S. HRG. 107–1138

EXAMINING ENRON: ELECTRICITY MARKET MANIPULATION AND THE EFFECT ON THE WESTERN STATES

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

APRIL 11, 2002

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ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

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EXAMINING ENRON: ELECTRICITY MARKET MANIPULATION AND THE EFFECT ON THE WESTERN STATES

THURSDAY, APRIL 11, 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 9:36 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. This is a hearing of the Consumer Affairs, Foreign Commerce and Tourism Subcommittee of the Commerce Committee, and we are meeting today to discuss the Enron Corporation once again.

If I might have the door to the hearing room closed, please. We'd ask the audience to please take seats.

We, on previous occasions, have held hearings with respect to the Enron scandal, as it's described in the press and elsewhere, and we had, in this room, testimony by the author of the Powers Commission report. That investigative report was empaneled by the Board of Directors of the Enron Corporation itself.

We know that the Board of Directors found that what was happening inside the Enron Corporation was to quote the report "appalling." The Board of Directors' own report says that this corporation booked $1 billion in income that it didn't receive in a year. Let me say that again. This is a corporation that claimed to have $1 billion in income in a given year that it did not have. That's according to the Board of Directors' own investigative report. They also disclosed that substantial amounts of debt that the corporation had incurred were kept off the books. The Enron Corporation is the subject at the moment of a criminal investigation by the Justice Department.

Given all of that, the question that Senator Boxer and others have asked—my colleague, Senator Wyden, as well—what was involved with Enron's activities on the West Coast, particularly California? Enron was a corporation that had a climate of corruption inside of the company sufficient so their own Board of Directors says they were booking a billion dollars of income they didn't receive and keeping debt off the books and so on. Did it play fair with the consumers on the West Coast?

Well, Senator Boxer and Senator Wyden asked questions of Enron executives in previous hearings on that subject. And, of course, they insisted that things were just fine. There's other evidence and other allegations that exist that this corporation did to consumers on the West Coast what it was doing inside its own company, and that is, they cooked the books. They created partnerships, bought and sold from partnerships they controlled and created, created sham transactions, effectively manipulated the market price for electricity, and took billions of dollars out of the pockets of consumers in California and in the West Coast.

Enron was one of the largest participants in the electricity markets and had an enormous amount of market power. They helped create that market power and, some will say, manipulated that market power in a way that cheated consumers out of billions of dollars.

The testimony we will hear today from a number of witnesses paints quite an appalling picture. I mentioned the word "appalling" was used by the Board of Directors looking inside their own company. They said what they found was, quote, "appalling." The testimony that we will receive today suggests that there was some appalling behavior by this corporation with respect to the manipulation and distortion of markets for electricity in a manner that systematically cheated the consumers and ratepayers in California and on the West Coast.

So, I think this will be an interesting hearing. I appreciate my two colleagues from Oregon and California in pressing for this inquiry. I think that it is a reasonable inquiry, given what the Board of Directors of this corporation has said about the behavior of the corporation itself inside the company. Would they have been cheating inside the company and expected not to cheat with respect to what they were doing with the manipulation of electricity markets? Well, we'll see. I think the testimony today will bear on some of that, and it will be interesting testimony.

This will not be the last hearing. We are scheduling a hearing on this subject with respect to some pension funds. I don't have a date on that. That's been set—I think it's in a week-and-a-half or so from now. And, we will have some other activities, as well.

But let me call on my colleagues, if they have statements. Senator Wyden.

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

Senator WYDEN. Thank you very much, Mr. Chairman. I very much appreciate your holding this hearing and giving us a chance to examine issues that are so important to the consumers of Oregon, California, and Washington. I particularly want to commend our colleague, Senator Boxer, who has just been a persistent advocate for the consumer on so many issues and particularly has led the Subcommittee on these issues.

There's been considerable discussion, Mr. Chairman and colleagues, about the matter of there being a "smoking gun" to prove that Enron manipulated West Coast energy markets. Because of our requests, the request of West Coast senators, the Federal Energy Regulatory Commission is looking into the matter.

But one thing is very clear. In this effort to find a smoking gun, what we do know is that Enron has clearly produced a smokescreen that is designed to obscure its role and its actions in this matter. For years, Enron was able to fly under the regulatory radar screen. It traded power among its various subsidiaries and divisions, in my view, specifically to make it hard to track Enron's role in these energy markets. And, I think what we ought to do as we begin this morning's inquiry is talk for a moment about what we know for sure with respect to Enron's role in the West Coast energy markets.

First, what we know for sure is that Enron clearly had the power to manipulate these markets. It's been estimated that Enron controlled 30 percent of the trades at West Coast trading hubs, which gave Enron sufficient market power to influence prices.

Second, we know for sure that Enron had a motive to use its market power to manipulate West Coast energy prices. The former CEO, Jeff Skilling, was even quoted in *Business Week* magazine as saying that Enron benefits from volatility in the West Coast market.

Third, we know that in the summer of 2000, the West Coast energy markets experienced unprecedented volatility, with prices soaring to ten times what they had been just the year before. Enron capitalized on this volatility by developing and marketing energy contracts that supposedly protected consumers against the risk of skyrocketing prices. Meanwhile, the subsidiaries were trading power among themselves at extraordinary prices, and that clearly helped to drive up the overall market.

Now, previously, under questioning that I and others asked after Enron filed for bankruptcy, we've learned that forward prices in West Coast electricity markets dropped 30 percent that day. Now, absolutely nothing else was occurring in the market at that time to explain that drop of 30 percent. The clear implication was, and the question remains, were prices artificially inflated by Enron's presence in the West Coast market?

The evidence also indicates that Enron knew West Coast energy prices were going to skyrocket even before the West Coast crisis began. The evidence includes Enron's overall hedging strategy and its efforts to sell off a power plant in my home State of Oregon to one of its off-the-book partnerships.

Finally, some have argued that the fact that there were no energy supply problems or price spikes following Enron's collapse means that markets were working. But what does that say about the markets during the West Coast crisis when Enron was a major player and rolling blackouts and record price spikes were everyday occurrences?

The bottom line here, what we know for sure, is that Enron had the market power and the motive to manipulate the West Coast energy markets. Not all the facts are in yet. And one of the reasons it's hard to get the facts is because of this Enron pattern of setting up smokescreens and stonewalling to keep the evidence from coming out, but certainly there's a lot of circumstantial evidence that raises troubling questions about whether market manipulation was taking place.

The last point I would make, Mr. Chairman, and I appreciate your indulgence—given the fact that the derivatives measure, a measure that Senator Boxer and Senator Feinstein and so many of us worked for, does not look like it's going to be in the energy bill—we need to examine this morning's specific measures that are going to protect consumers. I was able to add to the energy bill legislation that would set up a consumer advocate within the U.S. Department of Justice so as to regulate the kind of interstate wheeling and dealing that Enron was engaged in. Right now, the states don't have any authority over those interstate activities. It now is in the Senate energy bill that goes to the Conference Committee.

Hopefully, with your support and Senator Boxer's, and obviously we're anxious to work with our colleague from Montana, we can add to that. But right now, that's one of the few tools that we have in place or have an opportunity to put in place to protect the consumer. I look forward this morning, under your leadership, Mr. Chairman, to examine other ways in which we can advocate for the consumer on these critical issues.

Senator DORGAN. Thank you, Senator Wyden. Senator Burns.

STATEMENT OF HON. CONRAD BURNS, U.S. SENATOR FROM MONTANA

Senator BURNS. I have no opening statement, Mr. Chairman. Thank you for holding this hearing. And we've come to listen to the witnesses this morning and learn. I have drawn no conclusion. I think we ought to caution ourselves not to draw any conclusions until all the facts are known.

So thank you very much for this hearing. That's the purpose of it.

Senator DORGAN. Senator Boxer.

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

Senator BOXER. Mr. Chairman, I want to thank you so very much on behalf of the people of California. This is the only Senate hearing that ever looked at the role of Enron in the California crisis. My colleague, Senator Wyden, his state suffered from what occurred. My state is still suffering the shock of what occurred. And I'm going to take, with your indulgence, probably about five minutes to make my opening statement.

I want to welcome our panel that's coming before us. Mr. Chairman and members, these people are good people. They were on the ground during all of this. They know what was happening, and they're going to help us find the facts that Senator Burns is looking for. I can assure him of that.

Just one year ago, California was suffering from an incredible energy crisis. In April 2001, wholesale electricity was selling for $201 per megawatt. A year earlier, before the crisis, it was selling for $32 per megawatt. That is a 528 percent increase. The result was that everyone in my state was paying more for electricity. Not only did prices go up, but people in industry were facing rolling blackouts. Silicon Valley clearly could not operate without electricity and a short supply of electricity. The agriculture industry faced great financial stress with the thought that they could lose refrigeration. Elderly people could have died in the summer without air conditioning. And, Mr. Chairman, from what I know so far, I believe that Enron played a key role in what happened to the people of California.

Over the last several months, in dribs and drabs and piece by piece, we've begun to get a picture of exactly what Enron did and exactly how Enron used its influence with this Administration—and, by the way, the one before—to continue to manipulate the California market.

I have, on several occasions, laid out many of the pieces of the puzzle, and I'm not going to do that today, except for a couple of new pieces. And today we'll get more pieces of the puzzle. But based on what we do know so far and what today's witnesses will help us see far more clearly, the financially shaky Enron bled California dry, used us as a cash cow to keep that company afloat, to keep the price of the stock up so that the insiders could sell out.

I would say that Enron used its influence with this government to ensure that it could continue to manipulate that market. And the one entity that could have helped California, the only one, FERC, they did not help us until almost a year later.

At this point, I want to make sure the record of this hearing is very complete. From the beginning of the crisis, there were desperate calls for help, and I want this record to be complete. I sent numerous letters to FERC asking for cost-based pricing. Senator Feinstein did the same. Forty-one members of the congressional delegation of California—this was bipartisan, Mr. Chairman—wrote to the President and to FERC asking for relief. The Governor asked for relief. The California State Legislature asked this Administration for relief. Mr. Chairman, I would like to submit for the record letters from myself, Senator Feinstein, the California delegation, the Governor, and the California State Legislature——

Senator DORGAN. Without objection.

Senator BOXER.—put those in the record.

Senator DORGAN. Without objection.

Senator BOXER. Thank you.

[The information referred to follows:]

January 12, 2001

President-Elect GEORGE W. BUSH,
Bush-Cheney Presidential Transition Foundation, Inc.,
McLean, VA.

Dear President-Elect Bush:

You recently commented about the current energy situation in this country. One of the first opportunities you will have to address the problem is through appointments to the Federal Energy Regulatory Commission (FERC). There are two vacancies that need filling, and you will also be charged with designating one of the Commissioners as the Chairman.

Unfortunately, no current FERC Commissioner hails from further west than Arkansas. Therefore, I ask that you appoint a Commissioner from California to remedy this problem. Not only is California's economy larger than all but five nations in the world, California is the site of America's most acute energy problem. It is imperative that whomever you appoint to the Commission and whomever you designate as its Chairman fully comprehend the California crisis and fully understand California's concerns.

The San Diego area was the first region to experience a crisis of unprecedented proportions. In many cases, electricity rates doubled and tripled there last summer. Small business owners and people on small or fixed incomes, especially the elderly, were hit hardest. In recent weeks, supply and demand problems have plunged the state into emergencies that could result in brownouts or rolling blackouts. Utility companies report that they have lost billions of dollars; natural gas prices have quadrupled; and some suppliers may be taking advantage of the situation.

This crisis threatens to have economic ramifications. If the lights go out in California, there will be a brownout across the country. FERC has taken partial, but not adequate, steps. Much work still lies ahead.

Thank you for your consideration, and please let me know your thinking on this.

Sincerely,

BARBARA BOXER,
United States Senator.

February 2, 2001

Hon. CURT HÉBERT, JR.,
Chairman,
Federal Energy Regulatory Commission,
Washington, DC.

Dear Mr. Chairman:

I appreciated the opportunity to meet with you recently in my Washington office.

I was encouraged to hear that you believe energy conservation is an important part of the solution to our energy problems. As I mentioned, I have introduced legislation, which would provide a refundable tax credit to consumers who install conservation measures, grants to schools for energy conservation retrofits and additional information for consumers showing electricity use during peak and off-peak hours to further encourage conservation. I have enclosed a copy of the legislation for your review.

It was disappointing to hear directly from you, and from other Administration officials, that there is currently no Administration support for the concept of a Western Regional Price Cap. Both Senator Feinstein and I have introduced legislation—my bill is the Filner-Boxer bill—in support of such a cap. I have enclosed a copy of my bill.

It is clear to me, given the outrageous profits of generating companies and the suspicious supply shortage that we have been experiencing, that a Western Regional Cap on wholesale electricity prices would provide immediate relief for consumers and assist in stabilizing a dysfunctional market.

California's problem has been receiving the most attention. However, it is reported that utilities are imposing or asking for double digit rate increases in Oregon, Washington, Idaho, Utah and Montana as well. Western Governors, meeting today in Portland, are suggesting "cost-plus" price caps as an immediate solution to protect consumers.

In light of this growing bi-partisan support for a regional price cap, I ask you to reconsider your objection and act as soon as possible to spare consumers, both business and residential, the agony of enormous increases in their bills.

Please do not hesitate to call me if you believe I can be of assistance to you in your important work.

Sincerely,

BARBARA BOXER,
United States Senator.

CONGRESS OF THE UNITED STATES
Washington, DC, February 21, 2001

CURT HÉBERT, Chairman,
WILLIAM L. MASSEY,
Commissioner,
LINDA KEY BREATHITT,
Commissioner,
Federal Energy Regulatory Commission,
Washington, DC.

Dear Mr. Chairman and Commissioners:

We are contacting you regarding the ongoing energy crisis facing the Western United States.

As you know, the State of California is in the process of finding a solution to the short-term problem of skyrocketing energy prices. Currently, Governor Davis and the California Legislature are attempting to allow the State to enter into long-term contracts with generators and marketers which will eliminate the need for the California Independent System Operator (ISO) to buy most of its power on the spot market. Clearly, the current situation of the ISO buying enormous amounts of power from the spot market is contributing to the extremely high energy prices we face today. While we fully support efforts to take the California ISO out of the spot market, we must recognize that success in these efforts, at least in the short-term, is not certain.

The current energy regulatory system in California has created unnatural and obviously dangerous market conditions throughout the West. Under these extraordinary circumstances, we believe a temporary "time-out," in the form of price caps in the energy market, is needed until we can fix the underlying problems of this distorted market.

To avoid any future energy crisis, we are all looking for long-term solutions, such as investments in renewable energy, serious conservation measures, and appropriate construction of new generation. Clearly, however, before any serious consideration can be given to these proposals, we must deal with the short-term problem at hand.

We strongly urge you, as commissioners of the Federal Energy Regulatory Commission (FERC), to use your authority to immediately implement wholesale energy price caps for all Western states employing the following conditions:

- The caps are set at cost-based rates, plus a reasonable level of return for the seller
- The caps are temporary, with a finite time limit, or until energy prices in the West stabilize
- The caps are not applied to new generation, as doing so may remove incentives for new generation

We are requesting this action recognizing that this authority must be used in a very judicious manner and only in extraordinary situations. We believe that the current energy crisis facing our region qualifies for such action as intended by the authority vested in FERC.

Thank you for your attention to this matter, and we look forward to hearing from you soon.

Sincerely,

Jay Inslee, M.C.
Peter DeFazio, M.C.
David Wu, M.C.
Jim McDermott, M.C.
Gary Condit, M.C.
Adam Smith, M.C.
Sam Farr, M.C.
Brian Baird, M.C.
Lois Capps, M.C.
Darlene Hooley, M.C.
Bob Filner, M.C.

UNITED STATES SENATE
Washington, DC, February 28, 2001

Mr. CURTIS HÉBERT,
Chairman,
Federal Energy Regulatory Commission,
Washington, DC.

Dear Chairman Hébert:

Since the Federal Energy Regulatory Commission experimentally suspended a price cap on the cost of transporting natural gas to Southern California, the prices have increased exponentially dramatically escalating the state's electricity crisis. While the suspension of this cap was meant to last for two years, the experiment is clearly a failure and I ask that you end it immediately.

For your reference, I have enclosed a graph and chart that compare natural gas prices in California with its neighbors, Natural gas prices in Southern California reached $60 per decatherm in the middle of December and last week still averaged more than $25 per decatherm, almost five times higher than in the rest of the country. The result has been winter gas prices for 18 million consumers of Southern California that are more than 400% higher than last year.

I recently met with the President of El Paso Merchant Energy who told me that the cost of transporting natural gas from San Juan, New Mexico, to Southern California is only about 67 cents per decatherm. Thus, if natural gas is selling for about $5 in San Juan it should be selling for $5.67 in Southern California, not $25.

By issuing Order 637 in February 2000, FERC suspended for two years the price cap for short term capacity release transactions for service to the Southern California border and to points of interconnection between interstate pipelines and California local distribution companies.

Until last year, the maximum charge to transport gas to Southern California from Texas and Oklahoma, where much of the production capacity exists was about 50 cents per decatherm, which already included a reasonable rate of return. Had FERC not engaged in this questionable experiment, the price of natural gas in Southern California would have more closely paralleled the prices everywhere else.

I am also asking that FERC require natural gas sellers to declare separately the transportation and commodity components of the bundled rate for gray market transactions. These transactions are not covered by Order 637.

This requirement would at least provide the necessary transparency on the difference between the transportation and commodity prices for natural gas at the border. If FERC were to rescind Order 637, provide this transparency for the bundled rate and implement cost of service based rates, California's electricity rates would return to "just and reasonable" for the first time in ten months.

Thank you for your continued attention to this matter.

Sincerely,

DIANNE FEINSTEIN.

CONGRESS OF THE UNITED STATES
Washington, DC, March 6, 2001

Hon. GEORGE W. BUSH,
President of the United States,
The White House,
Washington, DC.

Dear Mr. President:

We are writing to request an opportunity to meet with you and the Administration's energy task force regarding a plan to address the Western States energy crisis.

As this crisis deepens, and its economic impacts become more pronounced, it becomes increasingly apparent that federal action is necessary to prevent this problem from injuring our economy on a longer term basis. We believe a wholesale price cap should be employed to address this situation, and that such a cap can be structured to ensure that it is short term and does not act as a disincentive for the creation of new generating capacity. We also look forward to discussing other aspects of a response plan to our energy crisis, including the use of renewable energy, energy efficiency, and conservation action that must be part of the solution.

This is an issue of great urgency in the Western States and among the constituents we represent, and it is our hope that we can have an opportunity at your earliest convenience to meet with you and the task force to discuss our concerns.

Thank you for your consideration of this request.

Sincerely,

(Signed by 26 Members of Congress)

March 9, 2001

Hon. CURT HÉBERT, JR., Chairman,
Hon. WILLIAM MASSEY, Commissioner,
Hon. LINDA BREATHITT, Commissioner,
Federal Energy Regulatory Commission,
Washington, DC.

Dear Mr. Chairman and Commissioners:

This letter is to request on behalf of our three states, California, Oregon and Washington, that the Federal Energy Regulatory Commission take steps on an interim basis to restrain the unreasonably high wholesale costs of electricity in our region. Specifically, we would suggest something like the plan proposed by Commissioner William Massey of the Federal Energy Regulatory Commission in a February 8 speech. He recommended:

> ". . . a temporary cost-based price cap on spot market sales in the western interconnection. Such a price cap could be calculated on a generator-by-generator basis at each generator's variable operating costs plus a reasonable capacity adder perhaps in the range of $25/mwh. New generation sources should be exempt. In addition, such a cap should have a well-specified sunset provision, tied either to a date certain or the attainment of certain specific conditions, such as some measure or adequate reserves."

Such a price cap would allow generators to recover all of their operating costs plus a return. Of course, bilateral contracts and long-term contracts would be exempt in order to encourage a long-term, market-based solution.

We understand that some of the federal power marketing agencies such as BPA, which are not controlled by the FERC, would voluntarily adhere to such a plan.

While we fully recognize the benefits of a free market, our problem is that we have a shortage of electricity. In spite of our aggressive and urgent efforts, the problem will only get worse throughout the year and particularly this summer. This shortage has enabled, and, is enabling generators to receive "unjust and unreasonable" charges for their wholesale energy. A report prepared by the California ISO's Department of Market Analysis concluded that 21% of real time energy costs during December 2000, and 63% of real time energy costs for January 2001, represent charges that may exceed just and reasonable levels. Indeed, last week the FERC determined that the wholesale prices for some power purchased in California during January, 2001, were not just and reasonable, and has ordered limited refunds.

These excessive charges have virtually bankrupted California's two largest utilities, Pacific Gas & Electric and Southern California Edison, while the generators have earned record profits which exceed 1999 levels by several hundred percent. The ISO report, which is on file with this Commission, indicates these changes are significantly above costs.

The reasons for the shortages are well known. These include lower precipitation in the Northwest, a shortage of natural gas, a damaged natural gas pipeline, inadequate transmission, and the failure throughout the Western states over a period of years to build sufficient generating capacity to meet the expanding demand.

