOD. Correct, but it has got a new head.

Senator DORGAN. Well, it has got a new head, but the body still looks the same to me. I am trying to figure out whether there is a will and a heart and an interest in doing the right thing. As Senator Boxer described in her chart, these things ratcheted up and the California people believed that the interests were gaming this system and stealing from ratepayers.

My question is why, if FERC knew that this system was being gamed and manipulated and deceptive practices were existing in the year 2000, why did we not see price caps until June of 2001? What was FERC doing and why was it not taking action?

Mr. WOOD. I could stand corrected, but I believe throughout that whole period there were price caps. They did not work the same way that the price caps worked forward.

Senator DORGAN. You put wholesale price caps on in June 2001 and that is what stopped this. But my understanding is that you

did that in contravention of the Administration's interests. They did not want you to do it; is that correct?

Mr. WOOD. I am sorry, Senator Dorgan?

Senator DORGAN. The Administration was opposed to you applying these price caps in June 2001, is that not correct?

Mr. WOOD. I did not talk to them about the pending matters.

Senator DORGAN. But you know they were displeased.

Mr. WOOD. In fact, I read it in the paper.

Senator DORGAN. But you know they were displeased? You read that in the paper?

Mr. WOOD. I did.

Senator DORGAN. Yes. Well, first of all, I want to thank you for taking that action. But what I am trying to understand is the agency that you head sat on the sidelines all during that period. Other people knew what was going on or at least were digging into it and it does not seem to me like FERC was. If you cannot rely on the referee or the regulator here, you know, you are at risk for losing billions of dollars in ill-gotten gains for the company and taking billions of dollars from the customer they should not have to have taken from them.

Mr. WOOD. I would agree with your assessment that the FERC has got some changing to do and, quite frankly, it requires bringing in the new blood and that is why I am very grateful that Congress has given us the resources to allow us to do that.

Senator DORGAN. But are you upset at the way FERC behaved during that period?

Mr. WOOD. That is why I took the job, sir. I wanted to come up and fix it.

Senator DORGAN. Are you upset with them?

Mr. WOOD. Yes, sir. I wanted to come up here because I was a state regulator in the same shoes that President Lynch is today, not quite as dependent on FERC because of the nature of the Texas grid, but in some ways dependent on FERC, and wanted to make sure that, in fact, FERC did do its job, because it mattered to my home state just, as well.

I think there might have been other things that I would have rather done with my life, but I felt that this was important, and I still believe it is important to fix it.

Senator DORGAN. But I understand you were not here during that period, but you came here day to day preaching deregulation once again. I think—I will tell you what. I have had a belly full of being restructured and deregulated, only to find out that everybody else gets rich and the rest of the people lose their shirts.

So I am very worried about somebody who says, boy, this has really worked well, when we have a regulatory agency that fails to regulate. We have got people coming to this town saying what we want is less government. Do we really want less government in the face of this kind of wholesale cheating? I do not think so. I think we want more effective, aggressive regulators who are willing to stand up and speak up and take effective action on behalf of ratepayers, especially in the electricity area.

So Mr. Wood, I will let my colleagues continue to ask questions, as well, but it seems to me that that agency that you now head was shamefully absent during a critical period, and I cannot tell you

how angry I am about that. I almost feel like we ought to abolish the agency and start over, because we want people in an agency like this to stop cheating when it happens.

We had hearings, and I questioned the folks at FERC, and the fact is they sat there on their hands and did nothing. It was so enormously frustrating. We knew what was going on, and now we finally understand that the evidence exists of this massive deception, but FERC would not do anything.

I hope that we are able to look back at your tenure, Mr. Wood, and say that you dramatically changed it, you had an emergency break, you had aggressive overseers, you were an aggressive regulator, you saw wrongdoing, and that you took action immediately. I hope that is the legacy you will leave at that agency.

My colleagues have other questions. Senator Hollings.

The CHAIRMAN. Mr. Wood, is that not the case, that you noticed this wrongdoing? Certainly the prices were out of control, and thereby you instituted price caps in June of last year; is that not correct?

Mr. WOOD. Yes, sir. We did refer to them as price mitigation, but I think either name is applicable.

The CHAIRMAN. Price mitigation, that is a fancy word. Why did you not followup on the need for mitigation? Why did you not followup and investigate and do something about it after June and, in fact, according to the California witnesses, until now? I mean, from June until May of this year, the testimony before our Committee is to the effect that you not only did nothing, you blocked anything being done in California.

I am just wondering. You saw mitigation was necessary in June and, bam, you put it in, and then nothing happened. Correct my thought.

Mr. WOOD. I attached to my testimony all the things we have done in a long period of time dealing with various aspects of the California markets. There is a refund hearing that began in July. We had settlements relating to that right after the June order. We sent the parties into settlement discussions about the refunds for the overcharges that happened prior to our price cap. There is a locked-in period of time in which under the law some refunds——

The CHAIRMAN. They had requests from September of last year, I remember that, and they said they got no response.

Mr. WOOD. September of?

The CHAIRMAN. September of 2001. Otherwise, they had subpoenas that they wanted to issue and you would not help them issue the subpoenas.

Mr. WOOD. I heard that, sir. I am not sure that FERC has any authority to give subpoena power to a state that the state cannot do. I am not sure what that referred to.

The CHAIRMAN. It was some bureaucratic situation that you have control over that forbade them from moving forward with their particular case, as I understand it.

Mr. WOOD. The court case, and I have got it here attached on the back, we were in court on the court case from December of 2000, which is the court case with all the price caps. The California commission and others have sued the FERC over various and sundry

rulings in that large order, and that is before the court now, and the record has been certified to the court.

So there is plenty of litigation relating to this whole California experience, some of which has gone through the agency and some of which is out of the agency. But there is quite a bit, and I will confess it is not all finished. But the court case is in court as we speak today.

The CHAIRMAN. Well then, let me ask another question, Mr. Wood, because I am a little nonplussed at the response that you made that you had not discussed the price caps with either the President, the Vice President, or anyone connected with the Administration. Because on May the 30th it is reported in the press, of course, that President Bush came out categorically opposed to price caps. You had no discussion whatsoever with anybody, with the President or anybody connected with him, is that right?

Mr. WOOD. That is correct, yes, sir.

The CHAIRMAN. I hesitate because—well, were you not selected by Mr. Lay to be the commissioner in Texas?

Mr. WOOD. No, sir, I was not.

The CHAIRMAN. I read a story to that effect, that you were Kenny Boy's boy in Austin, Texas.

Mr. WOOD. I was Governor Bush's man.

The CHAIRMAN. You were Governor Bush's man, all right. Well, that is better. But it is sort of intriguing when you hear that Mr. Lay did approach Mr. Hébert and asked him to go along with his type price deregulation and he would not, then he selected you. Is that correct? Do you know anything about that?

Mr. WOOD. No, sir. I had discussions with then-Governor Bush's staff in October of 2000 about how I might wish to serve the Administration if the event happened, and I think my response, which at the time has proven itself out, was: Just give me something hard.

The CHAIRMAN. How about the energy plan, now that we have the Administration's energy plan? How often did you meet to help them promulgate that plan, with Vice President Cheney?

Mr. WOOD. There was—well, actually I was on what was called the transition team, which was to write the energy action plan for the incoming Secretary of Energy, who I believe at the time had not been named, Senator Abraham. I was on that group, and we met once prior to the Inauguration, but I actually did not even make that meeting because I was not able to be there.

But that was my involvement with the transition before the Inauguration. I was not involved in the energy advisory team other than providing the comments that I had given earlier to the transition team about general thoughts about what would be good for the energy future of the country.

The CHAIRMAN. Did you meet with the Vice President in promulgating the energy plan?

Mr. WOOD. No, sir, I did not.

The CHAIRMAN. You did not. Very good, I thank you, Mr. Chairman. Let me yield my time to the next witness.

Senator DORGAN. Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman.