We are taking aggressive actions in each of our states to deal with the problem. For example, in California since April 1999, nine new major power plants (eight of which will produce 500 MW or more) have been licensed. Six are under construction. These plants, together with new peaking and renewable facilities, will total approximately 5,000 MW of new power production on line. By summer 2002, approximately 5,000 additional MW will be on line.

We are also taking aggressive actions on energy efficiency and demand reduction. These actions include a $1 billion energy conservation program in California. In California, we are also creatively resolving environmental issues including emissions requirements. We are attaching news releases which describe these actions in more detail.

We will continue to implement every reasonable action to meet this challenge. But in spite of our best efforts the present shortage may get worse. The California ISO forecasted a shortage of 4,100 MW in its report of November 30, 2000—before the drought of this winter further diminishes supplies.

Under its new law California is seeking long-term contracts for its energy supply and has had some real success in doing so. However, short-term contracts signed by the Department of Water Resources have required prices averaging $228 per MWh. A substantial portion of the power necessary to serve load will still be required to be purchased in the more expensive hour/ahead and spot markets. Of course, the relief we are requesting will be necessary only in the event of a shortage and only for this year.

The economy of our region depends, we believe, upon successfully managing this energy crisis. As Chairman Alan Greenspan stated in testimony before Congress in January, prolonged energy troubles in the world's sixth largest economy could jeopardize the nation's economic health. We urgently request your help.

Sincerely,

GRAY DAVIS,
Governor of California.
GARY LOCKE,
Governor of Washington.
JOHN KITZHABER,
Governor of Oregon.

March 19, 2001

Hon. DICK CHENEY,
Vice President of the United States,
Eisenhower Executive Office Building,
Washington DC.

Dear Mr. Vice President,

We are writing to confirm Steven Ruhlen's refusal, on behalf of Vice President Cheney and the Energy Task Force, to grant a meeting with the twenty-five bipartisan Members of Congress who requested an opportunity to discuss energy price caps in the Western States in writing on March 6, 2001.

We are extremely disappointed in Vice President Cheney's refusal to meet with Members from the Western States about price caps. By refusing to hear our thoughts and concerns about the energy crisis, the Administration is sending an unfortunate signal to Americans about how it intends to govern—based on ideological reaction, rather than factoring in local input or the particulars of a specific situation.

President Bush told the nation today that he looks forward to hearing the recommendations of Vice President Cheney's Energy Task Force. We feel that the Task Force, by refusing to hear the viewpoint of the states that are suffering the effects of the energy crisis, will base their recommendations on incomplete information at best.

As a group representing California, Washington and Oregon, three states that are inextricably tied together in this energy crisis and in its solution, we repeat our disappointment in the Vice President's decision not to meet with us.

We are requesting a confirmation, in writing, that Vice President Cheney and the Energy Task Force refuses to meet with us as a group. We do hope for a reversal of this decision.

Sincerely,

JAY INSLEE,
SAM FARR,
PETER DEFAZIO.

CALIFORNIA LEGISLATURE
STATE CAPITOL
Sacramento, CA, March 26, 2001

Hon. SPENCER ABRAHAM,
Secretary of Energy,
U.S. Department of Energy,
Washington, DC.

Hon. CURTIS L. HÉBERT, JR.,
Chairman,
Federal Energy Regulatory Commission,
Washington DC.

Dear Secretary Abraham and Chairman Hébert:

Although California was the first state to experience energy shortages and skyrocketing prices, California's energy crisis is neither just a "California problem" nor limited solely to "energy" in terms of negative fallout. Despite unique wholesale pricing problems associated with its own dysfunctional market structure, California's greater energy problem is part of a broader supply shortage throughout the westernmost states. Furthermore, the problem is so severe that it now threatens the very economic foundation of the state. And, increasingly, the economic well being of the nation.

This is not just about California. Other states now have deregulated or are in the process of doing so. They soon may suffer similar problems if similar market conditions prevail. The Federal Energy Regulatory Commission (FERC) and the U.S. Department of Energy (DOE) have the power to stabilize the national energy environment by guaranteeing a free, competitive electricity market characterized by reasonable wholesale prices, and by supporting policies and programs that promote energy infrastructure management, energy efficiency, and renewables.

This crisis threatens Californians in many ways. If it persists in driving capital and jobs out of the state, we face a serious economic downturn—with the concomitant loss of revenues that threaten crucial public programs such as education, health, and public safety. The electrical grid's unreliability imposes high shutdown costs and eliminates the certainty needed by industrial consumers to produce goods and keep California workers on the payroll. The high-technology industry that has fueled the national and state growth cannot maintain its productivity without reliable, affordable power. Farmers and ranchers will suffer greatly if irrigation and water-pumping machinery cannot operate. Food cannot be processed if canneries are shut down.

California is not standing idly by. The state recognizes it must do everything possible to solve its problems with all available tools. We are undertaking bold initiatives to enhance reform and expedite power-plant siting, expand the applications of innovative distributed energy technology, and encourage conservation by residential and commercial energy consumers. But responsibility for energy policy and regulation is bifurcated between the state and federal governments.

Request for federal action. The federal government, especially the Commission, must maintain a strong regulatory presence to discourage price manipulation within California's admittedly dysfunctional market. The Commission has acknowledged that some generators have overcharged for electricity, and appropriately required refunds—or justification for prices—on March 9 and 14.

The California State Legislature Requests:

- That FERC aggressively pursue overcharges and order refunds whenever appropriate.
- That FERC use its authority to review wholesale electricity prices in the recent past and future to ensure they are "just and reasonable and not unduly discriminating or preferential."
- That DOE take steps to promote strategic energy infrastructure planning for electricity and natural gas, as well as continued support for renewable energy projects and energy efficiency programs and technologies.

FERC must take efforts to protect the integrity of wholesale prices to avoid catastrophic outcomes in California, and powerful, harmful ripples throughout the nation's economy. Continued strong policy leadership by DOE and appropriate regulatory action by the Commission will provide our state the time and opportunity to reform our market structure before irrevocable damage is done to California's economic and social well being.

Sincerely,

ROBERT M. HERTZBERG,
Speaker of the Assembly.

JOHN L. BURTON,
Senate President Pro Tempore.

Signatories

1. Senator Mike Machado (D)
2. Senator Joe Dunn (D)
3. Senator Nell Soto (D)
4. Senator Wesley Chesbro (D)
5. Senator Martha Escutia (D)
6. Senator Sheila Kuehl (D)
7. Senator Jack Scott (D)
8. Senator Jim Costa (D)
9. Senator Richard Alarcon (D)
10. Senator Byron Sher (D)
11. Senator Jack O'Connell (D)
12. Senator Debra Bowen (D)
13. Senator Kevin Murray (D)
14. Senator Don Perata (D)
15. Senator Ed Vincent (D)
16. Senator Dede Alpert (D)
17. Senator Liz Figueroa (D)
18. Senator Jackie Speier (D)
19. Senator Deborah Ortiz (D)
20. Senator Richard Polanco (D)
21. Senator Betty Karnette (D)
22. Senator Gloria Romero (D)
23. Senator Tom Torlakson (D)
24. Senator Steve Peace (D)

CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
Washington, DC, March 30, 2001

The Hon. GEORGE W. BUSH,
The President,
The White House,
Washington, DC.

Dear Mr. President:

We are writing because our constituents and millions of Americans across the West need your intervention at the Federal Energy Regulatory Commission (FERC) in order to address serious problems with the Western energy market.

As you know, California has been experiencing an electricity crisis that has resulted in blackouts throughout the state, inconvenienced millions of citizens and businesses, and disrupted the state's and region's economy. Indeed, this crisis seriously threatens to cause long-term damage to the economy of California, the Western region, and perhaps the entire country.

The crisis is the result of a dysfunctional energy market where wholesale prices of electricity have spiked exorbitantly. For example, wholesale prices on December 15, 2000, ranged from $429 per Mwh to $565 per Mwh, compared to prices from $12 per Mwh to $29 per Mwh one year earlier. Wholesale prices have jumped as high as $1400 per Mwh. In fact, the California Independent System Operator (ISO), the state's power grid operator, has projected that electricity which cost $7 billion in 1999 will cost $70 billion this year. These skyrocketing prices can only partly be explained by natural gas price increases and increased energy demand.

These exorbitant price spikes have led FERC Commissioner William L. Massey to state on February 8, 2001:

> These high prices serve only to continue a massive wealth transfer out of the region. Is it worth dragging down an entire regional economy, or perhaps even the national economy, for the theoretical purity of unfettered price signals? I say no. I call on my fellow commissioners to consider a time out now. It's our statutory obligation. . . . FERC's timidity and hands-off approach is eroding consumer confidence and destroying the consensus that heretofore supported a market based approach.

The dysfunctional nature of the market has apparently allowed it to be manipulated. The California ISO last week presented FERC with findings of a comprehensive study of pricing data in California's wholesale electricity market over the last

10 months. According to the *Los Angeles Times,* the ISO's study found "evidence of market manipulation and consistent patterns of bidding far above costs" and that "suppliers commonly offered electricity at twice their costs." The ISO has estimated the cost of the potential overcharges between May 2000 and last month are high as $6.3 billion.

Unfortunately, FERC actions have fallen far too short. To date, FERC has not aggressively worked to address market manipulations, despite finding last fall that wholesale prices were not "just and reasonable." Nor is FERC apparently willing to seriously consider addressing runaway wholesale rates.

The state of California is taking heroic measures, but this is an issue California cannot address alone. In a February 28, 2001, meeting with the California delegation, FERC Chairman Curt Hébert confirmed the widespread understanding that the California market is not working. He called the California market "broken," and acknowledged the regional problems posed by the market. Additionally, Chairman Hébert stated that "I don't think there is any way California can pull itself out of this thing alone." As Mr. Hébert knows, California has no authority over wholesale electricity sales. These sales fall solely within the jurisdiction of the federal government.

Despite FERC's recognition that California cannot address this problem alone, FERC seems unwilling to assist California and the West. FERC's March 9 order sets the arbitrary expectation that unjust and unreasonable prices cannot occur in the absence of a Stage 3 Emergency. Energy economist Severin Borenstein has stated that this expectation "defies economic logic." The March 9 order is also inconsistent with FERC's December 15 order and ignores the fact that when market power exists, prices can be unreasonable even when supply is not within 1.5% of demand.

Mr. President, you have the authority to rein in the impacts of this dysfunctional market and protect the citizens of California from exorbitant wholesale price spikes. In October 2000, when you were in California, you stated, "I believe so strongly that part of this region is going to suffer unless you have a president who is willing to tell the FERC to do what is right for the consumer." Now, we are respectfully calling upon you to do just that.

This is not a partisan issue. There is widespread support in both the U.S. House of Representatives and the U.S. Senate for wholesale price caps throughout the region. Governor Davis of California, Governor Kitzhaber of Oregon, and Governor Locke of Washington have now requested that FERC implement a short-term pragmatic proposal that will preserve adequate incentives to attract additional generation.

We believe that electricity generators should make a reasonable profit and that these profits should be sufficient to encourage the development of needed generation. Federal action to temporarily intervene in California's failed wholesale market can accommodate these needs. Governors Davis, Kitzhaber, and Locke have referenced Commissioner Massey's suggestion of a temporary cost-based price cap on spot market sales in the Western interconnection, combined with an exemption for new generation sources to ensure that new sources of energy are encouraged. Such an approach could reinstate consumer confidence in wholesale sales, ensure generators receive sufficient market signals, and prevent future economic hemorrhaging in the West.

Mr. President, we request that you help protect California's economy, and indeed that of the Western region and the nation. Please support the Governors' request on wholesale rates, investigate the recent allegations of overcharges, and act to prevent a dysfunctional electricity market from damaging our constituents and a major engine of the nation's economy.

Sincerely,

Signatories to the March 30, 2001 letter to the President regarding FERC

Henry A. Waxman
Lois Capps
Mike Thompson
Joe Baca
Sam Farr
Robert Matsui
Nancy Pelosi
Norm Dicks
Jim McDermott
Hilda Solis
George Miller
Pete Stark
Bob Filner
Lucille Roybal-Allard
Grace Napolitano
Loretta Sanchez
Peter DeFazio
Dianne Feinstein
Darlene Hooley
Mike Honda
Earl Blumenauer
Anna Eshoo
Jane Harman
Jay Inslee
Barbara Boxer
Brian Baird
Brad Sherman
Susan Davis
Gary Condit
Zoe Lofgren
Ellen Tauscher
Barbara Lee
Tom Lantos
Xavier Becerra
Adam Smith
Rick Larsen
Lynn Woolsey
Juanita Millender-McDonald
Howard Berman
Adam Schiff
Maxine Waters
David Wu

GOVERNOR GRAY DAVIS
April 10, 2001

The Hon. CURT HÉBERT,
Chairman,
Federal Energy Regulatory Commission,
Washington, DC.

Dear Mr. Chairman,

I cannot be with you and the western state representatives this morning. Speaker Bob Hertzberg of the California State Assembly will be present with a legislative delegation. However, I must submit this letter to you to share my perspective on the energy crisis.

As you know, I have appeared before you in person, by video tape and through letters submitted to the FERC over the last 10 months. Each time I have asked you to impose real and effective price restraint in what is obviously a dysfunctional electricity market in California and throughout the West. And during that time, nothing has changed your position against price controls . . . even when wholesale prices in California and other western states have skyrocketed by over 1000% in many cases.

The FERC has recently issued orders to refund overpayments to consumers in California which I applaud. But these refunds, if ultimately made, represent a tiny fraction, just 2% or less, of the overpayments made in a wildly dysfunctional marketplace that, according the California Independent System Operator, may exceed $6 billion.

Last month, Governor Kitzhaber of Oregon, Governor Locke of Washington and I called on the FERC to adopt a temporary cost-based regional price cap that would allow generators and marketers to recover all of their costs plus a reasonable rate of return. We believe that this plan would go a long way in protecting consumers and businesses from the unpredictable nature of the current market and almost certain disruptions this summer.

Under our proposal, the proposed regional price cap would be temporary—no more than two years—and the generators would have the ability to recover all of their operating costs and receive a return. Such regional price relief would stabilize the market, reducing uncertainty in planning for new generation development and would not discourage the development of new generation facilities as some have stated.

I want to reiterate that we are doing all we can to generate more power in California. In the 12 years before I took office, not a single major power plant was built in California. Since the start of my Administration, we have licensed 12 major power plants. Four will be online this summer. Three will be online next summer. Ten more are in the pipeline. And we are doing all this while maintaining our commitment to clean air and clean water.

We significantly streamlined the permitting process and established an interagency Clean Energy Green Team to cut through state, federal, and local red tape. We are also moving to establish a public power authority. If the private sector fails to build all the plants California needs, the state will build them.

Californians are conserving energy. We rank 49th in the nation in per capita electricity consumption. California is the most energy efficient state in the West, but we are doing even more to save energy. In February, consumers exceeded my challenge to save 7% by reducing electricity use by 8%. I am now asking everyone to conserve at least 10%. We are launching an aggressive $800 million conservation program. We are retrofitting our government buildings for energy efficiency and incorporating sustainable building designs into new state building projects. We have adopted the strongest energy efficiency standards in the world for residential and non-residential buildings and appliances. We have established an innovative rebate plan, otherwise known as the "20/20" program, that rewards those who conserve 20% by a 20% rebate in their energy bills. And we have adopted ambitious demand reduction programs for the commercial sector.

Even with all these efforts, it has become increasingly clear that the Federal Energy Regulatory Commission's failure to control costs has precipitated an increase in rates to keep our lights on and our economy strong. In this regard, last week I urged the California Public Utilities Commission (CPUC) to adopt a proposed rate increase that will protect average consumers, reward those who conserve and motivate the biggest users to cut back. These rate increases will give Californians some of the highest electricity rates in the nation.

We are reducing our reliance on the spot market through long-term contracting. The state has more than 40 long-term contracts and agreements with major power companies that will deliver a total of 629,000,000 megawatt hours over the next 10 years at prices 5–10 times lower than what we are paying today in the day-ahead and real-time markets.

Although we cannot fix 12 years of inaction overnight, we are making real progress in California. It is critical that you fulfill your legal obligation to the people of California and the entire West to assure just and reasonable prices, and impose cost-based wholesale price controls at the earliest possible time.

Sincerely,

GRAY DAVIS.

CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
Washington, DC, May 4, 2001

The Hon. SPENCER ABRAHAM,
Secretary,
Department of Energy,
Washington, DC.

Dear Secretary Abraham:

We are writing to request your prompt action to direct the Federal Energy Regulatory Commission (FERC) to address the serious problems besetting electricity markets in California and other Western states. As we all know, consumer prices are skyrocketing, electricity marketers have reaped record profits, and Californians have endured repeated service interruptions. The outlook for this summer is hardly cheering, with forecasts of continuing price volatility and more blackouts.

Mr. Secretary, consumers in California and other Western states need new electricity supplies. But until new supplies can be brought on line, western consumers need protection from blackouts and spiraling prices for this essential service. To make matters worse, the Chairman of FERC has declined to use his authority to protect western consumers. Last fall, the Commission found that electricity prices in California are not "just and reasonable." Yet FERC has refused to impose cost of service prices that would fairly compensate suppliers without permitting them to exploit consumers, despite the fact that the Federal Power Act demands nothing less. In a recent series of orders, FERC has taken only marginal actions which purport to solve the crisis but in reality do little more than nibble at the edges.

Mr. Secretary, we recognize that FERC is an independent commission and you are not authorized to take direct action on pricing matters. However, there is one step you can take that would force the Commission to do its duty to ensure just and reasonable prices. Under section 403 of the Department of Energy Organization Act, the Secretary of Energy is authorized to initiate rulemakings at FERC, and to set time limits for final action by the Commission. We respectfully request that you initiate a rulemaking at FERC to reimpose cost of service prices for all wholesale sales in California and the other twelve states in the Western Systems Coordinating Council (WSCC), including full refunds back to October 2, 2000, and to take final action by a date certain. There is nothing novel about section 403 authority, which has been available to the Department since its creation and used as recently as November 15, 2000.

You can implement our request with no change to current law and without changing the principles of the Federal Power Act. Should market conditions change in the future, a later Commission could determine that cost of service rates are no longer necessary to ensure just and reasonable prices. Our proposal also avoids the dangers inherent in Congress attempting to devise new standards through new law which would have to be tested in the courts.

Mr. Secretary, it is regrettable that FERC did not take aggressive action earlier, in time to avert problems in western electricity markets this summer that now appear inevitable. However, since FERC refuses to fulfill its statutory duty to ensure just and reasonable prices, we urge you to use your power to direct it do so. Without this action, further chaos will ensue and California and other western consumers will continue to pay the price.

Sincerely,

RICHARD GEPHARDT,
Minority Leader.

JOHN D. DINGELL,
Ranking Member, Committee on Energy and Commerce.

ROSA DELAURO,
Co-Chair, Energy Task Force.

MARTIN FROST,
Chairman, Democratic Caucus.

RICK BOUCHER,
Ranking Member, Subcommittee on Energy and Air Quality.

ED MARKEY,
Co-Chair, Energy Task Force.

and 38 other Members of Congress.

July 10, 2001

Hon. CURT HÉBERT, JR.,
Chairman,
Federal Energy Regulatory Commission,
Washington, DC.

Dear Mr. Chairman:

I am writing to urge you to order $8.9 billion in refunds owed by the power generators to California consumers.

I am very concerned about yesterday's statement by FERC Chief Administrative Law Judge Curtis Wagner that California is owed no more than $1 billion. Although this is not his official recommendation to you under the June 18 FERC Order, I am concerned from his statement that his recommendation will not adequately address price gouging by the generators.

The evidence is clear that the generators gouged California. Generators' profits increased on average by 508 percent between 1999 and 2000. One company, Reliant Energy, experienced a 1,685 percent increase in profits in the same time period. This compares to a 16 percent increase in profits across the electric and gas industry and an increase in demand of only four percent. FERC failed to act to correct this part of the electricity crisis. Now you have the opportunity to rectify this oversight.

I appreciate your consideration. I urge you to act strongly for the California consumer and order $8.9 billion in refunds.

Sincerely,

BARBARA BOXER,
United States Senator.

Senator BOXER. We were all ignored. I, as well as other Members of Congress, also introduced legislation for cost-based pricing and refunds to help California. In the House, the legislation had Democratic and Republican support, with cosponsors including Representatives Capps, Matsui, Cunningham, and Issa.

Mr. Chairman, I would like to submit for the record these various bills. May I do that?

Senator DORGAN. Without objection, they'll be put in the record.

[The bills referred to are in the Appendix.]

Senator BOXER. The FERC and the Administration opposed that legislation, as well. Why were all the efforts of all these elected officials, both Republican and Democrat, ignored? I believe because Enron did everything in its power to influence the Executive Branch to do nothing. And that is what they did.

And let me state, Mr. Chairman, sometimes doing nothing is an affirmative action. It is what Enron wanted. It is what they got for almost a year. And we know this, because when Jeffrey Skilling made his statement to *The San Diego Union-Tribune,* once FERC did act, he stated in so many words, very clearly, that Enron really went under when the California crisis was, quote/unquote, "solved."