Mr. Wood, I think probably nothing is going to determine whether FERC has learned its lessons as clearly as what you decide on September 30th when the price caps expire. I would like to get a sense of how you are going to approach it. At a minimum, at a bare minimum, it seems to me that FERC has an obligation to those on the West Coast, people who have been flattened, as Senator Boxer and I have been talking about for several hours now, that you have an affirmative obligation to show that there is going to be protection for consumers by what you do and that you do it in an open hearing.

Suffice it to say I am very concerned that these caps are just going to expire by inertia. We cannot have a hearing here every day, as useful as it might be. So tell us what is going to be done to protect the Western ratepayer come September 30th, and be as specific as you can, if you would.

Mr. WOOD. Let me just state up front, though, Senator Wyden, the restrictions on that.

Senator. WYDEN. I understand. I want to know how you are going to approach it. Specifically, do you think there ought to be an affirmative finding that is a foundation for your decision that there are consumer protections so people will not get gouged?

Mr. WOOD. In May, I think about 10, 15 days ago, the California ISO filed a request to extend the price caps, as they are referred to, or in the alternative to do other things that would replicate the benefits that the price caps had given while the market is healing.

Senator WYDEN. Right.

Mr. WOOD. That is a pending proceeding before the Commission. The four commissioners are looking at that. It is a front-burner item for us this summer. I will say what I said prior to its filing to the Governor of California directly, that we are not going to go from what we have now to something that is less effective. Basically, we are not going to drop the potato. We are going to move forward with what is appropriate for that market and for the customers out there.

We have learned a lot in the last year living under the price caps, looking at other markets where price caps or some other types of tools exist, and putting those out there. But all that, it is not like an on or off switch, Senator Wyden.

It is the order we gave California and the state agencies in California what they asked for, which will get us through two summers. We went to the end of September just in case September was hot. So we had done that. That is what the order last summer said. It is clear that all the conditions for a successful competitive market are not likely to be existing by that time.

Senator WYDEN. Then that is key.

Mr. WOOD. Correct.

Senator WYDEN. If there is evidence that there is not a competitive market on the West Coast——

Mr. WOOD. Then you cannot deregulate it, basically.

Senator WYDEN. Do you think that there should be a finding on that point specifically before the price caps are lifted?

Mr. WOOD. That there be——

Senator WYDEN. A finding that there is a competitive market, before you lift the price caps? Do you feel that that has to be found before you lift them? I would like a yes or no answer on that.

Mr. WOOD. Let me make one clarification to answer your question. You say the price caps. There are a lot of things in that order other than the cap and the formula itself that are part of the mitigation plan. I would say I think that you have to have—yes, you do have to have a competitive market before you eliminate a mitigation plan, and the price cap is part of that. But I do not know—I will just say, because there are a number of other tools, some of which I think were more effective than the price cap, that the price cap itself per se may not be the best tool to use in that market.

Senator WYDEN. Well, what would be a better tool, then?

Mr. WOOD. Well, the must-offer requirement, I think, has been a remarkably effective tool out there. It did not exist before the Commission adopted it. In fact, they adopted it in April before I was on board. But the must-offer requirement that says, unless you are off-line to do prescheduled maintenance or what have you, that you have got an obligation to sell your power into the market. That brought a lot of power into the market that was kind of sitting on the sidelines.

In fact, since that time, at least since June, there has not been a shortage of power.

Senator WYDEN. If you are going to go that route, I hope that you will give people on the West Coast of the United States an opportunity to be heard on that, because I know there are a lot of people that are very skeptical about whether there is anything other than price caps in the short term that is going to protect the consumer. That is why I want to see you make a finding of fact that there is a competitive market before you lift the price caps on people on the West Coast of the United States.

Certainly I will tell you I believe there ought to be an open hearing on alternative remedies if you are going to look at other things besides price caps, because I think my colleague and I have heard from a lot of constituents who really feel that there is no other alternative right now, given the pounding our region has taken, other than to continue the price caps.