Enron lobbied FERC. We know there were at least 25 meetings during that California crisis between Enron officials and FERC decisionmakers. Mr. Chairman, I'd like to submit for the record a letter from FERC listing its meetings with Enron executives.

Senator DORGAN. Without objection.

[The information referred to follows:]

FEDERAL ENERGY REGULATORY COMMISSION
Washington, DC, February 21, 2002

The Hon. BARBARA BOXER,
United States Senate,
Washington, DC.

RE: MEETINGS AND PHONE CALLS WITH ENRON EXECUTIVES

Dear Senator Boxer:

This letter responds to your January 31, 2002 request for information on the number of meetings and telephone calls between Enron executives and FERC Commissioners and senior staff between August 2000 and June 2001.

Let me assure you that I do not think the Enron Corporation, or any of its subsidiaries, has had any undue influence on the decisionmaking process at the Commission. Although the period about which you have inquired effectively predates my tenure at the Commission (having arrived on June 5, 2001), I sincerely believe that the agency's decisions have not been compromised or otherwise improperly shaped by any communication with Enron executives. I also assure you that I have not and will not countenance any effort by any company to influence Commission action, outside appropriate agency regulatory procedures. Indeed, as FERC Chairman, I have stressed strict compliance with the Federal government's ethics rules, including the prohibition in the Administrative Procedure Act, 5 U.S.C. § 557, and the Commission's own regulations, 18 C.F.R. § 385.2201, against communication between persons outside the agency and FERC decisional employees such as commissioners and senior staff on the merits of any issue in a contested FERC proceeding. To underscore my commitment to ethical behavior, I ordered every Commission employee to receive ethics training in the Fall of 2001, shortly after I became Chairman. I am pleased to report the Commission's Designated Agency Ethics Official ultimately trained 1,158 employees (out of a total 1,123 full-time permanent employees and 56 part-time or temporary employees as of November 1, 2001).

After we received your January 31, 2002 letter, we e-mailed, hand-delivered, or FedEx'd a copy of the letter and a list of all Enron companies to the Commissioners and senior staff (office directors) who were at the Commission during the August 2000 to June 2001 period. A compilation of their responses, organized alphabetically, with their titles during this period, is enclosed. (Individuals who are no longer at FERC are italicized.) In brief, for the relevant time, there were nineteen (19) people who served as FERC Commissioners and senior staff and over the eleven months in question, seven (7) report that they had no contact with Enron executives and twelve (12) recall having approximately twenty-five (25) meetings or telephone calls with Enron executives, addressing a variety of issues. (We counted participation in the same meeting or telephone call by more than one person as one event)

As you can imagine, it is difficult to recall every chance meeting or brief telephone call one may have had over a year ago. I believe, however, that all of the respondents made a good faith effort to give us the information so that we could respond meaningfully to your request.

If I can be of any further assistance in this or any Commission matters, please feel free to contact me.

Best regards,

PAT WOOD, III,
Chairman.

Enclosure

RESPONSES TO SENATOR BOXER'S REQUEST
FOR NUMBER OF MEETINGS AND TELEPHONE CALLS
BETWEEN ENRON EXECUTIVES AND COMMISSIONERS
AND FERC SENIOR STAFF BETWEEN AUGUST 2000 AND JUNE 2001

February 21, 2001

Note: Commissioners or Senior Staff no longer at FERC are indicated by italics.

Name of FERC Commissioner or Senior Staff	Description of Meeting or Telephone Calls
Adamson, Daniel *Former Director of Energy Projects*	(1) Possibly met with Enron executives on natural gas pipeline matters.
	(2) Met with some unrecallable Enron executives about a proposed pumped storage hydroelectric facility and the development of energy infrastructure on Indian lands.

Name of FERC Commissioner or Senior Staff	Description of Meeting or Telephone Calls
Breathitt, Linda K. *Commissioner*	(1) On September 7, 2000, in a courtesy visit, along with staff assistant, met with Rick Shapiro, Managing Director, Government Affairs—Enron (Houston) as well as Charles Bone, Nashville Attorney. General discussion of electric deregulation. (2) On January 18, 2001, in a courtesy visit, along with staff assistant, met with representatives of Enron, EPSA (Electric Power Supply Assoc.), ELCON (Electric Consumers Resource Council), Reliant, and Dynegy. Discussion of need for demand response programs. (3) On January 21, 2001, made a brief (15–20 minutes) stop at an Enron-hosted Inaugural Brunch at Red Sage Restaurant. Prior approval received by DAEO (designated agency ethics officer). (4) In late January 2001, had a dinner meeting with Rick Shapiro, Managing Director, Government Affairs—Enron (Houston) along with Charles Bone and Johnny Hayes, both from Nashville. Discussed RTO's and transmission access issues. Paid for own meal. (5) In late March 2001, had a dinner meeting with Rick Shapiro, Managing Director, Government Affairs—Enron (Houston) along with Charles Bone and Johnny Hayes, both from Nashville. Discussed need for large RTO's, FERC transmission jurisdiction and tariff reform. Paid for own meal.
Brownell, Nora Mead *Commissioner*	No meetings or telephone calls to report.
Chamblee, Donald A. *Former Acting Director of External Affairs*	No meetings or telephone calls to report.
Ferguson, Walter L. *Chief of Staff for Former Chairman Hébert*	No meetings or telephone calls to report.
Hébert, Curtis L. *Former Chairman*	On February 9, 2001, spoke on the telephone with Ken Lay regarding remaining FERC Chairman. This was the subject of the August 16, 2001 GAO Report, which found nothing illegal about the call.
Hirning, Kathleen M. *Former Director of the Office of External Affairs*	No meetings or telephone calls to report.

Name of FERC Commissioner or Senior Staff	Description of Meeting or Telephone Calls
Hoecker, James J. *Former Chairman*	(1) On January 19 and 13, 2001, attended meetings convened by White House staff to arrive at a negotiated resolution of California's electricity problems before Inauguration Day. General Counsel Doug Smith and electric policy advisor Pat Alexander attended with me. The meetings were presided over by Secretary of the Treasury Lawrence Summers and Secretary of Energy Bill Richardson participated in the first meeting. In all, 30 to 40 persons attended each of these meetings, although about half of the attendees participated in the January 13 meeting by video conference from Sacramento, California. Ken Lay attended the first meeting and probably attended the second, although from California. He may have been accompanied by other Enron executives. Among the other participants were Governor Gray Davis, members of his staff, President Loretta Lynch of the California Public Utilities Commission, leaders of the California legislature, senior executives of California's three major utilities and other energy suppliers in the California market, and members of the Council of Economic Advisors. (2) On September 18, 2000, had a courtesy visit Joe Hartsoe of Enron. There is no record of others in attendance. (3) On October 19, 2000, had a courtesy visit from the Gas Industry Standards Board, which may have included Stan Horton, Enron executive and head of GISB at the time.
Herlihy, Thomas J. *Executive Director and Chief Financial Officer*	(1) On December 7, 2000, was present at a lunch with Jeff Skilling, seven other FERC employees, and several other Enron employees participating in showing Enron's trading room. (2) During December 6–8, 2000, participated in a visit to Enron, Dynegy, and El Paso in Houston to talk with Information Technology staff and traders to ascertain what type of data sources and hardware set-up they use.

Name of FERC Commissioner or Senior Staff	Description of Meeting or Telephone Calls
Larcamp, Daniel L. *Director of Markets, Tariffs, and Rates*	(1) On July 18, 2000, met with Stan Horton and others in the Enron Pipeline Group, and toured the Enron trading floor and gas control center.
	(2) On December 7, 2000, was present at a lunch with Jeff Skilling, seven other FERC employees, and several other Enron employees participating in showing Enron's trading room. Recall meeting Shelly Corman and Joe Hartsoe. From business cards collected, may have met Kevin Presto, Vice President—Enron North America, John Lavorato (COO, Enron Americas), Lloyd Will (Director, Control Area Operations—Enron North America Corp.), and Dave Delainey, President and CEO, Enron Americas.
	(3) On June 28, 2001, met with Richard Shapiro, Managing Director, Government Affairs—Enron Corp., and three other Enron Representatives. From business cards collected, others may have been Linda Robertson, VP, Federal Government Affairs—Enron, Ray Alvarez, VP, Federal Regulatory Affairs, Enron Corp., and Alan Larsen, Senior Counsel—Enron North America Corp.
	(4) On March 21, 2000, and on several other occasions the dates for which are not known, met with Joe Hartsoe from Enron's D.C. office to discuss current gas industry issues. Mr. Hartsoe also attended several briefings given to industry participants to explain major FERC orders on the California energy crisis, after regularly scheduled Commission meetings.
	(5) Attended during this period Outreach Program sessions hosted by FERC OMTR to hear various industry group concerns on specific energy issues. Enron executives among other industry representatives were listed as present at those sessions.
Madden, Kevin P. *Former General Counsel*	(1) In Winter-Spring 2001, met with Stan Horton as INGAA Chairman to discuss pipeline safety, rate design, and the affiliate conference. Jerry Halvorsen was also there.
	(2) In Winter-Spring 2001, had dinner with Stan Horton as INGAA Chairman to discuss pipeline safety and affiliate conference. Steve Kean may have been there. Other INGAA representatives and pipeline representatives were there.
	(3) On February 9, 2001, was present for part of a telephone call between former Chairman Curtis Hébert and Ken Lay regarding Mr. Hébert remaining FERC Chairman. This was the subject of the August 16, 2001 GAO Report, which found nothing illegal about the call.

Name of FERC Commissioner or Senior Staff	Description of Meeting or Telephone Calls
Massey, William L. *Commissioner*	(1) On October 19, 2000, met with Stan Horton, Chairman and CEO, as Gas Industry Standards Board (GISB) Chairman 2000, for a courtesy visit and briefing regarding the GISB Board. Steve Bergstrom, Jim Templeton, and Bill Boxwell were also in attendance. (2) On December 18, 2000, met with Stan Horton, Shelly Corman, Steve Kean, Executive Vice-President and Chief of Staff, regarding pipeline safety matters. Jerry Halvorsen was also in attendance. (3) On January 18, 2001, met with Joe Hartsoe, Vice-President Regulatory Affairs, and/or Sara Novosel, regarding a motion to ask the Commission to hold a technical conference on the implementation of Function 8 of Order No. 2000. Also in attendance from the outside: Mary Doyle, Julie Simon, John Anderson, John Hughes, Sara Schotland, Mike Briggs, and Lorraine Cross. In addition, Wilbur (Bud) Earley was there. (4) On May 9, 2001, met with Stan Horton and Joe Hartsoe for lunch. Jerry Halvorsen was also there. (5) On May 25, 2001, met with officials of The New Power Company, Eugene Lockhart, President and CEO, Cynthia Sandherr, Vice-President, and Kathleen Magruder, Vice-President, Law and Government Affairs, to discuss generally impediments to new competitors' entrance into existing competitive energy markets. (6) On June 21, 2001, met with Steve Kean, to discuss generally energy issues. (7) Perhaps during the relevant period, one or more telephone conversations with Steve Kean and Terry Thorne (and perhaps Jeff Skilling) about generic energy policy issues.
Robinson, J. Mark *Director of Energy Projects*	No meetings or telephone calls to report.
Smith, Douglas *Former General Counsel*	On January 9 and 13, 2001, attended two large meetings convened by senior Administration officials to try to arrive at a negotiated resolution of California's electricity supply problems. Chairman Hoecker and Pat Alexander were also in attendance. The meetings were chaired by Secretary of the Treasury Lawrence Summers and National Economic Council Chairman Gene Sperling. Participants included Secretary of Energy Bill Richardson, Governor Gray Davis and energy officials from his administration, President Loretta Lynch of the California Public Utilities Commission, leaders from the California legislature, and senior executives from the California electric utilities and a number of energy suppliers in the California market. One or more Enron executives attended each meeting. Ken Lay attended the first meeting, and may have attended the second meeting. In all, 40 or more persons attended the meetings.
Strasser, Virginia *Former Director of the Office of Administrative Litigation*	No meetings or telephone calls to report.

Name of FERC Commissioner or Senior Staff	Description of Meeting or Telephone Calls
Wagner, Jr., Curtis L. *Chief Administrative Law Judge*	November 2000 to July 2001, as settlement judge, held regular meetings with Enron officials and counsel during negotiations in the California Forward Contract proceedings, the Midwest/Alliance ISO settlement discussions, and California Refund case negotiations. No recollection of the names of the people who participated.
Whitmore, Charles S. *Former Director of Strategy and Performance Staff*	(1) On December 7, 2000, was present at a lunch with Jeff Skilling, seven other FERC employees, and several other Enron employees participating in showing Enron's trading room. (2) During December 6–8, 2000, participated in a visit to Enron, Dynegy, and El Paso in Houston to talk with Information Technology staff and traders to ascertain what type of data sources and hardware set-up they use. (3) In May 2001, met with James Steffes, Vice President for Government Affairs. (4) Attended during this period Outreach Program sessions where Enron executives were probably present.
Wood, III, Patrick H. *Chairman*	No meetings or telephone calls to report.
Young, Fernanda F. *Chief Information Officer*	(1) On December 7, 2000, was present at a lunch with Jeff Skilling, seven other FERC employees, and several other Enron employees participating in showing Enron's trading room. (2) During December 6–8, 2000, participated in a visit to Enron, Dynegy, and El Paso in Houston to talk with Information Technology staff and traders to ascertain what type of data sources and hardware set-up they use.

Senator BOXER. And FERC did not help California. Enron lobbied the White House in 2001 of April, Kenneth Lay had a 30-minute meeting with Vice President Cheney about the California electricity crisis and energy policy. And I'm just showing quickly here a chart. We see that, without reading this, Mr. Lay gave him the words that he should use, in terms of not taking action on a cap. And there you go. The very next day, he tells the *Los Angeles Times* that he doesn't see the cap as a possibility.

So I'm going to submit for the record the eight-point memo Mr. Lay gave to the Vice President, if I might.

Senator DORGAN. Without objection.

[The information referred to follows:]

National Energy Policy: Priorities

The 1992 Energy Policy Act (EPA) intended to introduce competition into the wholesale market for electric power by providing transmissions access. Events in California and in other parts of the country demonstrated that the benefits of competition have yet to be realized and have not yet reached consumers. To realize the vision set forth in the EPA, the following actions need to be taken:

1. Fair Transmission Access

In Order No. 888, the FERC attempted to formulate fair terms and conditions of access to the transmission grid for all users. However, the FERC failed to extend its jurisdiction to transmission services bundled together with retail sales. Consequently, distinct rules apply to different parties for use of the *same* transmission asset and such rules provide vertically integrated utilities the opportunity to use their transmission assets to disadvantage independent third party generators and wholesalers.

To achieve robust competition in wholesale power markets, the FERC must actively exercise jurisdiction over all aspects of electricity transmission in interstate commerce and place all uses of the grid under the same rates, terms, and conditions. Moreover, FERC jurisdiction must extend to the terms of access applicable to transmission systems owned and operated by non-FERC jurisdictional entities including Federal Power Marketing Associations (PMAs), states and municipalities.

To improve reliability, the FERC has encouraged utilities to combine transmission facilities into large Regional Transmission Organizations (RTOs) and to assign the responsibility for operating RTOs to an independent management team. Properly structured RTOs can ease the movement of power between states and between users within a state, and will enhance reliability, commercial activities, and competition in the energy industry.

However, the FERC has refused to make RTO participation mandatory. This, coupled with the lack of non-discriminatory open access terms, has weakened the RTO initiative. Therefore, the Administration must encourage the FERC to approve only those RTOs with sufficient size and scope and with non-discriminatory terms and conditions for access and to require that all transmission owners participate in an RTO. Finally, the Administration should revise those tax provisions that prevent the transfer of assets to new, stand alone independent, for-profit transmission companies (Transcos).

2. Independent Energy Reliability Organizations

Governance of the North American Electric Reliability Council (NERC) is cumbersome and places new market entrants at a competitive disadvantage. There is a necessary role for FERC oversight of a new Independent Reliability Organization (IRO).

Legislation to establish a new IRO is required. However, the "consensus" reliability language in the proposed Murkowski bill is ineffective since it establishes an unsatisfactory procedure to resolve conflicts between the IRO and the various RTOs established by the FERC.

Legislation that permits the FERC to delegate authority to develop reliability standards and enforce those standards, establishes an appropriate funding mechanism, includes a limited States' savings clause and provides the IRO participants with anti-trust immunity will accomplish the shared goal of establishing an effective IRO.

3. Wholesale Market Price Caps or Cost-Based Wholesale Rates

The Administration should reject any attempt to re-regulate wholesale power markets by adopting price caps or returning to archaic methods of determining the cost-base of wholesale power. Price caps, even if imposed on a temporary basis, will be detrimental to power markets and will discourage private investment by significantly raising political risk. Similarly, a return to cost-based wholesale rates will be extremely difficult to implement and will effectively negate significant investments made by new market entrants made in reliance on the presence of deregulated wholesale power markets.

4. Interconnection Policy

Competitive generation (including Distributed Generation "DG") and wholesale power markets have been hindered by grid interconnection policies and procedures that restrict new entry. The lack of a uniform and effective interconnection policy creates uncertainty, delay and unnecessary costs in development of new generation capacity and DG technologies. To correct this problem, FERC must develop and enforce standardized, non-discriminatory interconnection procedures.

5. Federal Transmission and Generation Siting Policy

An efficient and reliable interstate wholesale market requires construction of new transmission and generation facilities. Siting and permitting problems have frustrated construction of new facilities. Consistent with rules for certification of natural gas facilities, granting condemnation rights to private parties that have obtained federal authorization to construct facilities can significantly reduce these problems. In addition, Federal Agencies and Tribunal Governments should streamline the regulatory processes to enable expedited construction and efficient operation of energy infrastructure.

6. Demand Reduction Incentives

The Administration should mandate the creation of a regional demand exchange (implemented by mandatory RTOs) that would allow large consumers to post bids for the reduction of demand. If implemented expeditiously, such a mechanism can have an immediate impact in reducing demand this summer.

7. California Power Crisis

The political leadership in California has made limited progress in solving its power crisis. All of the above items would mitigate this crisis.

8. Natural Gas Supply Outlook

There are concerns that natural gas supplies may not be adequate to meet market demand. Yet all studies indicate that remaining economically recoverable resources in North America are ample for decades to come. These supplies can be further supplemented by imported liquified natural gas. This will allow natural gas to continue to provide an increasing share of the total energy needs to the U.S.

Senator BOXER. Enron lobbied the Energy Department. On March 29, Secretary Abraham held a meeting on the California crisis with 16 industry officials, including two from Enron.

And there's more. Between February 14 and April 26, as the electricity crisis continued in California and Enron insiders sold stock, Energy Secretary Abraham also met with 36 energy and business groups about energy policy, met with an additional 20 heads of oil companies and energy groups. And I ask that an article about these meetings be included in this record.

Senator DORGAN. Without objection.

[The information referred to follows:]

ENERGY CONTACTS DISCLOSED; CONSUMER GROUPS LEFT OUT, DATA SHOW

The Washington Post, March 26, 2002

Dana Milbank and Mike Allen, *Washington Post* Staff Writers

Energy Secretary Spencer Abraham met with 36 representatives of business interests and many campaign contributors while developing President Bush's energy policy, and he held no meetings with conservation or consumer groups, documents released last night show.

The information was released by the Energy Department just a few hours before a court-ordered deadline, and after 11 months of resistance by the administration to lawsuits by public interest groups seeking to determine who influenced the writing of the administration's energy plan.

A first review of the 11,000 pages of documents bolsters the contention of Democratic lawmakers and environmental groups that the Bush administration relied almost exclusively on the advice of executives from utilities and producers of oil, gas, coal and nuclear energy while a White House task force drafted recommendations that would vastly increase energy production.

Of the corporations that met with Abraham, all but a few were large contributors of unregulated soft money to the Republican Party during the 2000 election cycle. A dozen of the companies that had meetings with Abraham contributed $1.2 million to the GOP, mainly for Bush's election. Ten of the 12 gave more soft money to Republicans than Democrats. Large portions had been deleted from the documents released last night by the Energy Department, the Environmental Protection Agency, the Agriculture Department and the White House Office of Management and Budget. Most attachments were missing and in many cases documents were withheld except for the subject line. Thousands of other documents were withheld entirely, and the groups that won release of the documents through lawsuits said they may return to court.

Abraham's meetings, between Feb. 14 and April 26 of last year, included groups such as the National Association of Manufacturers, the Independent Petroleum Association of America and the Nuclear Energy Institute. Top executives of Westinghouse Electric Corp., Duke Power, Entergy, Exelon Corp., UtiliCorp United (now Aquila Inc.), American Coal Co. and others sat down with Abraham.

Environmental groups said their efforts to meet with the energy task force were rebuffed. The Energy Department has said that environmental groups did not respond to its request for input, and the administration has said it held at least one substantive discussion with 10 environmental groups in late March, prior to the May release of the energy policy.

Because of the deletions and omissions, there is little information about what the donors and business interests were seeking in their high-level meetings. The documents released include hundreds of unsolicited suggestions from citizens, companies and lawmakers, most of whom received form responses promising the ideas would receive "close and careful attention."