By the way, you might be interested, I was the West Coast Democrat who initially had some skepticism about price caps.

Mr. WOOD. I remember that.

Senator WYDEN. If I had seen all this market manipulation, I would have been out there earlier with my colleague Senator Boxer.

Let me go next to the question of why it took FERC until recently to uncover these December memos. The memos date from December of 2000. FERC seemed to come up with it here just very recently. How did it take so long to come up with them?

Mr. WOOD. We began our investigation of the energy markets—as I committed I believe to you personally and to the other members of the Energy oversight committee—in January of this year and I think in February began issuing the subpoenas and data requests not only to Enron and its affiliates, but all the market participants in the West. I think this was a response to a request in a filing in March, to a data request in March that asked for some

specific types of documents. I do not have the exact subpoena before me.

But I will share your concern that it took as long to get from, I guess May the 5th or 8th or so, after a March 20th subpoena request for these documents. I am not sure I have gotten comfortable on what the right answer on that is, so I really do not have anything to share with you there. But it is not for me in the investigatory business a business-as-usual time line.

Senator WYDEN. How would you characterize selling non-firm interruptible power as a sale of firm power? That was what I was told this morning. That is what the Enron witness admitted was going on in the Pacific Northwest. I guess the defense is, well, everybody is doing it. Mr. Freeman basically, he thought it was not adequately disclosing to people what was going on.

I would like to hear how FERC characterizes something that strikes my constituents as pretty much fraud.

Mr. WOOD. Well, I characterize it on page 11 of my testimony today as deliberate misrepresentation of information. That may be a longer way of saying fraud, but I think to me that—again, the full Commission will probably weigh in on this as a Commission. But for one commissioner, clearly that type of activity is wrong.

Senator WYDEN. I want it understood how significant this is. Mr. Sanders said in response to my question, he admitted to this, that Enron was characterizing non-firm power as firm power. You told me that that pretty much strikes you as fraud. You said that the Commission is going to, in your view, look at it.

Describe to me how that would come about? I would like your assurance this afternoon that you personally will look into that matter and report back to me and other members of the Pacific Northwest. But describe to me how it is that the Commission would look into that?

Mr. WOOD. The pending investigation, sir, we have committed, and I think both you and Senator Boxer wrote me personally in late January to followup on this issue as it came up in the Energy Committee, to provide you a report, hopefully a final report, but also even an interim report by the summer break as to where we are on this issue and others.

But one of the things——

Senator WYDEN. Let me ask one more. I think we probably have a vote. Just one other question and I want to let Senator Boxer ask one.

You know, on this round-tripping issue where two companies swap the same amount of energy at the same price, what is the justification for that? I mean, it is illegal in the securities market. Why is it justifiable in the energy market?

Mr. WOOD. The issue I think first came up with regard to Dynegy and CMS, that the Securities and Exchange Commission is looking into, I am not sure that that is legal in the energy markets any more. It is not in violation of a law that we have because, quite frankly, we do not have one one way or the other on that. We have a disclosure requirement which was just re-adopted about three weeks ago that says you have got to lay all these transactions out in the public record in your quarterly report and that is a publicly

available report. You cannot net them out as a zero. You have got to put them out as a full quantity.

But that is as far as our Commission has gone on those issues. They have not come up, quite frankly.

Senator WYDEN. It is our understanding that Bonneville's loads on the Oregon-California inter-tie were less than the capacity of the line while the ISO's scheduling was showing the line to be congested. Did you investigate why there is a discrepancy between actual loads and what the ISO thought the loads were?

Mr. WOOD. That sync-ing up of those data is exactly one of the things that we opened the investigation in January to do.

Senator WYDEN. You plan to do?

Mr. WOOD. We have got the data already to do that and we have got the help, honestly from the outside, to help us analyze all those types of issues. But loading up of congestion, the phantom congestion issue that was referred to in the memoranda, is one of those issues, yes, sir.

Senator WYDEN. We have got a vote. I want Senator Boxer to have her questions. I gather you and I are going to spend the afternoon together because I will be heading with you over to the Energy Committee. But suffice it to say we have got a lot to do to drain this swamp. I mean, there have been a lot of people hurt, and we need you to be far bolder than the agency has been in the past. I will have some more questions later on this afternoon.

Mr. WOOD. Thank you, Senator Wyden.

Senator DORGAN. Senator Boxer.

Senator BOXER. Thank you. I think the vote starts in about 5 minutes.

Thank you for being here, Mr. Wood. I like some of the things you say, but I am really nervous about what they really mean. So let me try to find out.

You say you want to solve this crisis—I am quoting from you—and you want to make the future better for everybody. I like that. But you need to make the present better now for the people of California. We were robbed as sure as somebody hit us, all 30 million people, at the same time and grabbed our wallet.

Now, if your grandma got hit on the head and a thief took her wallet, first you would want to stop the bleeding. You did that with your price cap and your must-order both together. That is in place now. You stopped the bleeding. Now, after your grandma gets better you want to get her money back.

We need our money back. So you act to stop the bleeding. I am very afraid you are going to take off the bandage too soon, though.

Mr. WOOD. I hope my answer——

Senator BOXER. No, your answer did not help me, because the point about must-offer as being a substitute, must-offer and price caps, does not sit well with me after we know clearly what these guys will do. Maybe they will act right for a few days or months and then they will say: We do not have enough power.

Did you get to see any of the information that Congresswoman Eshoo and I provided to Dick Cheney about how many power plants were taken off line for so-called maintenance? Do you know about the issue?

Mr. WOOD. I recall. I cannot recall it specifically, but yes, ma'am.

Senator BOXER. Well, I want to share that with you. You want to talk about gaming the system. Just unbelievable, Mr. Chairman. Every year they took off X percent for maintenance. Now this year where they ripped us off, it was like three times, four times the amount they took off line for maintenance.

They will game it. If all it is a must-offer, they say: We want to offer, but we do not have any power. So be careful. I am telling you, I hope that you will not be afraid to do the right thing, sir.

You know something, we are all watching. If you are taken off your position because you did the right thing, you will become a hero in our country. Do not be afraid to do the right thing. We need more people who are willing to do the right thing, because everyone is watching. If you are taken off because you keep these price caps on, the whole world will know why. If that is what you conclude in your heart is the right thing—and I only want to show you this chart, because what an opportunity it is to share my charts with you.

Look what happened to us. Look what happened. You said that there were price caps at this point. We have doublechecked it, sir. No price caps.

Mr. WOOD. It was called a break point, you are right. It was a different type of deal.

Senator BOXER. No price caps, sir. They went in here. And look at the wondrous thing that happened when you came on and you did that. You solved our problem.

We do not mind paying a fair price. Californians are the most notoriously generous. We are the second most energy-efficient state in the Union on a per capita basis. Actually, it used to be North Dakota, but a couple of those thieves got us out of the second position and now we are in the first position, and we will stay there. We do not mind doing our part.

We are the fifth largest economy in the world if California were a country. Do you understand what you have in your hands here? Then add on Oregon and Washington; the region, we are huge. You need to make sure this economic engine does not go back to sputtering, please.

We know what works. You do not have to sit around a table and say, gee, what will work in the California market? You know because you did it. It is working. Do not abandon us. That would be a terrible thing.

So this must-offer without the price cap does not work and will not work.

Now, I understand this morning there was a meeting of your Commission, is that correct? My staff sent me a little note——

Mr. WOOD. We met this morning, yes.

Senator BOXER.—and said that Commissioner, I think it was Massey, right?

Mr. WOOD. Yes, ma'am, he made a statement about——

Senator BOXER. Said some very good things, and you said you agreed with a lot of the things he said.

Mr. WOOD. I agree with 100 percent of what he said.

Senator BOXER. 100 percent, OK.

What he does not say is that California should get our money back. He said rebates should be issued to customers where there

was abuse. Well, excuse me. We know where the abuse was. You have seen it, you know. I cannot even imagine what you thought when you saw those documents.