Among the items released is a letter from the Alliance of Automobile Manufacturers favoring tax credits for hybrid-fuel and fuel-cell vehicles and similar incentives for fuel efficiency that were included in the Bush energy report.

One company, Citgo, urged the administration "to exercise federal authority to prevent states" from establishing separate fuel standards. These "boutique fuels" cause distribution problems for the industry, and Bush's energy plan directed the EPA to work with states to eliminate them.

An Energy Department e-mail indicating close coordination with industry notes that Texaco was seeking to help Bush's energy policy rollout. Texaco "has offered to try to produce an announcement on a 1500 megawatt facility at a TVA site in harmony with such a rollout," the May 7 e-mail said.

"Finally there is some evidence of who was actually shaping the energy policy," said Sharon Buccino, senior attorney for the Natural Resources Defense Council, which won the court order on Feb. 27 requiring the Energy Department's information release.

Buccino said the group plans to challenge many of the omissions in court. The Energy Department released a chart suggesting Vice President Cheney's task force had adopted nine NRDC recommendations, which Buccino called "an outright lie." Another 15,000 pages were withheld for privacy, security and other reasons, Energy officials said.

Larry Klayman, chairman of Judicial Watch, the watchdog group that won the court order requiring the OMB, EPA and Agriculture releases, said the White House appeared to be "playing games" with the release. He said he expects to "go back to court to seek testimony as to why we don't have the substantive e-mails."

Trent Duffy, OMB's spokesman, would not explain the deletions beyond saying, "The items that were part of the deliberative process were redacted."

Abraham issued a statement calling the energy plan "a balanced and comprehensive energy plan for America," and said that the administration "not only sought but included all viewpoints."

Several of the documents indicate that officials were aware of efforts to obtain information about their actions under the Freedom of Information Act, and they adjusted their correspondence to limit the release of materials. "We have an FOI request for all NEPP material," said one April 25 e-mail, referring to the task force. "Keep in mind that whatever I get I will have to include with it." Another e-mail about the FOIA requests asked, "Did you want me to include Kyle?"—an apparent reference to Abraham's chief of staff, Kyle McSlarrow, whose e-mails were not included in the release.

Abraham held meetings with more than 20 other heads of oil companies and energy trade groups while the report was being written, but the Energy Department said those meetings included other topics.

Abraham's staff had several meetings with Enron officials, the documents showed. Enron, a major Bush donor that collapsed late last year and is facing a criminal probe, met with other representatives of the task force six times, the administration has disclosed. Energy Department officials said most of their meetings with Enron were not related to the energy policy. Abraham met with two Enron executives on March 29 as part of a meeting of 16 industry officials about the California electricity shortage. Energy officials said Abraham declined requests for meetings with Jeffrey Skilling and Kenneth L. Lay of Enron Corp.

The OMB materials that were released also indicate the energy task force's emphasis on production over conservation. One e-mail from Feb. 22 listed seven chapters for the energy policy report: short-term supply disruptions, consumers, economic impact, alternatives, increased production, infrastructure and energy security. There was no mention of conservation. An e-mail from March 22 made reference to an "energy efficiency" chapter, and a March 27 e-mail indicates that an "environment chapter" had been included. By April 2, there were "energy conservation targets."

The Energy Department documents indicate a late surge of activity to include more renewable fuels in the energy report. Karen Knutson, the deputy director of the task force, wrote to the Energy Department on April 27 seeking information about solar energy.

The OMB documents indicate Bush was involved in the shaping of the report well before it was released May 16. The task force briefed him on March 19, a schedule indicates, and a final report was circulated on April 23.

The e-mails also indicate that the task force was involved in Bush's March 13 decision to reverse a campaign pledge to characterize carbon dioxide as a pollutant that should be restricted, a position shared by environmental groups. A March 7 e-mail among task force staffers refers to "CO_2 as a Pollutant." Ultimately, the report did not take a position on whether to raise fuel economy standards for vehicles, but the e-mails indicate there was extensive work on making recommendations about the corporate average fuel economy (CAFE) standards.

The EPA and Agriculture documents were also stripped of content except for meeting and publication schedules and interoffice chatter and bureaucratic fencing. "Lots of typos and the like," said an EPA official, "but I assume they'll catch those."

A long redacted section in one memo closed with a comment, "just kidding—Mona."

Included among stacks of documents from the EPA and Agriculture Department were a few position papers from industry groups, including the Fertilizer Institute and the Clean Energy Group—a coalition of electric power companies urging a "reasonable time frame" for pollution control strategies. Their pitches to the administration appeared to be familiar agendas the groups have lobbied for and testified about many times.

The subject lines on thousands of pages of government e-mail traffic described the wide horizon of energy and resource issues, from "boutique" gasolines blended for a particular region's needs to rules on offshore drilling disputes.

The documents released indicated some dissension about how the energy report was assembled. A March 28 OMB e-mail requests that "if you see any particularly egregious recommendations that you alert me to by tomorrow 10:30 . . . . I could raise it in the meeting to highlight the process problems." A Feb. 26 e-mail states: "The agency/chapter meetings got a little discombobulated."

Bush's energy plan encourages increased production of fossil fuels, including relaxed regulations and subsidies for the coal and nuclear industries, oil and gas drilling in the Arctic National Wildlife Refuge and construction of 1,300 to 1,900 power plants over the next 20 years.

Most of Bush's energy recommendations were incorporated in a bill that passed the House in August after heavy lobbying from labor unions. The Senate has begun debating its version and is expected to take up the most controversial part, the Arctic drilling, when lawmakers return from recess in two weeks.

Large donors meeting with Abraham included Duke Energy, which contributed $61,500 in soft money, all to the GOP, according to figures kept by the Center for Responsive Politics. Constellation Energy gave $38,950, all to the GOP. Northeast Utilities contributed $43,580, all but $2,000 to the GOP. UtiliCorp United gave $66,000, all to the Republicans. American Coal Co. gave $20,500, all to the GOP. Kerr-McGee gave $240,350, all but $20,000 to Republicans. Exelon Corp. gave $454,305, 74 percent to the Republicans.

Senator BOXER. Department of Energy did not act to help California. They actually started to blame California for the crisis. In June 2001—and I've got about a minute left—the Administration had a California message meeting. Attendees at this meeting included Secretary Abraham, Mary Matalin, Karl Rove, Lawrence Lindsey, Nicholas Calio, Karen Hughes, and Ari Fleischer. Mr. Chairman, I want to submit for the record an *AP* article on this political meeting.

Senator DORGAN. Without objection.

[The information referred to follows:]

POLITICS, POLICY MIX IN WHITE HOUSE RESPONSE TO ENERGY CRISIS

Associated Press, April 5, 2002

By Mark Sherman, *Associated Press* Writer

Washington—As the Bush administration resisted calls from Democratic Gov. Gray Davis for electricity price caps during last year's energy crisis, top officials met with past or future Davis foes and key White House political operatives.

Administration documents released by a court order showed that administration officials kept a close eye on soaring energy prices and intermittent power blackouts in California. At least two of the meetings included Karl Rove and Mary Matalin, the top political advisers to President Bush and Vice President Dick Cheney, respectively.

Records show that Energy Secretary Spencer Abraham participated in at least 19 meetings during his first five months on the job, including at least seven during the first three weeks of his tenure. While Abraham didn't meet with Davis until late February, he huddled with Republican Secretary of State Bill Jones and former Northwest Airlines executive Al Checchi before then, records show. Jones unsuccessfully sought the Republican nomination for governor in last month's primary, while Davis had beaten Checchi in the 1998 Democratic primary.

Abraham and Checchi knew each other from when Abraham represented Michigan in the Senate and Checchi was at Northwest, which has a hub in Detroit, Abraham spokeswoman Jill Schroeder said.

Checchi had criticized Davis in newspaper opinion pieces at the time. In a brief interview, he said he asked to meet with Abraham to "put my two cents in" on the energy issue.

Abraham, Cheney and other top administration officials repeatedly and publicly criticized Davis for his handling of the situation. Cheney called the state's power purchases—begun by Davis when investor-owned utilities tottered on the edge of bankruptcy—a "harebrained" scheme.

Republicans also began a multimillion dollar television advertising campaign—paid for in part by power-generating companies—trying to blame the governor for the crisis.

At the time, Davis was viewed as a potential rival to President Bush in the 2004 presidential election and California had for the third consecutive presidential election gone solidly for the Democratic candidate.

In late April, shortly before Abraham traveled to California, Joseph Kelliher, a senior policy adviser, asked other staff members to research Davis' assertions that conservation was helping the state through the energy crisis.

Referring to a press release on the governor's Web site, Kelliher asked, "Can we assess the accuracy of his claims of conservation?" Kelliher asked.

It's not surprising the administration worried about the politics of the California energy crisis, said Davis spokesman Steve Maviglio. "The administration was openly hostile to price caps much of the winter and spring. And they were harshly critical of the governor's decision to get the state in the business of buying power."

Leon Panetta, former California congressman and chief of staff in the Clinton White House, said he believes the new administration had already decided "they were going to hang California out there. It would be an example to the rest of the country what not to do. It would show the liberals that they better build new power plants or suffer the consequences."

Contrary to showing a lack of concern about California, Schroeder said, the frequent meetings demonstrated that "this was an immediate priority."

However, Sen. Barbara Boxer, D-Calif., said she's "convinced that politics played an enormous role in this.

"This was the period we were going through our worst troubles and FERC had already found that prices were unjust and unreasonable," said Boxer, who pushed for price caps and a federal investigation of electricity prices. "But the administration did not act."

Bush and Abraham made separate visits to the state in May, touting an executive order to reduce electricity use in federal facilities, but remaining firm in their opposition to capping the price of electricity—a move fiercely opposed by energy companies.

In early June, the administration convened what it called a "California message meeting." The participants included Abraham, Matalin, Rove, Lawrence Lindsey, Bush's chief economic adviser, Nicholas Calio, the administration's chief congressional lobbyist, presidential counselor Karen Hughes and press secretary Ari Fleischer.

The following week, Cheney went to the Capitol, where he held a long-requested meeting with California's congressional delegation. The message was the same: Expect no help from the administration on energy costs.

California had been "blown off" by Cheney, Rep. Maxine Waters, D-Los Angeles said after the meeting.

By this time, even some Republicans in California were pleading with the administration for help.

Less than two weeks later, two Bush appointees to the Federal Energy Regulatory Commission voted to impose limits on what energy generators could charge for spot purchases of electricity in California and other Western states, although they did not call that decision price caps.

Senator BOXER. For this Administration, it appears the California crisis was not about solutions, but about spin. In fact, in June 2001, a series of ads, "Gray outs from Gray Davis," began running in California. These ads blamed our Governor for this crisis. He has had to sue in an attempt to find out who paid for these ads. We know they were made—the ads were—by a Republican political operative. And, Mr. Chairman, I'd like to submit for the record copies of the text of one of those ads, as well as a newspaper article that talks about the political operative.

Senator DORGAN. Without objection.

[The information referred to follows:]

GOVERNOR SUES TO ID SPONSORS OF ATTACK ADS;
GROUP ACCUSED OF VIOLATING CAMPAIGN LAW

The San Francisco Chronicle, July 21, 2001

By Mark Martin

Sacramento—Gov. Gray Davis struck back yesterday at an organization running television ads that trash his power policies, asking a state court judge to force the group to reveal its donors.

Davis campaign officials say they believe big energy companies are behind the "Gray Out" media blitz, financed by the American Taxpayers Alliance, in Washington.

In a lawsuit filed in San Francisco Superior Court, lawyers representing the governor's political committee say the alliance broke state law by not registering as a political organization with the secretary of state. They also say the group has until the end of the month to file a campaign statement listing contributors and is asking a judge to make sure it does.

"This committee has to tell the voters of the state of California where they're getting their money," said Joseph Remcho, a San Leandro attorney who prepared the lawsuit. "The American Taxpayers Alliance has totally refused to do so."

Beginning in June, the alliance has spent $2 million on television ads that end with the line, "Gray outs from Gray Davis."

Just what the alliance is remains something of a mystery. Headed by Scott Reed, a Republican campaign consultant and the former campaign manager for Bob Dole's 1996 presidential bid, it is registered with the Internal Revenue Service as a nonprofit corporation. The group reported to the IRS in April that it was inactive but shortly after began its million-dollar media buy, according to the lawsuit.

Reed has refused to identify the group's contributors, but *Time* magazine has reported that Reliant Energy Inc. is a major donor. Davis political adviser Garry South suggested at a press conference announcing the lawsuit yesterday that the White House had asked power companies to go on the offensive in California.

Bush administration officials have previously denied that charge. Reed did not return calls for comment yesterday.

The lawsuit comes amid a recent barrage of ads regarding the state's energy crisis—an issue voters listed as the state's top concern, well above any others, in a poll released this week by the Public Policy Institute of California.

In response to the attack ads, Davis has dipped into his campaign war chest to buy $150,000-a-week radio spots defending his handling of the crisis.

The advertising battle is among the first skirmishes of the California primary season, albeit eight months before the March contest.

Remcho argues that the ads constitute campaign spots, and therefore the alliance is required to register with the state and file a campaign statement listing its contributors by July 31 under the Political Reform Act of 1974.

"Even if it doesn't say 'Vote against Gray Davis,' it's a classic candidate ad," Remcho said. "It clearly is an anti-Gray Davis ad."

But Kim Alexander, president of the nonpartisan California Voter Foundation, said that the lawsuit delves into state political advertising laws that remain murky.

"If it's not mentioning a bill or urging people to do something, maybe it's just free speech," she said.

Text of Grayout Advertisement

"He's pointing fingers and blaming others. Gray Davis says he's not responsible for California's energy problems. After all, the Public Utilities Commission blocked long-term cost-saving contracts for electricity. But who runs the PUC? The people Gray Davis appointed—Loretta Lynch and other Davis appointees who left us powerless. That's why newspapers say Davis ignored all the warning signals and turned a problem into a crisis. Grayouts from Gray Davis."

Senator BOXER. Finally, on June 12, 2001, nearly five months into this Administration, the Vice President met with a California delegation. All he did was blame us for using too much electricity. And I will tell you right now, California, at that time, was the second-most energy-efficient state in the country, behind only Rhode Island. California was not refusing to build more power plants. It licensed at least 20. And, as you know from other charts I have shown, we actually were conserving.

So, the story makes one thing perfectly clear, and I want to show one last chart here. This shows you—and it's very small, the print is small—these are the meetings Secretary Abraham had, and it shows you how many blackouts we endured during the period of time of those meetings. And, the third shows the stock that was sold by Jeffrey Skilling and Kenneth Lay during that time. So, the meetings were going on with Enron and the energy people, the blackouts were happening, the insiders were trading. It is an ugly story, an ugly story for the people of California.

So, I am very concerned about what has happened. I hope we can—when we do have all the facts in the record—we will all, in a bipartisan way, take action to make sure that this never happens to my state again or to any other state in the union. Colleagues, I wouldn't wish this on you. I want to help you avoid it.

Thank you very much.

Senator DORGAN. Thank you, Senator Boxer. The ranking member of the Subcommittee, Senator Fitzgerald.

STATEMENT OF HON. PETER G. FITZGERALD, U.S. SENATOR FROM ILLINOIS

Senator FITZGERALD. Senator Dorgan, thank you very much. And, Senator Boxer, thank you.

I will listen with interest to the testimony of today's hearing, but I have to say that I come into this skeptical with respect to whether Enron had any effect on California's energy crisis or as to whether Enron's political involvement really means very much.

I happen to believe, based on what I've seen so far, that Enron was really just a gigantic pyramid scheme grafted onto an underlying pipeline company. I think that they were essentially borrowing money, and booking borrowed money as income. They were able to do that by using the accounting rules to park the borrowings on the books of partnerships that were off their books and not consolidated with their books. And as the debts of those partnerships became due, they borrowed more money to pay off the earlier debts and booked more fictitious income.

I think Enron's political involvement was really a cover for the confidence game that they were running. I don't really even view it as—having been much of—a legitimate business. I haven't seen evidence that they derived much in the way of earnings from traditional energy-company services. I think that almost all of their reported earnings at the end were simply from their Ponzi operation or their pyramid scheme or their shell game.

And I think my colleagues know me well enough to know that I am fiercely independent. If I thought for a minute that Enron's political involvement was substantial, I would be the first to say so. But based on what I've seen so far, I don't think it's all that significant, but I will listen, nonetheless, with interest to the testimony today.

And I have to compliment my colleague from California for her tenacity. She is a pit bull in fighting for her constituents, and I have to take my hat off to her for that.

Thank you.

Senator DORGAN. Thank you. Senator Wyden, you had a unanimous consent request?

Senator WYDEN. I do. I wanted to put a document into the record that I think reflects the timeliness of this hearing. Right now, there are discussions going on involving the Bonneville Power Administration's ability to cash out of $700 million in high-priced power-purchase contracts that BPA has with Enron.

The reason that these discussions are so important and the issues we're examining right now are so important is that if fraudulent activity was taking place at the time that those contracts were entered into, that then gives the Bonneville Power Administration another opportunity to get out from under those contracts.

I would just ask unanimous consent, Mr. Chairman, that the article describing these negotiations and why these negotiations are so critical for Northwest ratepayers and the issues we're examining this morning are so important, be entered into the record.

Senator DORGAN. Without objection.

[The information referred to follows:]

NO EASY ESCAPE FROM ENRON; BPA MAY BE STUCK WITH COSTLY CONTRACT

The Seattle Times, February 8, 2002

By Hal Bernton, *Seattle Times* staff reporter

The Bonneville Power Administration appears stuck with buying $700 million worth of electricity from Enron at a price nearly double the current market rates for an equivalent amount of power.

By contrast, at least two other Western utilities have walked away from expensive, long-term contracts with Enron.

Officials of the Snohomish County Public Utility District and the Palo Alto, Calif., municipal utility both cited Enron's poor credit rating as justification to invoke escape clauses that terminated the deals. They now are preparing to defend those actions from any legal challenges that might arise during bankruptcy proceedings. But Bonneville Power Administration (BPA) officials say they have no easy escape clauses in their power-purchase contracts. Even though Enron is now fighting for survival in U.S. Bankruptcy Court, the Texas-based energy-trading company has continued to deliver power to the BPA. As long as Enron makes good on these deliveries, BPA officials say the only exit appears to be through a costly buyout.

The 320 megawatts of Enron power, contracted for delivery through 2006, will cost an average of about $50 per megawatt-hour.

Earlier this week, a buyer could have purchased power for Northwest delivery through 2006 for about $28.50 a megawatt-hour, said Keith Kelly, a vice president of energy broker TFS Energy. That would be a savings of about $300 million over the six-year contract negotiated with Enron.

"We continue to look at our options, but just because a company files bankruptcy doesn't mean that you can walk away from your agreements," said Ed Mosey, a spokesman for the BPA.

Enron officials agree. Enron is trying to fulfill as many contracts as possible, and the contracts remain in force, according to Eric Thode, a company spokesman.

The BPA markets wholesale power from 29 federal hydroelectric dams and a nuclear power plant to Northwest industries and utilities, including Seattle City Light. It sells power in times of surplus but sometimes ends up short and has to buy power.

Last year's drought forced the BPA to make big buys, and in October the agency raised rates by 46 percent to help cover those costs. The BPA is considering another rate increase this spring.

The BPA's power purchases with Enron represent about 3 percent of the agency's total power load. The agency purchased most of this power between fall 2000 and spring 2001, a period when Enron ranked as the largest private market of Northwest power. Purchase prices ranged from $30 to $85 but averaged about $50.

The terms of all power purchases are detailed in contracts, and hundreds are signed each day in the West. Most of these deals are for short-term deliveries and detailed in relatively standard contracts developed by an industry group known as the Western Systems Power Pool.

But as contracts edge up toward multiyear deals, the standard contracts in recent years often have been abandoned in favor of contracts with more highly refined escape clauses, according to Michael Small, general counsel for the power pool.

When Enron put on its buyer's hat and sought to purchase BPA power in the late 1990s, the corporation appeared to have taken an active interest in escape clauses. Enron insisted that the contracts include clauses that voided the deals should either party become insolvent, according to BPA spokesman Mosey.

The BPA last week announced it would cancel contracts to sell $285 million worth of power to Enron in deliveries scheduled through 2006.

In 2000 and 2001, when the BPA sought to buy power from Enron, no similar escape language was included in the contract.

Instead, the BPA used the standard contracts of the Western Systems Power Pool. Those contracts allow the BPA to declare Enron in default. But to get out of the contracts, the BPA could be required to fork up big dollars to compensate Enron for the loss of the contract.

Mosey said that it was standard procedure for the BPA to use the Western Systems Power Pool contracts because the BPA was an active member of the pool.

Small, the general counsel for the power pool, said members also are free to use other contracts.

"What I've seen is that most people who are going into a multiyear contract . . . don't use the standard contract," Small said.

Snohomish County PUD officials said they did not use the pool contracts as they negotiated an eight-year, $192 million dollar deal to buy Enron power. That deal was negotiated in January 2001 as power prices neared record highs and the average cost per megawatt-hour topped $100.