By the way, who made those available to us? Who made those available?

Mr. WOOD. We did, the FERC.

Senator BOXER. Thank you. As my Chairman said, that was a road map to this abuse.

So here is the deal in my mind. You see what happened, how you acted and it helped us. You see what happened when you would not help us. You were not there then.

Could you hold that up again. Look what happened when the former Commission did not help. We got killed, we got killed for months.

By the way, there is an overlay to the chart that shows your friend Ken Lay selling out his shares that whole time, and also Jeffrey Skilling, at the same time they were telling employees buy more, put all your 401(k) into Enron. But that is not your problem. It just should make you mad.

Mr. WOOD. It does.

Senator BOXER. Good, because now that we all know the truth, we need to get the rebates and we need to have the renegotiation of contracts.

My final point and I will stop is this. You said your friend Loretta Lynch—and I am glad you called her a friend. She is a good woman in a difficult spot. As our friend Nancy Pelosi says, certain jobs are not for the faint of heart. Yours is not for the faint of heart. Her's is not for the faint of heart. Everyone was looking to blame everyone.

Bottom line, she has detailed her problems with your agency today going back. Let me tell you, on May 1, 2002, that was just a few days ago, FERC's fourth motion to delay appeals pending issuance of final rehearing order—another example of stopping them from getting their court case heard.

So I would like to keep the record open for you to write me answers as to her charges as to why FERC is blocking her, blocking her. FERC's rolling barrier to judicial review, FERC continues to bar California from challenging its 2000–2001 orders. I am going to share this with you. This is an outrage, and this is on your watch. It continues. This has to stop. These are the people who are trying to find justice.

You did not find justice. You put in a price cap. You still have not given us our $8.9 billion back.

Mr. WOOD. Can I?

Senator BOXER. Yes.

Mr. WOOD. On that issue, we set that for hearing to basically calculate what the price should have been and use that as the cap to shop off the high prices and then give all that money back. We sent that to a hearing. We are critically dependent on the data from the California side, from the ISO and from the now-bankrupt Power Exchange, to fill in who actually got paid what. That data came in I think about two or three weeks ago. That is much later than had originally been anticipated.

But the independent judge running that case is the one who is in charge of getting that data. He is having a hearing on that, I understand, in San Diego this summer, and we expect to have the final basic numbers on that. But it would have been, I think, much worse for the state had we gone forward with the evidence that the generators put in only. But the state needed more time to get its numbers right, and I think that that will make for a better hearing.

Senator BOXER. Well, you may think that. Loretta Lynch is very upset. She calls it FERC's rolling barrier to judicial review. It is her opinion that FERC continues to bar California from challenging its 2000–2001 order. So I am just saying there is a strong disagreement here. I have to say, Loretta Lynch has been one of the strongest advocates for the consumer. So when she tells me FERC is barring California from challenging its orders, I tend to believe her.

I do not question your candor with me, but you need, if you would, to answer this chart.

Second, she also says you have a lack of response to unjust and unreasonable prices. I want to just say this is the ongoing feeling that we have. When you put it all together, it comes up with a very bad answer, which is that FERC has not protected the people of my state and the other western states from unjust and unreasonable prices. You can call it anything you will; you still have not done it. You have the proof. I would hope to see the checks written, and I would hope to see that we are made whole, because, sir, we cannot take it any more, because we have been robbed and we know it. And we know that there is redress, not only from Enron but from these other actors.

Very last question; I am not even going to talk any more. Have you heard anything back from the other actors? You sent the affidavits, thank you. Have you heard anything back about whether they have engaged in any scams?

Mr. WOOD. I think we have given them until the 22nd. A few have done that early, and I think all those that have made it public in the press. I believe one of them said we have done two of the ten sins, and I think there were three others in the past 2 days that said no. I did not look at the file before I came, Senator Boxer, but we are looking at those.

I expect most people will have it in their best interest to make those public documents. If, in fact, they do, we will post those.

Senator BOXER. Well, go after them whether they do it publicly or not.