The Snohomish County PUD's long-term contract has more flexibility in terminations than the standard Western pool contract, according to Neil Neroutsos, a PUD spokesman.

The PUD canceled its Enron contract Nov. 27, five days before Enron filed bankruptcy.

PUD officials say the contract was canceled because of Enron's lack of credit, insolvency and failure to truthfully disclose its financial situation at the time the contract was signed. Palo Alto utility officials put forth some of the same justifications in canceling contacts with Enron.

The utilities hope they are free of the costly contracts, which Snohomish County PUD officials say were ridiculously overpriced.

But the utilities may yet face legal challenges in Bankruptcy Court proceedings under way in New York. Enron's filing is the biggest bankruptcy case in history, and creditors are hungry for assets to help pay off debts. And they may press the bankruptcy judge to override the escape clauses and reinstate the long-term contracts.

"In Bankruptcy Court, a lot of the contractual language often doesn't mean a thing," said Jan Ostrovsky, a former Bankruptcy Court trustee in Seattle. "Those contracts are big enough money to trigger a fight."

Senator DORGAN. Let me just say, before I call the witnesses forward, Senator Burns and I believe Senator Fitzgerald, have made a suggestion that ought to be the guiding principle for every Committee hearing, which is that we should first receive the facts and the evidence, before coming to any formal conclusions. Clearly this must be the case with respect to these issues. It's a fair point, and we shall abide by it.

And let me restate again, when I began this hearing, why I think it's an important hearing. That which we know to this point tells us that the Board of Directors of this corporation did an investigation called the Powers report. The Powers report said that the Enron executives effectively cheated the Board of Directors. The Enron executives cheated investors, their investors. And the question then is did Enron executives also cheat West Coast electric consumers?

I think those are very important questions to ask, given what we now know about what Enron did inside its own corporation. What did it do outside its corporation? And I think the witnesses that we have today will have some interesting testimony.

Let me call them forward: the Honorable Joseph Dunn, Senator, State of California; Ms. Loretta Lynch, President of the California Public Utilities Commission; and Mr. S. David Freeman, Chairman of the California Power Authority. I would ask that you all come forward to the witness table. Ms. Wenonah Hauter, Director, Critical Mass Energy & Environment Program, Public Citizen, and Mr. Robert McCullough, Manager Partner, McCullough Research, who is from Portland, Oregon. So, if you will all come forward, we will begin. Why don't we begin with Mr. Dunn, and then I—we'll just do it in the order that I called them.

Senator Dunn, my understanding is that you were involved in this issue in the State of California. Why don't you proceed, and we will include your entire statement as a part of the permanent record, and you may summarize.

STATEMENT OF HON. JOSEPH DUNN, CALIFORNIA STATE SENATOR

Senator DUNN. Thank you, Mr. Chairman, and good morning to all the Committee members, particularly our home-state senator, Senator Boxer. Thank you very much for the opportunity to testify about Enron's role in deregulation and, in particular, Enron's role in the California electricity crisis.

I am the Chair of the State Senate Select Committee to Investigate Market Manipulation in the Wholesale Energy Market in California. We began that committee over a year ago, and we've had numerous hearings, depositions. We've issued document subpoenas. We've received millions of documents that we've reviewed in Portland and Sacramento and Houston and New York, and we're not through yet.

Much of the written testimony that I've submitted to this Committee comes from those documents that we've reviewed. However, those documents are under confidentiality agreements, and I plead with this Committee to make a formal request to the California Senate for access to those documents so we can work out the confidentiality provisions and give this Committee access to those documents.

And each of us before you today hold a very similar view with respect to Enron, and much of it is in my detailed written testimony which I'll not read today. I'm going to focus on Enron's conduct before our investigation committee through the past year.

But before I do that, I'd like to make one statement with respect to Enron's role in deregulation and the California crisis, and let me state a very important premise.

We do not have a crisis in electricity in California. We have a crisis in economics. The longer we focus on this problem as one of electricity, the further from the solution we get. Everyone's focus has to be on economics and the rules of market behavior—in particular, the exercise of market power and the philosophic question of whether electricity, because of its unique characteristics, can work as a commodity. There lies the cause, and there lies the solution.

Now, I personally support deregulation of most markets. I believe competition does benefit the consumer. However, this deregulation, led by Enron, has become perhaps the greatest fraud ever perpetrated on the American consumer. It was done with the promise of lower prices. And our review of the internal documents of the market participants show they never, ever intended to deliver lower prices to the American consumer.

And I know some of my colleagues here will dispel some of the myths that have surfaced since the crisis befell California. I won't spend time with those other than to say: Do we have a shortage of electricity? No. Less surplus, yes. Shortage, no. Unexpected increase in demand? No. Facts don't bear that out. Just a California problem? No. It just happened to first surface in California, as many things do, good and bad.

But let me go directly to Enron's behavior with our committee over the past year. We began in March of 2001. We were given promises by every market participant, including Enron, that they would cooperate fully with our committee. I'm sure this Committee has received the same promises.

In reliance upon those promises, we served voluntary document requests of over a hundred categories of documents last April. After two months of receiving zero documents, but all kinds of excuses, we were forced, in June of last year, to do what the California Senate has rarely done, and that is issue document subpoenas. We issued them to generators, to traders, to municipal electricity systems, to financial institutions, to the Cal ISO, to the PX, and many other entities, requesting via subpoena over a hundred categories of documents, embracing millions of documents.

We also asked, at that time, for each of the market participants to enter into a voluntary non-destruct agreement, because we were concerned about relevant documents disappearing. They refused at that time. And every single one today as I sit here still refuses to enter into a voluntary non-destruct agreement with our committee.

Once those subpoenas were served in June, we did receive documents from all market participants but one. That one was Enron. Enron's response to our document subpoena was to file civil litigation against our committee, requesting not only that the subpoena be quashed but questioning the very authority of the California legislature to look into the behavior of the market participants in the California wholesale electricity market.

They still did not produce after the court rejected that lawsuit in August. And, thus, we, the California State Senate, were forced to commence contempt proceedings against Enron. We, in fact, found

Enron in contempt. And, on the last day of our legislative session, September 14, before the fall recess, we had a motion on the Senate floor for sanctions for that legislative contempt.

Those sanctions that were proposed in that Senate resolution were $1 million per day until they resolved their contempt. In addition, the resolution demanded that CALPERS, the Public Employee Retirement System, one of the largest retirement funds in the world, required them to divest themselves of all stock holdings in any company in contempt of the California legislature, in this case, Enron.

In response to that resolution, as it was pending on that last day of our session, on September 14, Enron flew all kinds of corporate executives to Sacramento who met with us throughout the day. Our session went well into the night, as it usually does on the last session, and we reached an agreement whereby they agreed, finally, to produce documents. And, in fact, in the fall, they started to produce documents, about 300,000 documents, to a Sacramento depository. We have been through that depository. And they, except for a handful of documents, are all but worthless to our investigation.

In addition, in late fall, as this Committee knows, reports of document destruction by both Arthur Andersen and Enron itself surfaced. We immediately began an inquiry into those reports, because we wanted to know if any of the documents under our June subpoena had been destroyed.

Enron and Arthur Andersen have refused to cooperate with that part of our investigation. In fact, both of them have refused to honor a deposition subpoena of both an Arthur Andersen and an Enron—sorry, of an Enron individual about the document destruction. The Arthur Andersen subpoena has not been served yet. Enron refused to produce someone in response.

As a result, this January we started contempt again. And, in fact, we voted for contempt and we're moving forward with potential sanctions. We also did one other thing. We voted to refer Enron over to local law enforcement officials for purposes of criminal prosecution for the destruction of documents under a legislative subpoena. California, like every state in the nation, has it be a crime to destroy documents that are under a subpoena.

Enron, in response to that move in January, finally agreed to open up their files to us. And I have to say they have opened up many, many files to us, in Houston and in Portland, where their western trading floor exists—or existed. We were pleased with their level of production and the level of access that we have had. However, one of our requests was for all e-mails from Ken Lay, Jeff Skilling, Steve Kean, and other corporation executives. We received those e-mails on nine disks about a week-and-a-half ago.

Our IT team has now reviewed those disks, and we've come to the unfortunate conclusion that prior to the production of those nine disks, there was willful destruction of key e-mails on those disks. We're about to go to war with Enron one more time in the California legislature.

I implore this Committee in its investigation to pursue this aggressively and to use the full weight of the law that you have available to you. Otherwise, I can assure you from our experience in

California, you will get many promises, but you will get nothing delivered.

I'd like to end by dispelling one more myth about the California energy crisis, and that myth is, this whole mess was caused by the deregulation scheme that was adopted by the California legislature in 1996. There is no question that what the California legislature did in 1996 wasn't perfect, but the legislature relied heavily on the industry, particularly Enron, and we trusted their representations at that time.

That trust proved to be misplaced. And so the analogy I oftentimes draw is, while the California legislature may have left the car unlocked, the energy industry, led by Enron, stole that car. And that is the real crime. And, unfortunately, the cop on the beat, FERC, won't do anything about it. I ask that this Committee and the entire U.S. Congress assist us in California to once and for all bring resolution to the energy crisis.

Thank you, Mr. Chairman.

[The prepared statement of Senator Dunn follows:]

PREPARED STATEMENT OF HON. JOSEPH DUNN, CALIFORNIA STATE SENATOR

Good morning, Chairman Hollings, Ranking Member McCain, Senator Boxer and members of the Committee on Commerce, Science and Transportation. Thank you for the opportunity to present testimony to the Committee on Enron's role in influencing the structure and function of California's deregulated energy market and its role in the energy crisis.

Since last March I have chaired the California State Senate Select Committee to Investigate Price Manipulation of the Wholesale Energy Market. The Committee is conducting an extensive investigation into all aspects of the California 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.

Our Committee has had protracted and at times, acrimonious, dealings with Enron. I hope my experience in dealing with Enron and my intimacy with the California energy crisis will provide insight into decisions your Committee and Congress must address.

I preface my testimony with the admonition that my Committee has documents to prove the claims made herein. Because of confidentiality agreements reached with market participants, however, I am limited in my ability to share many of these documents without a formal request by you or your Congressional investigators. I encourage you, Senators, to make a formal request if you wish to view these documents.

My comments today speak to the pivotal role Enron played in influencing the design of California's deregulated wholesale market, its behavior as a market participant as the market grew more and more dysfunctional in 2000 and 2001 and the part Enron's conduct played in the huge price spikes California experienced.

Let me begin by saying that there has never been a "power shortage" in the state of California. The state has always had a sufficient supply of electricity to meet its need. That some have said the state experienced periods where demand outstripped supply is one of the many myths of the energy crisis. What California experienced in 2000 and 2001 was not a crisis in electricity, it was a crisis in economics. Enron and its team of economists knew this better than most.

Enron's Early Foray into California

Enron was involved in the California electricity market well before the inception of the deregulated market. In fact, Enron was the most pivotal (future) market participant in shaping the regulatory and political environment that gave birth to the commoditization of electricity.

Enron testified before and submitted comments to the California Public Utilities Commission (CPUC) more than a dozen times before 1996, the year legislation was passed that authorized "deregulation." This is a critical point—*Enron's sophisticated lobbying efforts helped create the very market it would later exploit.* To be clear: I do not believe there is anything wrong with lobbying public officials on behalf of one's business interests. Done properly, it is good business and a democratic right. However, Enron's lobbying consisted of hyperbolic promises that its internal predictions do not appear to support.[1]

For example, former Enron CEO Jeff Skilling, then the President of Enron Capital & Trade, told the CPUC on June 14, 1994, that California would save billions in a few short years under a deregulated market.

> In this industry in California, the potential savings are enormous. . . More specifically, in California, our view is that California is an industry run amok. If California consumers were paying even the same costs as surrounding states' consumers are paying, the state would save about $8.9 billion per year. If you had $8.9 billion that you wanted to spend, let me tell you what you can buy every year. You can triple the number of police in Los Angeles, San Francisco, Oakland and San Diego, and you could double the number of teachers in Los Angeles, San Francisco, Oakland and San Diego. You could pay all the interest on the California state debt. You could pay full interest in debt service for all three bond issues that failed last year [1993] and you'd have enough pin-money left over to cover the CPUC's budget. And you'd have another billion dollars a year left over.

With California facing a more-than $15 billion budget deficit this year, the hollowness of this prediction is not wasted on anyone in my state.

Beyond what some might label insignificant grandstanding, Enron lobbied for very specific market rules that stood to benefit its business at the expense of consumers. Two months after giving that testimony, and again in October 1994, Mr. Skilling appeared before the CPUC to argue for the superiority of an "OpCo" electricity market versus a "PoolCo" market that was modeled on similar markets in other countries, including the United Kingdom.

OpCo and PoolCo refer to competing approaches of market management. In each model, the respective guardians of each approach—a Power Exchange for the PoolCo method and a Power Marketer for the OpCo method—promise an optimization of market efficiency. Efficiency is achieved by the PoolCo method through a transparent "pool" system in which buyers and their "bids" are pooled and sellers and their "asks" are pooled. The two pools are then overlaid, and buyers and sellers are matched. The ultimate price is posted, and participants in the "auction" use this pricing information to make "efficiency decisions" on their own, such as the when and where of committing their generation units.

The OpCo method championed by power marketers relies on a different underlying assumption: i.e., "competitive markets need help in performing efficiently."[2] The "value-add" of a marketer lies primarily in its risk management, founded on superior understanding of market fundamentals, including price, bidding and demand history. Enron argued that the resulting efficiency wrought by power marketers, in the end, benefits consumers.

Many economists have noted that this premise is faulty. "Generators wish for a high price paid to generators, and consumers want to see low prices paid by loads, but power marketers want the opposite of both. They want to buy low (from generators) and sell high (to consumers). Power marketers are a new breed and they have different objectives. . . they are mistakenly viewed as market makers. . . Currently power marketers often find themselves in the position of trading wholesale power while adding very little value. In this case their principle opportunity for profit exists at being a better speculator in the market."[3] Speculating for profit is not what California consumers needed to ensure an efficient delivery of energy.

In arguing for the OpCo approach, Mr. Skilling referred to Enron-generated forward price curves.[4] Enron confidently predicted that the benefit of a liquid futures market for electricity would bring stability, efficiency and competition—but only in an OpCo-modeled market. A PoolCo method would lead to volatile and unpredictable prices, which was bad for the consumer, he told the CPUC. Ironically, Enron would later create volatility for profit.

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[1] To the extent that Enron knowingly published any false statement to affect the wholesale electricity market is worthy of further investigation, as it is a violation of California law (Penal Code § 395).

[2] Steven Stoft's April 29, 1997 study, "What Should a Power Marketer Want?" I ask whether this is an unintentional concession that a deregulated model does not work.

[3] Stoft.

[4] Despite a subpoena compelling their production and specific conversations about this data, our Committee has never received copies of these price curves or the staff work that gave rise to them. Mr. Skilling has also refused to testify before the Committee to address this and other issues.

But in the early days of deregulation, Enron's apparent losses were always mitigated by subtle gains: California instituted a modified-PoolCo approach by creating the California Power Exchange (CalPX) and the California Independent System Operator (CAISO), but made key concessions to Enron in the process. For example, the CalPX was required to follow a strict set of protocols in its auction procedure that no power marketer was similarly saddled with. The result in every instance was to make Enron and other power marketers more nimble, more flexible to buyers and sellers in ways the CalPX could not be.[5]

Needless to say, economists characterize OpCo and PoolCo as incompatible and to this end, the two models are seen as competitors.[6] As early as 1997, a number of economists, including Steven Stoft, correctly predicted that these concessions would give Enron and other power marketers the tools to bankrupt the CalPX.[7]

Given this, it is not surprising that the success of the CalPX seemed to be inversely correlated with the success of Enron, and, not coincidentally, the success of the CalPX was directly correlated with low wholesale electricity prices. When the CalPX teetered on the edge of solvency, Enron thrived and wholesale prices skyrocketed.

On May 13, 1998, the California Senate Committee on Energy, Utilities and Communications issued a statement that demonstrated this relationship. The committee credited the CalPX with "buying electricity at substantially lower prices than expected." Shortly before the release, Enron announced that it "suspended" its involvement in the California residential service market, though it did not publicly acknowledge the relationship between the success of the CalPX and its own failure.

Enron and the Deregulated Market

The state's deregulated market opened on March 31, 1998. Enron's misconduct in the day-ahead market was first discovered in May 1999. Through the CalPX day-ahead auction, Enron successfully purchased the right to sell 2900 megawatts over a 16-hour time period. The company then proceeded to schedule all 2900 megawatts over a line with a 15-megawatt capacity. Enron unabashedly admitted that the company intentionally congested the line.[8]

Despite claims from Enron CEO Ken Lay that Enron "believes in conducting business affairs in accordance with the highest ethical standards,"[9] the company maintained internally that the intentional congesting of the power line was a "test" and was "not a big deal."[10] The CalPX maintained that the "test" resulted in a $6 million detrimental impact on the market. Amazingly, Enron was fined just $25,000 for the incident.

The CalPX was not the only regulator to cite Enron for market misconduct. In 2001, CAISO released a study about market behavior between May and November 2000. The report asserted that Enron Energy Services strategically bid into the market with the intent of manipulating the price of electricity. The company's "economic withholding" of megawatts resulted in excessive profits of nearly $28 million in ISO's real-time market.[11] The cost of this behavior among all the companies implicated in the report was over $1 billion.

CAISO asserted that Enron was able to charge "excessive rents" because it was able to exercise market power, an anti-competitive behavior in which a single company can determine a price the market is compelled to accept. I maintain, as I have since the beginning of the crisis, that market power is at the heart of California's dysfunctional market. The astronomical prices of 2000 and 2001 have been blamed

[5] In fact, consider the decision to separate ISO and PX as an example of the concession. One of the most important advantages of a PoolCo system is the historic database available to the PoolCo of pool prices and demand, information that is not available to any single power marketer. In creating a separate ISO to manage this information, the CalPX was stripped of an inherent advantage. "If equal treatment includes taking away PoolCo's ability to make use of its advantage, then the experiment has been rigged," Stoft wrote.

[6] Enron later explicitly acknowledged this during an investigation of misconduct by the CalPX. "We are mystified that our competitor, the CalPX, believes that it has the authority to be judge and jury . . . Enron and the CalPX are direct competitors." Ironically, the Committee heard testimony from a CalPX executive who denied that Enron was viewed as a competitor.

[7] Stoft predicted the CalPX's demise "less than a year after the requirement is lifted on January 1, 2003 that the three major IOUs must trade through the CalPX." The FERC effectively moved the January 2003 date forward with its December 15, 2000 order. (The order spelled out in detail the FERC's elimination of the mandatory buy-sell requirement into the CalPX.) The CalPX ceased trading six weeks later on January 31, 2001.

[8] Undated internal Enron memorandum, "Main Messages."

[9] November 23, 1999 letter to the CalPX.

[10] Internal memo provided to the Committee.

[11] Dr. Anjali Sheffrin, Ph.D., "Empirical Evidence of Strategic Bidding in California Real Time Market," March 21, 2001.

on many things, and I agree that a confluence of factors contributed to the crisis. However, California spent billions of dollars on electricity because a cadre of companies led by Enron were, in industry parlance, "price makers." [12]

Market Power and the Role of Trading

How did Enron acquire and exercise market power? As I mentioned earlier in my testimony, this is a question of economics and is not easily sorted out. I believe that Enron's fiscal improprieties, still the subject of numerous federal probes, drove Enron's strategy and behavior in the California electricity market. Thus, it is impossible to dissect Enron's manipulation of the California market without understanding its aggressive culture and potentially fraudulent accounting practices.

There are three important prongs to Enron's business in California as: 1) a direct access provider to large commercial and industrial entities, such as the University of California; 2) a trader and marketer of electricity; and 3) an unregulated auctioneer in the electricity and, more importantly, the natural gas market.

I have already discussed the relationship between Enron and the CalPX, but I will add another distinction between the two: the role of volatility.

In theory, Enron would not necessarily need volatility in the market to succeed as a trader of electricity. Bond traders, for example, make money trading and speculating in a very stable, liquid commodity. In fact, Enron VP Steve Kean told our State Senate Energy Committee in January 2001 that Enron "sell[s] protection from price volatility to both producers and end users. Consequently our interest in California's power market is to ensure that the market works effectively . . . Enron has no interest in high power prices." [13]

This simply is not true. Enron was like a glass-repair business that advertises on bricks thrown through windows: "Buy protection from the volatility we create!" In practice, Enron *did* require high prices, because high prices were a symptom of a volatile market. Not only did Enron need high prices, it worked to ensure them, in order to do two things: 1) SELL "protection from volatility" and 2) undermine the CalPX, in order to establish itself as the primary market maker.

Let me state this another way. In a regulated electricity industry, protection from the impacts of unexpected price movement is the responsibility of regulators. Since Enron sold volatility management products, anything that increased volatility was good because it created a demand for Enron's products. Thus, during the height of the energy crisis when California was requesting that the Federal Energy Regulatory Commission (FERC) impose price caps, Enron and its sister traders opposed them because price caps would staunch volatility and undermine the trading operation, which provided 90 percent of Enron's revenues.[14]

The success and stability of the transparent CalPX market worked against Enron. Market participants did not need to buy or sell "protection" from Enron when the CalPX was already operating efficiently enough to mitigate volatility. Enter the traders.