Mr. WOOD. We will.

Senator DORGAN. Senator Boxer made the point, Chairman Wood, on chart 5 of Ms. Lynch's testimony she said, for example, "The CPUC has sought FERC action to provide limits on Enron's Trans-Western Pipeline affiliate and FERC has never responded." "PUC has filed opposition, yet FERC recently issued a new rule terminating the requirement for both generators and marketers like Enron to file their contracts at FERC."

So there are things that she has raised. Would you please ask your staff to respond to them or you respond to them to us, so that we understand that?

Mr. WOOD. We will.

Senator DORGAN. And is it your intention to cooperate with Ms. Lynch and also cooperate with Senator Dunn's investigation? Is it the intent of FERC to cooperate with the California authorities who are doing these investigations?

Mr. WOOD. Yes, sir. I have traded phone calls with Senator Dunn for the last two days, but I expect that is what he and I will want to talk about. Certainly with regard to the California PUC, the only problem with some of these parties——

Senator DORGAN. Senator Dunn is right there, by the way.

Mr. WOOD. I saw him packing up to go.

Senator DORGAN. This would be a good opportunity.

Mr. WOOD. The only difficulty with some of these comes when the parties also are participating as litigants before the FERC. That is difficult, to have a co-investigatory role there. But that is just to protect everybody else's rights.

Senator DORGAN. Mr. Wood, we want you to succeed.

Mr. WOOD. Thank you.

Senator DORGAN. We want you to be aggressive, we want you to be a tiger as a regulator.

I am going to do something unusual, with your forbearance, for about a minute and a half. Congresswoman Anna Eshoo has been here since 9:30 in the morning. We were not able to accommodate the Members of the House who wished to testify. This hearing has gone on a long, long time. I am going to give her the last word for a minute and a half.

Would you take a seat next to Chairman Wood. Congresswoman Eshoo, I know how important this is to you and others, and you have sat here since 9:30. I want you to at least have the last word in this hearing. Thank you very much.

STATEMENT OF HON. ANNA G. ESHOO,
U.S. REPRESENTATIVE FROM CALIFORNIA

Ms. ESHOO. Well, thank you very, very much, Mr. Chairman and the distinguished Members of the Committee, all my friends.

I have to tell you that in 4 hours and 15 minutes one overriding thought has riveted through me. That is that the American people tuned in to this hearing are hearing people standing up for them, and I want to thank you for that. I do not have to add to what has been said at this hearing.

The sadness I have is that, as a Member of the House of Representatives, a deaf ear has been turned to our legislative attempts right up until last week when the memos came out. I salute Chairman Wood for pushing on that, I salute him. He is doing the right thing, but more has to be done.

To this date, to this very moment, what you are doing here has not been done in the House. I hope that that will change. I think the entire Congress has to act on this so that the American people know that the laws that are on the books are not a sham, that the mission that directs the FERC and what we as legislators when we took our oath of office really is the truth, that we will get to the bottom of this, but not only get to the bottom of it, but we can assure them that the system that is in place now will not reproduce what we have experienced.

I think that is really what the lesson of today is. I cannot thank you enough. I am very proud of the questions that you have asked, that you have made the determinations to get to the bottom of this. I pledge that I will work with Chairman Wood, but I want Chairman Wood to know that he can be really one of the great heros of our time. I could not mean that more. Have the strength to do what is the right thing to do. Do not make mush out of the law. It should not expire. We have to resurrect this and guarantee to the American people that we can do better, that we are going to, and that we are going to put a system in place that will not be manipulated by anyone. It is a disgrace to place next to the name of "America."

So thank you for what you have done today and we will continue to work with you, and I hope that this will be replicated in the House.

Senator DORGAN. Congresswoman Eshoo, thank you very much.

Ms. ESHOO. Thank you.

Senator DORGAN. Chairman Wood, thank you for being here.

That is the last word. This hearing is adjourned.

[Whereupon, at 1:50 p.m., the Subcommittee was adjourned.]

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