Enron argued to the CPUC that in an OpCo model, power marketers would make the market more efficient. This was supposed to be because "risk management" trading companies like Enron were better able to interpret market fundamentals than other market participants. Generators, for example, would pay a premium for Enron's expert analysis of the market instead of relying on their own interpretation of the neutral information in a transparent pool. Once the CalPX was operating, however, the point was moot. The CalPX handled the vast majority of the trades, so no matter how brilliant Enron's interpretations were, they were based on a small percentage of the overall transactions done in the market.

This created a dilemma. How could Enron, as an individual company, compile a larger database of price, bidding and demand history than the CalPX? The simple answer was to book more trades. Since the price of energy in each bilateral contract

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[12] In a functional market, participants serve as "price takers," indicating that the price is dictated by what the market will bear. In a dysfunctional market, participants act as "price makers," indicating that they have the ability to set the market price above a competitive level. This is a common test for market power by economists.

[13] Jeff Skilling echoed this view at various points in time. Skilling told *Business Week* that, Enron benefits from volatility, not high prices (Feb. 12, 2001). And Enron's 2001 Q3 earnings release points to a direct relationship between "a low level of volatility" and "flat" profitability. Generators also benefit from volatility. Duke, Dynegy and Williams executives have all acknowledged the correlation between company profits and market volatility.

[14] Thus, the FERC and California's combined Spring 2001 efforts to reduce Western price volatility had a significant negative impact on Enron's 3rd quarter 2001 financial results, confirming the claim by Anderson's CEO that Enron's demise was at its heart a business failure. This paragraph (including footnote) is taken directly from a February 6, 2002 letter from California State Senator Steve Peace to Rep. Henry Waxman.

was a proprietary secret, the more Enron traded, the greater its market share became, and the more its traders became the resident experts about the future price of electricity.

The dimension of trading is critical in understanding market manipulation because markets are manipulated by influencing traders' expectations about the future. Those expectations establish the forward price curves, which in turn affect the cost of long-term electricity contracts. Since the future is uncertain, an electricity user trying to minimize costs must decide whether to buy a long-term contract or commit itself to costs that might be higher in the spot market.

Traders themselves have a preference for long-term contracts because "mark-to-market" accounting rules benefit a company in the near term, an issue I will discuss later. Enron attempted to transfer the long-term contract trading approach it developed in natural gas to marketing electricity. In natural gas, Enron had already developed innovative long-term contracts, modeled on financial hedge contracts, that allowed customers to purchase "insurance" against future price and quantity risks, a.k.a. "risk management." The cost of this "insurance" was based upon traders' perception of the risk that the future could be different.

Its ability to sell the concept of risk management was limited by the success of the CalPX market. So Enron had to beat the CalPX price, which was published daily. This is the reason why contracts such as those signed with the University of California called for a discount to the CalPX price. In order to profit from such deals, Enron had to be able to purchase electricity at an even greater discount to the CalPX price. This meant finding suppliers willing to sell to Enron power for less than they could receive selling it to the CalPX. Since this was virtually impossible, Enron's California operations as a direct access provider were a big money loser as long as the Power Exchange was in business. That was all the motivation Enron needed to find ways to discredit the CalPX and the market it operated.

Enron's desire to undermine the CalPX meshed with a well-documented pressure from management to show profits on its books. Enron traders found that the way to do both was to extend the "liquidity" of the futures market in California.[15] It took to trading "bundled energy" as far out as 2020, a market so far in the future that many wondered how it was possible to predict the price of electricity that far in advance—especially because the more established natural gas market was liquid only to about five years.

In order to make it work, Enron did two things. One, it leveraged its intellectual capital and marketing expertise to sell itself (and specifically, its traders) as the "experts" on the long-term future price of electricity. This was no small feat, since the future price was uncertain—economist Robert McCullough called such predictions "highly subjective." Two, it booked thousands of trades. The company developed a reputation for buying and selling everything it could, with price justifications based exclusively on Enron's mysterious, omniscient price curves, each used to justify thousands of trades.

We now know the folly of many of these trades, which propped up Enron's gross misstatements of earnings. Enron traders would sell "bundled energy," multi-year agreements for the future delivery of power, booking *uncollected* future revenues as *collected* revenues in the current quarter. This process, called "mark-to-market accounting," has been labeled "an incentive to abuse" by recognized economist Robert McCullough.

In 2000, however, Enron's accounting practices had not yet been exposed. The company may have been losing money on these trades—the traders called it "selling negatives"—but the market only recognized at that time that Enron was a willing and active trader of electricity. If you wanted to buy it or sell it, Enron was there. We know from the Daily Position Reports, which Enron provided our Committee, that as the summer of 2000 approached, Enron's traders had taken increasingly "long" positions in the market, meaning they had a growing amount of electricity to sell.

Diminishing reserve margins expected for 2000 caused some consultants to encourage such long positions. One consultant was unequivocal: "Go long with every dollar you have in the West."[16] As Enron acquired control of more and more energy through trades, it gained a commensurate amount of control of the market. By May

[15] Liquidity in markets means the degree of ease and certainty of value with which a security can be converted into cash. Liquid markets are heavily traded, meaning it is easy to find a buyer or seller for your position. Imagine you have a desire to sell energy tomorrow. There would be many buyers willing to offer you money to buy that energy. Tomorrow is a liquid market. Now imagine you want to find a buyer for energy you want to sell in 30 years. There are fewer interested buyers, if any, making the market for such a transaction illiquid.

[16] ICF Consulting offered this advice in July 1999.

2000, Enron already controlled enough of the market to withhold power until the "last minute," i.e., the spot market.

By offering to sell its electricity only at unacceptable, high prices in the CalPX day-ahead market, Enron effectively forced buyers (primarily the investor-owned utilities) to take a pass on the CalPX market and seek a better deal at a later time. The better deal never came. As real-time approached, Enron's leverage increased, and in real-time, it was CAISO buying power—without regard to price.

We heard testimony from CAISO executives who acknowledged that the directive of the CAISO did not include a consideration of price. The CAISO Board in 2000 disagreed. It repeatedly voted to ratchet down the price cap on electricity in order to mitigate the exercise of market power by Enron and other market participants. The board's final vote on the subject, in October 2000, prompted Ken Lay himself to write to the FERC imploring a reversal of the board's edict. The FERC ruled to overturn the board the following day.

By December 2000, Enron's goals clicked off like a falling row of dominoes. Enron got the tacit buy-in of complicit generators, the counter-parties involved in Enron's money-losing, long-term trades. None of them blanched at the notion of a liquid electricity market because they were getting sweetheart deals; the energy bundled in those deals that was to be delivered in 2000 helped establish Enron's market power, which in turn allowed Enron to force the market out of the now-irrelevant CalPX, which in turn raised the price of electricity, which in turn created volatility, which in turn created the very condition from which Enron said all along it was in the market to protect buyers and sellers.

Enron's culture of aggressiveness permeated the company no matter if there were sound business fundamentals underlying the endeavor or not. Its electricity plan was waiting to be replicated in other markets as well. "The Opportunity," one memo reads, is that "there is a lack of liquidity" in the credit risk market. "Our response: We offer to transact on more companies than anyone else by a significant margin."

Enron took pride in the aggressiveness that helped drive it to bankruptcy. I do not think it is a stretch to argue that this same aggressiveness dictated its behavior in the California market to the detriment of California.

Natural Gas and Enron Online

My Committee has heard repeatedly from generators and other market participants, as well as regulators and market managers such as CAISO, that the price of natural gas was largely responsible for the run-up in electricity prices in Fall and Winter 2000. The crisis reached its nadir, they testified, in early December 2000 when natural gas prices at the California border were running five times higher than prices at Henry Hub. Henry Hub usually provides the country's most accurate baseline for natural gas prices in the spot market.

During the course of our investigation, I have been appalled at the lack of skepticism employed by those regulators and market managers in simply accepting this relationship as gospel truth. Why was the price of natural gas so high? Could expensive natural gas justify expensive electricity so completely? Was there a certainty that generators "passing on" the cost of natural gas into the wholesale price of electricity were *actually* paying the spot market price? Had generators failed to hedge natural gas by entering into long-term contracts for gas?

These questions were answered in December 2000 when the price of electricity and the price of natural gas stopped tracking each other. With price caps lifted by CAISO request and the FERC order, electricity prices continued to rise. Meanwhile, the natural gas market stabilized and ultimately prices returned to historic norms. I ask you to consider whether it is unrealistic to consider the possibility that gas prices were artificially high in order to "justify" a regulatory decision to remove electricity price caps. Evidence suggests this possibility.

First you must understand the regulatory environment Enron negotiated in order to operate as it did in the natural gas market. Enron was the benefactor of a momentous regulatory ruling in its favor by the Commodity Futures Trading Commission (CFTC). I will not delve into the details of the political processes and money trail implicated in these rulings except to say that the cozy relationship between CFTC commissioners and Enron provides, at a minimum, the appearance of impropriety.

The import of the legislation and CFTC ruling must be acknowledged. The first, in 1992, exempted Enron's trading of futures contracts in response to a request for such an action by Enron that same year. The second, an amendment to a Senate banking bill in December 2000, allowed Enron to operate an unregulated power auction—EnronOnline—that gained market share in the natural gas market almost overnight.[17]

Internal documents provided to the Committee by Enron indicate a colossal reversal of traditional market share over the span of just five quarters. In Q4 1999, Enron was responsible for trading roughly 23% of the natural gas and power transactions in North America. One year later, in Q4 2000, EnronOnline claimed to have a 74% market share, easily outpacing the "traditional" market. Competitors independently claim that Enron was involved in somewhere between 50–75% of the trades in the natural gas market.[18]

The reason this is so important is because of Enron's admitted role as a speculator/trader in this market. Imagine if you will if the New York Stock Exchange were a for-profit company that operated the NYSE as an unregulated exchange. Every bid, every ask, every market trend, every individual stock trade, would be viewed by the omniscient company responsible for making the market. If the NYSE was trying to generate revenue, it would be logical to use this information to speculate on market trends.

This is precisely what Enron was allowed to do, and what it used EnronOnline to accomplish. EnronOnline was the de facto exchange and Enron was the market maker. Enron's traders logically used the "inside information" available to them from facilitating these trades to speculate on natural gas futures.

Thus, when El Paso Natural Gas (El Paso) "went long" on gas in 2000, Enron spotted the movement in the market and mirrored the move. Staggering shifts—a veritable sea change—from short to long positions are found in Enron's own books. Enron clearly had the motivation to ensure demand for natural gas, though we do not know the extent to which the company was able to restrict pipeline capacity or delivery. Was Enron merely profiting on speculation or was it aiding and abetting physical withholding?

El Paso is under investigation for this very thing. When natural gas capacity is purchased, the process is regulated. But when unused or unneeded capacity is returned, the capacity can then be sold to unregulated subsidiaries of the same company that can use the capacity as they wish. The subsidiary distinction is a paper distinction only. The subsidiary is housed in the same building, on the same floor and the employees "play on the same softball team," as one witness describes the relationship. The question for investigators is, given the motivation of a long position, did these unregulated subsidiaries have the ability to restrict capacity? And did they do that in Fall 2000?

The natural gas market is a pivotal piece to understanding price manipulation in the California market, and I believe the deregulated gas market is itself in dire need of oversight and investigation into past abuse. Alleged misconduct has been the subject of investigation by the FERC, but no investigation has provided an adequate description of Enron's ability to speculate on gas prices and to buy back unused capacity as an unregulated entity.

Political Sophistication

It is impossible to deny that Enron had a keen grasp of the political and regulatory environments necessary to carry out this plan. As the first state to deregulate, California was the laboratory for Enron's plan to trade energy in a destabilized energy market, a model they wanted to replicate in more states across the country.

An Enron memo from October 1996 indicates the obvious import: "The California market is the largest in the nation and California is the sixth largest country [sic] in the world. If Enron doesn't do well in California, Enron will have a difficult time convincing anyone outside California that they are capable of and committed to providing power services."

To accomplish this, the company had a comprehensive and well-executed strategy to gain political influence when and where it was necessary to: a) create new markets; and b) be left alone in those new markets. A memo from Ken Lay and Jeffrey Skilling in October 1998 codified what was already a standing practice in the company: "Our activism in the political and regulatory process is essential to our continued success. . . ."

Media reports and campaign finance disclosures have revealed the close relationship between President Bush, members of Congress and Enron. The company lobbied successfully at the highest levels for regulatory change that would further its strategy. For example, Enron was responsible more than any other company for the

[17] Public Citizen, "Blind Faith: How Deregulation and Enron's Influence Over Government Looted Billions from Americans," December 2001.

[18] Interviews conducted with an Enron competitor also revealed that Enron was on the opposite sides of many trades.

provisions of the 1992 Energy Policy Act that altered the historic structure of the nation's electricity industry. Enron was also responsible for sweeping deregulation approved by the Commodity Futures Trading Commission (CTFC) that paved the way for Enron to trade electricity futures.

Enron was even part of the very commissions responsible for oversight. For example, Enron was a sitting member of the CAISO board in November 1999, when the board decided to set CAISO's damage control price cap at $750. When the price cap was lowered during a series of votes in Spring and Summer 2000, Enron lobbied to have the cap remain at $750. That a $750 cap provides a much larger window for volatile pricing than the $250 cap ultimately adopted during its board tenure was not wasted on Enron.

Enron executives had unprecedented access to high-ranking public officials at both the federal and state levels. We know from our document review of Enron's government affairs department how much the company relied on political relationships. On the one hand, California's legislative leaders appealed directly to Enron for contributions and on the other received explicit instruction about specific legislation. It remains to be seen how close Enron executives were to the California Legislature, but documents seem to suggest the two were very close.

Enron Uncooperative with State Investigation

My Committee's experience with Enron has been contentious, at best. Enron has engaged in delay tactics, arrogant displays of defiance and unabashed non-compliance. Enron has defied the state's authority to investigate and has continued to stand in the way of lawful investigations of its business, including a probe by the California attorney general.

When our investigation was launched last April, we asked Enron to produce voluntarily several categories of documents. It refused. We then requested that Enron enter into a non-destruct agreement with the Committee to ensure that documents critical to the investigation were preserved. Enron again refused.

This issue has been a prominent problem for my Committee since well before Enron and Arthur Andersen were ever implicated in reports of document destruction. In a typical display of Enron's hubris, the company's counsel represented "as an officer of the court" that my Committee had entered into a non-destruct agreement with Enron. This is patently false. The claim, made before a San Diego judge during a civil proceeding against the company, was intended to deter a court-ordered imposition of a non-destruct agreement.

When the Committee served Enron with a document subpoena in June 2001, Enron told the Committee it still would not hand over documents. Enron sued the Committee, arguing that my committee "had no authority to investigate" Enron and its role in the energy crisis. The company relented only when threatened with a contempt finding and a substantial financial sanction by the California State Senate.

Enron has openly defied the Committee in numerous ways. Enron has failed to produce documents pursuant to our June 2001 subpoena and did not produce a company representative pursuant to a January 2002 deposition subpoena. Nor has Enron explained its role in the destruction of documents by Arthur Andersen or by its own employees as reported in the media.

Even in bankruptcy, Enron has managed to stand in the way of our investigation. Multiple visits to Enron's Houston headquarters resulted in inadequate document production and inappropriate assertions of privilege.

The most troubling behavior, however, has been Enron's deliberate destruction and/or concealment of documents. The Committee has not been provided documents it has compelled since June 2001. Coupled with reports that Enron documents have been destroyed, I believe Enron has committed criminal obstruction of justice.

This belief has been affirmed by our latest review of electronic documents provided to my Committee in the last week. Our technical consultant confirmed this week that emails, schedules, correspondence and other electronic documents have been overwritten in order to destroy evidence we presume is relevant to our investigation. We can only assume the destroyed documents demonstrate at best information unhelpful to Enron's case and at worst, criminal activity. In either case, Enron should be subject to criminal prosecution if this is true.

In light of the many reports of shady accounting practices exposed in the last few months, Enron's conduct over the last year should come as no surprise. From my perspective, however, Enron's recently exposed shady accounting practices come as no surprise in light of Enron's conduct over the last year.

Conclusion

Electricity deregulation has engendered heated debate since the first seeds were sown for an end to utility monopolies in the 1980s. I cannot recommend a complete reversal of the deregulation concept at this time. However, the current model is untenable.

Electricity is a unique commodity. It cannot be stored, demand is inelastic and the barriers to entry are sizable. There has been no worthwhile oversight of the industry by the federal agency charged with policing its bad actors. "This" deregulation, borne of Enron, adopted by regulators and foisted on the public, has proven to be the greatest fraud ever perpetrated on the American consumer. The public interest is not being served. Until there are fundamental changes in the present approach, I believe we are simply biding time for the next Enron to emerge.

Senator DORGAN. Senator Dunn, thank you very much. We will be in touch with you with respect to the records that you have in your possession and appreciate that offer.

Next, let us call on Ms. Loretta Lynch, the President of the California Public Utilities Commission. Ms. Lynch.

STATEMENT OF LORETTA LYNCH, PRESIDENT, CALIFORNIA PUBLIC UTILITIES COMMISSION; ACCOMPANIED BY GARY M. COHEN, GENERAL COUNSEL, CALIFORNIA PUBLIC UTILITIES COMMISSION

Ms. LYNCH. Thank you, Senator. And I would like to thank this Committee for the opportunity to discuss with you how Enron's activities in California have affected the regulatory structure of our markets and the pricing in our markets. I have with me the General Counsel of the Public Utilities Commission, who has been the lead in investigating Enron from the regulatory perspective.

I'd like to comment on the linkage of what Enron's been doing throughout the nation with the linkage of what Enron was doing in California. The economic and financial structures that were put in place in California and also nationally enabled Enron to plunder not only investors and consumers but also ultimately its own employees. Those structures need to be dismantled similarly to the way this Congress dismantled similar structures in the 1920's and 1930's through the passage of the Public Utilities Act of 1935.

Traditional regulation after the passage of the Public Utilities Act of 1935 has depended on three interrelated concepts. One is cost transparency. Two is financial transparency. And three is maintaining an appropriate nexus as the Federal Power Act requires, a just and reasonable linkage between cost and prices.

Enron and its political allies, including, I'm sorry to say, both politicians and regulators in California and at the Federal Energy Regulatory Commission, have systematically dismantled those mechanisms for assuring the three pillars of traditional regulation and for assuring that they work.

I have, as our first slide, a time line of Enron's activities in California before the California Public Utilities Commission and before the legislature. Enron pushed for the creation of a wholesale electricity market in California that would have absolute government or regulatory oversight of its activities in the market. As early as 1994—and I know that the slide is a long way from you—Enron pushed for a bifurcated market between an independent system operator and a power exchange which would enable Enron to gain the California market successfully.

In 1995, Enron objected to any state government market structure—any state government establishment of a market structure, preferring a non-governmental entity which the state could then not control. And throughout that year of 1995 and 1996, Enron objected to the PUC's placing of any consumer protection rules in that wholesale electric market.

Enron was active in shaping the deregulation of the California generation industry, both at our state regulatory commission and at the state legislature. When they were successful, Enron then participated in the creation of a wholesale market with rules that were enabled by the FERC. And those rules enabled both the FERC and the California independent system operator to allow further gaming and gouging by Enron in California.

Enron's methods were consistent in every venue it entered. Both in California, it would try to make the rules and then use those rules to exploit the government and the system for short-term advantage.

After Enron shaped the California market, starting in 1994 and extending through 2000, Enron came nationally, as we all know—as you know well, Enron first lobbied the Congress and FERC to kill rules and to obtain special status for its trading activities. In fact, Enron was before the Commodity Futures Trading Commission and this Congress in December of 2000, at the very time the FERC lifted the price caps in California, at the very same time Enron was reaping maximum profits out of the California market, and at the very same time that the California market was spinning out of control.

Enron continues its activities at the FERC, and it's really quite troubling. As we speak, the FERC staff is attempting to create opportunities for marketers like Enron to set prices and to make markets in contravention of the FERC price mitigation order that makes marketers price takers and not market makers. Further loosening of the rules by FERC makes California's job all the more difficult to contain its market.

FERC, for decades, published a Uniform System of Accounts, which has provided a template for state-level accounting and disclosure proceedings of costs and profits. FERC in every state has required annual reports by regulated entities in which detailed financial disclosures and disclosures of operating statistics, assets, and liabilities and particular categories of expenditures are disclosed to the public and used by state regulators to control the markets.

FERC, over the past few years, at the urging of Enron and others, have diluted those reporting requirements, loosened the accounting rules and exempted large classes of energy sellers from making these required disclosures. FERC does not even require minimal quarterly reports in the natural gas area, which makes it virtually impossible for the State of California to either track Enron's natural gas trades or to link their natural gas trading with their electricity trades and actions. As we know, they are so interrelated. This makes our job much more difficult, because it eliminates cost transparency for large segments of the energy sector.

But related to the issue of cost transparency is financial transparency. We have, on the next slide, Enron's affiliate relationships and how they operated in California. Enron's use of complex corporate structures, affiliates, partnerships, assets, and liabilities transfers among all of these entities have led to a further erosion of not only investor and consumer confidence, but also has given them the ability to manipulate financial disclosures and ultimately the costs and the prices in the California market.

The temporary monopoly positions that Enron's trading suggests appear to have been accomplished, at least in part, through the complex chain of self-dealing among these affiliates of Enron and a few of the other Enron compatriots.

In 1999, Enron created the first and largest electricity energy trading forum called Enron Online, becoming not just a customer in the market, but a market maker in both electricity and natural gas. With Enron Online, Enron became, by far, the largest trader of energy. According to Gas Daily, Enron sold nearly double the amount of natural gas as any other competitor. And Enron Online itself reported over $330 billion worth of electric trades in 2000. Those trades total more than the cost of electricity produced in the United States in total.

How did Enron do this? We have, for your consideration, just an example of Enron's affiliate trading activities just in the fourth quarter of 2000. This quarter is key and critical because this is the quarter when FERC blew out the price caps in California's wholesale markets and when the California market spun out of control. In the fourth quarter of 2000, five Enron affiliates—Enron Energy Services, Inc., Enron Power Marketing, Inc., Enron Energy Marketing Corp., The New Power Co., and Portland General Electric Co.—bought and sold over 11,900,000 megawatt hours of electric power to and from each other in the way that is demonstrated with those circles.

They were purchasing among each other at prices as high as $3,322 a megawatt hour. Just the month before, in October, the price cap in California's market was $250 a megawatt hour. These trades were not only among the affiliated companies. In fact, the same individuals were managing all of these companies. The next slide shows that all of those people who are listed below were, in fact, employees or directors or managers of all four of these Enron-related companies. So the companies had the same employees. They were essentially trading with themselves, but those trades racheted up the price in the California market.

I believe that these trades were actually sham transactions. Enron was selling the same megawatts back and forth to itself, causing the price to rise with each supposed sale, all under the rules they had helped create both in California and nationally. The selling back and forth, though, also is more pernicious. It created the illusion of an active, volatile market, appearing to the rest of the world as though massive trading was occurring on Enron's online trading floor. In fact, Enron has reported that 30 percent of those trades in Q4, 2000, were among Enron's own affiliates. Since Enron used accounting methods that let them book as revenue the value of every trade, not just the profit, they were able to create false value in their company with every affiliate trade.

I believe this was truly a Ponzi scheme. The effect of these trades was to increase the wholesale price of electricity in the California market. These transactions which Enron was engaging in, and with itself and its affiliates, caused wholesale prices to rise both because they directly influenced various price indices and because the prices that were reported on Enron's Internet-based trading site, Enron Online, became the benchmark in the market for wholesale bids into the California Power Exchange and the California ISO.

These purchases and sales were only possible between those affiliates because there was no regulation of this market. There were no rules imposed by the CFTC or the FERC to prohibit this kind of sham transactions between affiliated entities. And, moreover, the California entities had little ability and no appetite to discipline Enron in these markets.

This stopped only on June 19 of last year when the FERC put a stop to it with its historic action that brought order, albeit temporarily, to California's market. The FERC did three things that are critical. It set a must-offer order that required sellers to sell into California to creditworthy buyers, which reduced Enron's ability to game prices by withholding power and reduced other sellers' ability to do that, as well. And it prevented those who were not generating power, like Enron, from setting the price throughout the market, as they had been doing so successfully in the fourth quarter of 2000, preventing those who trade over and over internally from driving the price up above the price cap.

The problem with the FERC market mitigation measures is that they expire. They're temporary. And they expire September 30 of this year. They will expire unless there is a clear signal from this Congress to keep these basic minimal boundaries on California's market. These boundaries should be kept until FERC can assure you and the people in businesses in California that the transgressions of Enron and others will not reoccur in this market.

We know from bitter experience in California that more regulation is needed, and specifically I believe this Congress needs to tell FERC to ensure that market participants cannot be also market makers as Enron did and exploited so successfully in California and throughout the West.

Exemptions for online and electronic trading under the Commodity Futures Modernization Act of 2000 must be curtailed and must be improved so that we can have improved reporting and oversight. I believe all energy traders should be regulated as a utility subject to the control of FERC. Clear, detailed transaction reporting for natural gas and electricity trades must be required and enforced, at least on a quarterly basis, so that we can all know what's going on at the time instead of digging it out a year after the fact. And FERC should also be directed to strengthen its role in providing accountability and disclosure of costs and finances of energy sellers.

Until then, until FERC can assure you that the market is fixed and that sons of Enron cannot perpetuate these kinds of shady and affiliate transactions again, the protective measures that are now keeping a lid on California prices and prices throughout the West must be continued.

At the turn of the 21st century, the nation needs again to strengthen its regulation of energy companies. These companies have morphed into even more complex entities, as you have seen, and they are selling more complicated and risky products both on the wholesale market and to investors. We've seen this before in the 1920's and the 1930's. Congress must keep it simple, keep it clear, and keep regulation and enforcement of utility companies and energy traders strong, unlike the conditions that we still face today in California.

Thank you.

[The prepared statement of Ms. Lynch follows:]

PREPARED STATEMENT OF LORETTA LYNCH, PRESIDENT, CALIFORNIA PUBLIC UTILITIES COMMISSION; ACCOMPANIED BY GARY M. COHEN, GENERAL COUNSEL, CALIFORNIA PUBLIC UTILITIES COMMISSION

Thank you for the opportunity to testify about the effect Enron had on the California electricity and natural gas markets. Enron has become emblematic of a pervasive regulatory failure in the energy markets in the United States. In a sense it has supplanted California on the front page but, as we all understand, the failure that was the California energy market and the failure that is Enron are intimately linked. I would like to comment on the linkage from the standpoint of a state regulator and to warn the members of this panel that the forces that caused the Enron debacle are still at work and must be effectively curbed at the state and federal level if we are not to see many more failures.

It is crucial that we not view Enron as an outlier or outlaw in an otherwise working market. The economic and financial structures that enabled Enron to plunder investors and consumers and ultimately its own employees need to be dismantled, much as similar structures were dismantled by the Public Utilities Act of 1935, which included both the Federal Power Act (FPA) and the Public Utilities Holding Company Act (PUHCA). This landmark statute preserved to the greatest extent possible local authority to regulate local service. It has served us well for over sixty years, until very recently.

The utility scandals of the 1920's and early 1930's involving watered stock, out-of-control prices, shady accounting and financial and consumer abuse are being reprised today. It is time to say, "Enough is enough." The army of lobbyists for "PUHCA reform," laissez faire electricity pricing, grid federalization and the like are essentially asking you to unleash a horde of Enrons on the consumers of America. I respectfully suggest that we learn from history and the gaming and gouging that took place in the teens and twenties when I say, "Don't go there."

Consumers expect that utility service and costs will be stable and reasonable. Federal law requires that wholesale electricity prices be just and reasonable. Enron and its emulators want instability and high prices. The California experience suggests that the Enron approach is bad economics and bad policy.

Traditional regulation as practiced since the New Deal has depended on three interrelated concepts:

- Cost transparency
- Financial transparency, and
- Maintaining an appropriate nexus (a just and reasonable linkage) between cost and prices.

That system served consumers and legitimate long-term investors well. The only people it did not serve well were the energy speculators, like Insull and the cartels of the 1920s and Enron and its ilk at the turn of this century, seeking a fast buck. They have worked hard to undermine it.

Enron and its political allies, including, I'm sorry to say, politicians and regulators in California and at the Federal Energy Regulatory Commission, systematically dismantled the mechanisms for assuring these three pillars of traditional regulation. Enron pushed for the creation of a wholesale electricity market in California that would have no government or regulatory oversight of its activities in that market. Enron was active in shaping the deregulation of the California electric generation industry, both at the state Commission and at the State Legislature. Not surprisingly, with a legion of lobbyists at the Commission and before the Legislature and a business plan bent on taking advantage of deregulation and a bifurcated market, Enron got what it asked for in California. Enron then participated in the creation of wholesale market rules used by FERC and the California Independent System Operator further enabling their trading and gaming activities.

Enron itself has been active through a phalanx of organizations, and has facilitated activity by others. In California, Enron Corporation participated in numerous business ventures through its affiliates Enron Energy Services, Zond Wind Power, Enron Trade and Capital, Enron Oil and Gas, Portland General Electric, Transwestern Pipeline, The New Energy Company, and many more. Enron helped shape the policies of industry trade groups such as the Independent Energy Producers and Western Power Trading Forum and others. In addition, it spawned front groups such as the Alliance for Retail Markets (ARM) that purported to be coalitions of organizations but received the bulk of its funding from Enron. ARM and the Enron affiliates would both appear before the CPUC on electric restructuring matters, frequently represented by former high level PUC employees.

Enron was represented on the original board of the California Independent System Operator (ISO) directly and indirectly where it actively opposed price caps and other market power mitigation initiatives and—in an infamous episode—demonstrated the efficacy of "phantom congestion" in raising prices and then sought to prevent an antidote. After Enron demonstrated the tactic, others used it to manipulate prices "according to the rules."

The incremental creation and exploitation of loopholes and "opportunities" has been effective at least in part because FERC has been so slow to act to counteract them, once discovered. For example, it has long been known that a significant weakness in the ISO tariff is the practice of paying twice for an electric generation unit—once when it ramps up and again when it ramps down—that is inappropriately scheduled. The ISO has been attempting for nearly a year to change this feature of the tariff, only to be rebuffed by the FERC, who says simply that such a change is "premature." Meanwhile, Enron and others are exploiting this weakness for big dollars.

Enron actively sought business alliances with and takeovers of public and municipal entities. For example, it "partnered" with the City of Palm Springs to create direct access and "muni-lite" relationships with residential customers, only to leave the City program in the lurch when its attention wandered elsewhere. After Enron dumped its program without any appreciable downside to itself, others followed suit—as we learned to our dismay last Spring when the California DWR had numerous "direct access" customers dumped back on it when FERC-deregulated wholesale prices were at their highest. California went from 16% of its overall electric load served by non-utility providers in October 2000—the lion's share of which was Enron-provided—to 2% of all customers served by non-utility sources in June of 2001. Enron creamed off lucrative customers when prices were low then dumped those customers back on the utilities when natural gas and electricity prices rose so that it could sell its gas and electricity for the highest price—perhaps even back to the very same utility that was serving Enron's dumped customers!

Enron's methods were consistent in every venue it entered—it would try to make the rules—rules that it would then exploit for short-term advantage. After Enron shaped the California market to take maximum advantage of nonexistent government regulation and lax ISO rules, Enron turned its sights nationally. As we now know, Enron lobbied Congress to kill rules proposed by the Commodities Futures Trading Commission which would have provided at least some federal oversight of Enron's trading activities. Enron also obtained special status for its trading activities in December 2000—at the same time it was reaping maximum profits in the California markets.

Enron continued its strategic manipulation of public processes to create business opportunities through the dismantling or modification of accepted approaches: you are seeing this approach in action today at the FERC, where as we speak, the FERC staff is attempting to create opportunities for marketers to set prices and make markets in contravention of the FERC price mitigation order that makes marketers price takers. The incentives and rewards for such behavior are being described by others. I want to make you aware of its pervasiveness.

Every state has a regulatory body whose charter includes specifying the accounting procedures for utilities operating in its state. FERC for decades published a Uniform System of Accounts which has provided the template for state level accounting and disclosure procedures. FERC and every state have required annual reports by regulated entities in which detailed financial disclosures and disclosures of operating statistics, assets and liabilities and particularly categories of expenditures are disclosed to the public. **FERC has over the past few years at the urging of Enron and others diluted the reporting requirements, loosened the accounting rules and exempted large classes of energy sellers from making required disclosures.** FERC does not even require the same data to be filed in its quarterly reports, allowing companies like Enron to hide the true nature and extent of activities through skeletal public reporting and not be called to account by FERC. FERC does not require even these minimal quarterly reports in the natural gas area, making it virtually impossible either to track Enron's natural gas trades and activities or to link gas trading with electricity trades and actions. This makes the state regulator's job much more difficult, because it virtually eliminates cost transparency for large segments of the energy supply sector.

In the case of Enron and many other energy supply companies the lack of cost transparency, prescriptive accounting rules and regular or detailed public reporting has undermined investor confidence in both traditional regulated utilities and in new cadre of speculator energy companies. Congress should require that the FERC ensure the primacy of promulgating and enforcing appropriate reporting and accounting procedures.

Related to the issue of cost transparency is financial transparency. Enron's use of complex corporate structures, affiliates, partnerships, asset and liabilities transfers among these entities has led to a further erosion of investor and consumer confidence and an ability to manipulate financial disclosures and, ultimately, cost and prices. The temporary monopoly positions that Enron's trading statistics suggest appear to have been accomplished at least in part through complex chains of self-dealing among affiliates of Enron and a few of Enron's compatriots.

In 1999, Enron created the first and largest electronic energy trading forum called Enron On-Line, becoming not just a customer in the market but a market maker—in both electricity and natural gas. With Enron On-Line Enron became by far the largest trader of energy—both electricity and natural gas. According to Gas Daily, Enron sold nearly double the amount of natural gas of any competitor. Enron On-Line reported over $330 billion dollars worth of trades in 2000. That is more than the cost of all electricity produced in the United States.

How did Enron do this and what effect did it have on California? As an example, I will discuss just one period of time—the fourth quarter of 2000, as California's wholesale energy market spiraled out of control with the lifting of the wholesale price cap by FERC, at the instigation of Ken Lay, Jeff Skilling and the former conflicted California ISO board. What we find is that Enron's trading with its own affiliates was the major way that Enron did business and constituted a major factor contributing to the California energy crisis. In the fourth quarter of 2000, five Enron affiliates—Enron Energy Services, Inc., Enron Power Marketing, Inc., Enron Energy Marketing Corp., The New Power Co., and Portland General Electric Co.—bought and sold 10,167,782 MWh of electric power to and from each other, at prices as high as $1,100 MWh. These trades were not only among affiliated companies; the same individuals were managing all of these companies. These "trades" were actually sham transactions—Enron was selling the same MWs back and forth to itself, causing the price to rise with each "sale"—all under the rules that it had helped to create. The selling back and forth also created the illusion of an active, volatile market, appearing to the rest of the world as though massive trading occurring on Enron's online trading floor. By creating the excitement of a busy market place, they could entice other traders to come into their market (online). (What we would really like to know is how many of the trades Enron reported were actually *real* trades with parties other than their affiliates.) Since Enron used accounting methods that let them book as revenue the value of every trade (not just the "profit"), they were able to create false value in their company with every affiliate trade. This was truly a Ponzi scheme.

The effect of these trades was to increase the wholesale price of electricity in the California market. These transactions, which Enron was engaging in with itself, caused wholesale prices to rise both because they directly influenced various price indices and because the prices reported on Enron's Internet-based trading site, EnronOnline, became the benchmark for wholesale bids into the PX and ISO.

These purchases and sales between affiliates were only possible because there was no regulation of this market; there were no rules imposed by the CFTC or the FERC to prohibit sham transactions between affiliated entities. Moreover, the CA ISO and PX had little ability and no appetite to discipline Enron in the market.

In addition to trading among themselves, a number of these affiliates were scheduling coordinators (SCs) with the ISO. SCs serve as the link between retail buyers, generators and the ISO. SCs have access to electricity market information from many sources not generally available to average investors and are in a position to manipulate the market. For example, SCs can game the market by scheduling non-firm power to cover their needs, forcing the ISO to buy reserve power in the spot market to back the SC. As a market maker Enron also had the ability to influence the bids and costs of other Coordinators as well.

The consequences of this and similar activities by Enron's imitators—the sons of Enron—were devastating. The huge volumes of internal trades created volatility in the market from which Enron profited. Enron could create transmission congestion through meaningless trades with itself, and then get paid to eliminate that congestion or re-route electricity within California. Enron's internal trading could affect accepted market indices, thereby increasing the prices paid to generators and suppliers that are tied to those indices.

Enron could also use the rules and their internal trading to commit power that was made in California out of the state, thereby artificially creating the appearance of shortages of electricity generated in California that could only be remedied through "imports." This is a practice known as "megawatt laundering," and is a pervasive feature of the west-wide electricity market. It is the reason that mitigation measures must be West-wide. Experts have estimated that exports quadrupled from California from 1999 to 2000. Enron's moving of California-generated power out of state—through internal and other trades—raised prices and contributed to blackouts that were in fact unnecessary. At the times of the blackouts that California experienced, there was never any physical, real world shortage of generation capacity in California.

While Enron's failed ventures and accounting practices may have brought them to financial ruin, its energy trading enterprise was exorbitantly profitable—accounting for over 90% of Enron's overall revenues in 2000. The gravy train did not stop nor did the underlying systemic problems become apparent until the FERC put a stop to it on June 19, 2001, with its historic action that brought order, temporarily, to California's market. FERC imposed price caps that conservatively estimated costs of generating electricity in California, setting the effective price first at $92/mwh and modified it upward slightly. It set a "must-offer" order that required sellers to sell to creditworthy California buyers, reducing the ability to game prices by withholding power, although ISO management actions have reduced the effectiveness of this requirement. And it prevented those who were not generating power from setting the price throughout the market, preventing those like Enron who traded the same power over and over internally or with others solely to drive the price up by the time it was sold to the utilities, to the ISO or to the state. FERC intends to terminate these key and critical protections on September 30 unless there is a clear signal from this Congress to keep these basic, minimal boundaries on California's market until FERC can assure you and the people and businesses of California that the transgressions of Enron and others will not re-occur.

We know from bitter experience in California that more regulation is needed. Specifically, to fix this market Congress needs to ensure that:

- Market participants should not also be market makers.
- Exemptions for online and electronic trading under the Commodity Futures Modernization Act of 2000 must be curtailed to improve reporting and oversight.
- All energy traders should be regulated as a utility subject to control by FERC.
- Clear, detailed transaction reporting for natural gas and electricity trades must be required and enforced on at least a quarterly basis.
- Statutory affiliate rules are necessary to limit the proliferation of related trading entities that skew and game the market, gouging consumers—or outlaw these trades and interrelationships outright.
- FERC should be directed to strengthen its role in providing accountability and disclosure of costs and finances of energy sellers.
- FERC must update its systems and its ability to keep up with the games. For example, the FERC database needs to be updated, streamlined and made truly accessible to regulators and the general public.

As I conclude these remarks I am mindful that my role as a regulator doesn't end in the energy arena. Congress also has a real opportunity now to help insulate telecommunications consumers from these same types of accounting and reporting schemes executed so effectively by Enron and other energy companies. With cross-country mergers, bankruptcies, high technology affiliates and other changes rampant in the telecommunications industry, Congress and the Federal Communications Commission must ensure that the FCC strengthens uniform national reporting requirements for telecommunication companies and their affiliates about costs, profits, revenues and service quality. Instead, the FCC is leaning away from requiring such national reporting just at a time when we need more information to monitor our information infrastructure. This data is critical to the states' ability to meaningfully protect telecommunications consumers, from basic service to broadband, from the kinds of manipulation I've discussed today.

At the turn of the twenty first century, the nation needs again to strengthen its regulation of energy companies—which have morphed into even more complex entities—selling more complicated and risky products than what the nation experienced in the 1920s and 30s. Congress must keep it simple, keep it clear and keep regulation and enforcement strong—unlike the conditions California and the nation face today.

Senator DORGAN. Ms. Lynch, thank you very much. Next, we will hear from——

Senator BURNS. Begging the indulgence of the Chair, Ms. Lynch, do you have—I didn't notice in your testimony that you had copies of these slides that you presented there. We can't see them over here.

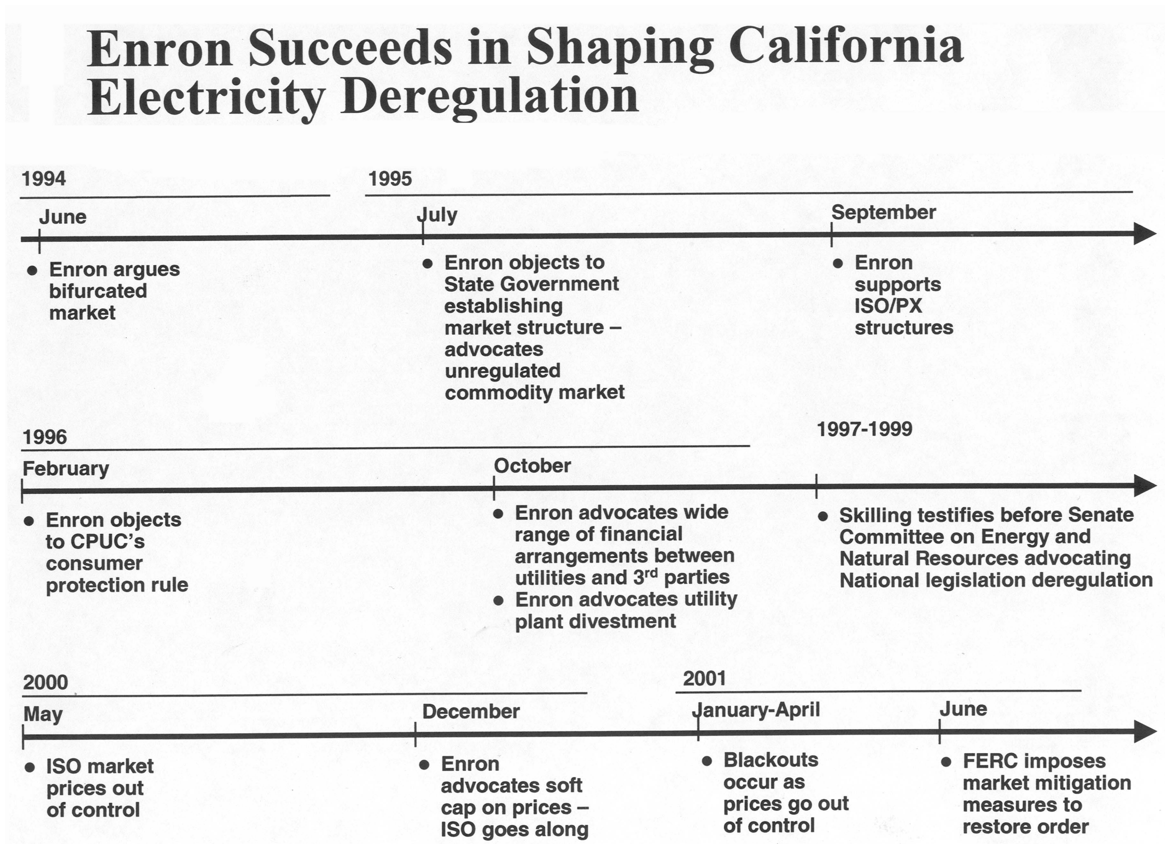
Ms. LYNCH. Oh, sure, we can get you those.

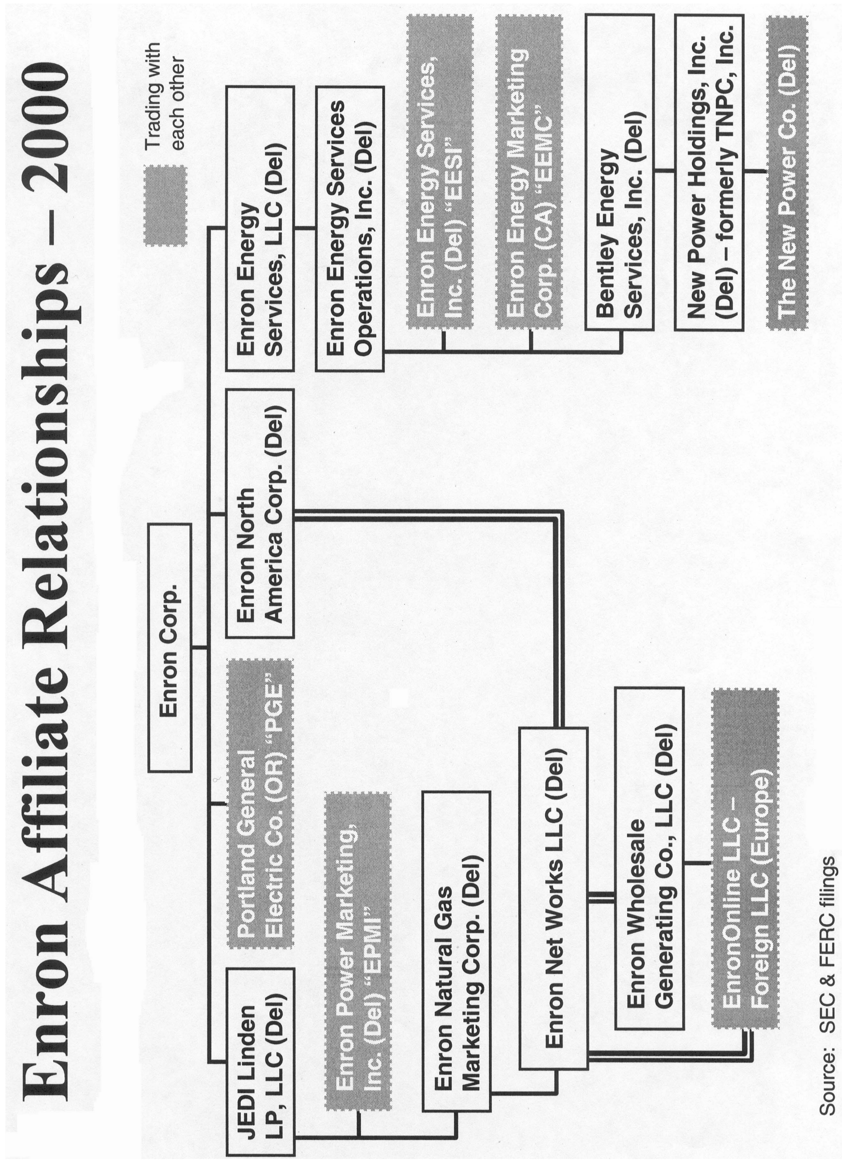
Senator BURNS. And those slides, I think it would be very, very helpful to us who keep this testimony and help us understand what—this whole thing. So I thank the Chair.

Senator DORGAN. That's a good suggestion. You will make those available, Ms. Lynch?

Ms. LYNCH. Sure.

[The information referred to follows:]


Enron Succeeds in Shaping California Electricity Deregulation
1994
June
• Enron argues bifurcated market
1995
July
• Enron objects to State Government establishing market structure – advocates unregulated commodity market
September
• Enron supports ISO/PX structures
1996
February
• Enron objects to CPUC's consumer protection rule
October
• Enron advocates wide range of financial arrangements between utilities and 3rd parties
• Enron advocates utility plant divestment
1997-1999
• Skilling testifies before Senate Committee on Energy and Natural Resources advocating National legislation deregulation
2000
May
• ISO market prices out of control
December
• Enron advocates soft cap on prices – ISO goes along
2001
January-April
• Blackouts occur as prices go out of control
June
• FERC imposes market mitigation measures to restore order



Enron Affiliate Relationships – 2000
Trading with each other
Enron Corp.
JEDI Linden LP, LLC (Del)
Portland General Electric Co. (OR) "PGE"
Enron North America Corp. (Del)
Enron Energy Services, LLC (Del)
Enron Energy Services Operations, Inc. (Del)
Enron Power Marketing, Inc. (Del) "EPMI"
Enron Natural Gas Marketing Corp. (Del)
Enron Net Works LLC (Del)
Enron Wholesale Generating Co., LLC (Del)
EnronOnline LLC – Foreign LLC (Europe)
Enron Energy Services, Inc. (Del) "EESI"
Enron Energy Marketing Corp. (CA) "EEMC"
Bentley Energy Services, Inc. (Del)
New Power Holdings, Inc. (Del) – formerly TNPC, Inc.
The New Power Co. (Del)
Source: SEC & FERC filings

The Same People Ran Each Of Enron's Affiliates, Holding The Same Position At Each Company

Enron Energy Services Operations, Inc. = Enron Energy Services, Inc. = Enron Energy Marketing Corp. = Enron Energy Services North America, Inc.

Chairman & CEO
- Lou L. Pai

Director
- Lou L. Pai
- Thomas E. White
- Victoria T. Sharp

Vice Chairman
- Thomas E. White

General Counsel and Secretary
- Victoria T. Sharp

Managing Director
- Victoria T. Sharp
- Jeremy M. Blachman
- Harold G. Buchanan
- W. Craig Childers
- Robert J. Hermann
- Daniel P. Leff
- Mark S. Muller
- Martin D. Sunde
- Elizabeth A. Tilney

General Tax Counsel
- Robert J. Hermann

Vice President
- 40 VP's

VP Finance and Treasurer
- Ben F. Glisan, Jr.

Senior Vice President
- Mike Harris

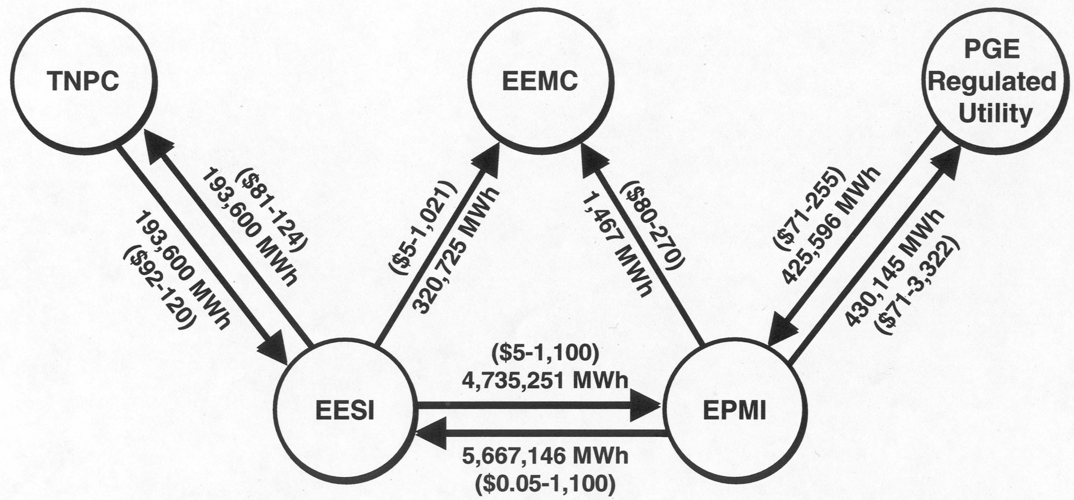
Assistant Secretary
- Kate B. Cole
- Teresa A. Callahan

Deputy Corporate Secretary
- Elaine V. Overturf

Source: FERC

4Q 2000 Enron Affiliate Trades

Total Internal Trades: 11,967,470 MWh
Price Range: $.05 to $3,322 $/MWh



TNPC – The New Power Company
EESI – Enron Energy Services, Inc.
EEMC – Enron Energy Marketing Corp.
EPMI – Enron Power Marketing Inc.
PGE – Portland General Electric

Source: Enron's FERC quarterly reports

4Q 2000 Enron Trades With Others

Entity Trading with Enron	MWh	Highest price Dollars
• APX	977,300	194.70
• Edison Mission Marketing & Trading, Inc.	5,604,973	801.55
• Morgan Stanley Capital Group, Inc.	4,474,339	2,000.00
• PG&E Energy Trading	452,950	42.05
• PGET-Power	10,744,380	330.00

Senator DORGAN. Next we will hear from Mr. S. David Freeman, Chairman of the California Power Authority. Mr. Freeman, you may proceed.

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

Mr. FREEMAN. Thank you, Mr. Chairman. It's a special pleasure for me to be here. I was a staffer to this Committee back in the 1970's when Chairman Hollings was really the junior Senator from South Carolina.

[Laughter.]

Mr. FREEMAN. I have been in this business a long time. I've worked the old Federal Power Commission and run utilities and I've been with the Governor of California for the last year through this crisis and was involved in the creation of the ISO and the Power Exchange that started us down deregulation road.

If I could offer this observation, in terms of the California situation, I don't believe the real story is about whether Enron broke the law or not. The real story is about the influence they had on the lack of law enforcement by FERC, the influence they had on the detailed rules for deregulation, both in California and in Washington, and most importantly their invisible role in the ripoff of California consumers.

Enron was by far—and I was there and saw it—the leading advocate for the most extreme deregulation at every step of the road, and they were the most active participant in that volatile market they helped create and profited from. It's time that we faced up to a harsh fact. The invisible hand of Adam Smith was Enron, and their fellow gougers having their hands in the hip pocket of the consumers of California to the tune of billions of dollars. And we're now beginning to connect the dots.

While the prices were skyrocketing in California in late 2000 and early 2001, as a direct result of Enron's influence and participation, at the same time, Enron was here in Washington, granted special attention, special privileges to advise a new administration to oppose the price controls that California and the delegation was literally begging for to protect consumers from the enormous profits that they and others were making. And it's not that we were asking for something special. We were simply requesting that the Federal Energy Regulatory Commission do its job.

The Federal Power Act was not abolished. There's a Texan named Sam Rayburn that got that law passed back in 1935. I worked to enforce the law back in the 1960's. Just and reasonable rates have been the law of the land, and they didn't just all of a sudden disappear, be repealed. They weren't. It was a lobbying effort led by Enron that persuaded FERC to just take the cop off the beat at the time we needed them worst of all. And it wasn't until the California delegation and the Governor of California and people from all over the West brought this to the attention of the American people, the Congress generally, and the new Administration that they helped us. I want to give them credit. They did name Chairman Pat Wood and Norma Brownell and came in and finally, in June, put in some measure of relief.

I must say, though, that the Federal Power Act does not end on September 30 of this year. They put some temporary controls in place that expire. Very interesting that they expire just before October of an election year. I am very concerned that we go back to a situation where folks that have no responsibility to keep the lights on, no responsibility to sell electricity, are able to artificially create shortages and problems for us.

And so our main plea here today, if there's no other point that I make to this Committee, that this Committee unanimously inform the Federal Energy Regulatory Commission that their mandate does not end on September 30. The law is on the books. It says that the rates "shall"—not "may," but "shall"—be just and reasonable.

I say to FERC don't become summer soldiers and quit on us just when we need your help the most, because we do not have a functional market in California that's competitive. Everyone knows that. FERC has said so. And until they can make a finding on a record and show that there's real competition that will protect the consumer, they have an obligation to continue what they put in place so well last June and continue it until they can make a finding that it's not needed.

I think the thrust of my written testimony is that what we have here before us is an example that a wealthy, famous company can just be dead wrong. And it's important, those of you who have the responsibility and are lobbied intensively by people, that just because someone with a lot of money and a good reputation comes to you, you have to examine their arguments just as thoroughly as anyone else's.

And this deregulation scheme that was concocted and put into effect just has been the most terrible economic disaster, in terms of electric power, in the history of the industry. And it's pretty clear, I think, to everyone in California at least, that electricity is different from anything else. We can't do without it, and everyone knows that, for even a nanosecond.—Reliability, smooth power, in the computer age is more essential than ever.

We cannot let private companies who have an interest in creating artificial or even real shortages be in control. The Congress needs to reexamine the Federal Power Act and look at the 21st century and set down some rules. Enron stands for secrecy and lack of responsibility. But in electric power, Mr. Chairman, we've got to have openness and we've got to have companies that are responsible for keeping the lights on.

Thank you.

[The prepared statement of Mr. Freeman follows:]

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

I appreciate the opportunity to appear before this Committee. I thank you for devoting your time to this issue, which, I believe, is fundamental to the future of the electric power industry as far as consumer protection is concerned.

On a personal note, I am especially pleased to be here since I served as a staff member to this Committee in 1974–76 when Chairman Hollings was really the junior Senator from South Carolina. My testimony reflects my personal views only. It is based on 40 years of experience with the electric power industry as a regulator, an official in federal and state government, and as the manager of large public utilities.

In my view the real story about Enron is not whether or not they broke the law, but about the influence they had on the lack of law enforcement by the FERC, on the rules for deregulation in California and Washington D.C. and, most importantly, their invisible role in the rip off of California consumers. Enron was by far the leading advocate for the most extreme deregulation of the electric power industry in California and they were the most active participant in the volatile market that resulted.

The fact that Enron's activities in California may have been legal is a most troublesome and lasting concern. It is all the more frightening because their profit-making role was largely secret.

We must recognize that the so-called invisible hand of Adam Smith was Enron and their fellow gougers picking the pockets of Californians to the tune of billions of dollars. And now we are beginning to connect the dots. Prices were sky rocketing in California in late 2000 and early 2001 as a direct result of Enron's influence and participation. At the same time Enron was granted special attention to advise a new administration in Washington to oppose the price controls sorely needed to protect consumers from the enormous profits they and others were making.

All this happened despite the fact that the Federal Power Act requires that the FERC assure just and reasonable rates. Even the FERC admitted the market was not functioning properly. Enron may not have broken the law but they encouraged the new Administration to fail to enforce the law which in my view was just as bad.

It was only after Governor Davis and the California delegation repeatedly called attention to the fact that the FERC was on a sit down strike that the President appointed new Commissioners who helped Governor Davis bring that market under a measure of control. But that happened only after Californians had been overcharged at least $9 billion.

Some may suggest that I am singling out Enron and "piling on" just because they are in trouble for other reasons. That is not true. It is important that Congress understand that a rich and famous company can succeed in achieving terrible results for consumers. This Congress and the several states have before them serious questions inherent in the deregulation of electricity. Is the removal of controls on the price of electric power at wholesale a good idea? Does it make sense to remove the legal obligation of a utility to build or buy enough power to provide reliable electricity?

The words competition and deregulation are seductive. They sound great but the reality we found in California was quite different. A public utility industry whose books are open to public inspection, who are legally responsible for providing reasonably priced electricity, and who did just that for decades, were replaced by companies that operated in secrecy, are accountable to no one (apparently not even their shareholders or employees), could sell or withhold power as they pleased and had no obligation to build new plants.

Let us be clear about what is at stake. Having been intimately involved in what California experienced in recent years, I feel the need to convey to you the enormity of this issue. If we don't recognize why it all happened then history will surely repeat itself.

Electricity is unlike anything else in our economy. It is truly the lifeblood. Ordinary consumers and businesses alike cannot do without it for even an instant. It can't be stored by customers. Reliable, smooth electricity at a reasonable, predictable price is an absolute necessity.

We found out in California, the hard way, that even the tiniest of shortages literally stops the economy. And without price controls, the prices shoot up to obscene levels. No one has yet suggested that in a drought we allocate water to the highest bidder (Enron did try moving into the water business) but that is exactly the scheme created in California by religious believers in the market combined with Enron's influence and persistence.

Proponents continue to talk of the potential benefits of deregulation. In California we learned who got the benefits—it was the power marketers. As for the consumers, in 1996 when deregulation was launched, the consumers were promised a 20% rate reduction by April, 2002. Instead the consumers are paying rates that are *40% higher!*

Even proponents of deregulation such as the Hoover Institution Fellow and Noble Laureate Gary S. Becker concede that Enron encouraged "further and faster deregulation of electricity markets at State and Federal hands especially when it would help its own power trading companies". Mr. Becker also concedes that the collapse of Enron and California's bad experience "are further evidence deregulation has many pitfalls".

It is true that Enron did not invent deregulation. Indeed because deregulation had been carried out with airlines and telecommunication companies it had considerable momentum. But we must not forget that electricity is different from other products and services. We can't do without it and it can't be stored.

It is important to take note that at every step of the rulemaking for deregulation in California from 1996 until today Enron, more than anyone else, used their enormous resources to urge the most extreme positions that resulted in maximum secrecy and lack of accountability. And Enron was a major participant taking advantage of the volatility in prices during the "Perfect Electrical Storm of 2001" while simultaneously waging an intensive, successful campaign that in six crucial months stopped a new Administration in Washington from doing its job of controlling prices.

Let me be specific about Enron's role:

Secrecy

California created a power exchange (PX) where power could be sold and bought openly with the public knowing the price. Enron stubbornly opposed the PX, claiming power contracts should all be secret. In the middle of the crisis in January of 2001, the PX closed down and then Enron had its way.

Transmission Rights

Enron wanted only companies that owned physical rights on transmission lines to be able to reserve capacity on the lines in advance. This would allow those with deep pockets, such as Enron once had, to monopolize the transmission of electricity. They were partially successful in California. That crucial issue remains a legacy of Enron as the FERC and the DOE continue to encourage market participants in generation to own and possibly gain control of transmission. Remember "gridlock" on the electrical highway means it becomes a heavy toll road for those who don't own it but must use it.

Price caps

The battle over price caps is perhaps the most glaring example of Enron's role in shaping the rules of deregulation in their favor. The basic idea of deregulation is that if competition is working, you don't need price caps. In California in 2000 and beyond even the FERC has admitted that the wholesale electric power market was dysfunctional. Yet Enron was the poster child for opposing price caps.

The California ISO imposed price caps in 1999 and as the head of the city of Los Angeles power system, I supported the price caps and indeed supported lowering the caps. Those caps were effectively abolished by the FERC and prices skyrocketed beginning in 2000.

I have personal experience with the persistent nature of Enron's lobbying efforts and attitudes. After a long phone argument with Ken Lay on the subject of price caps during which I rejected his arguments, he said to me at the end, not harshly but gleefully, that no matter what we "crazy people in California did that Enron had people working for him that could figure out a way to make money." And they did.

All through the fall of 2000 and the first six months of 2001 as prices at wholesale were at their gouging worst, Enron was the loudest and most persistent voice opposing price caps. They were vocal and persistent at the California ISO, at the FERC, with California public officials, the Clinton Administration, the Congress, and the Bush Administration. It was "all Enron all the time" against price caps.

Because Enron as a trader could hide behind a curtain of secrecy no one knew the full extent of how much they profited, and we may never know. But it is now clear that as the largest trader they were profiting big time.

It is beyond dispute that Enron lobbied hard for a system that permitted them to be a huge player in California with no physical assets in the state, just the equivalent of an electronic phone book. Enron then succeeded in keeping the federal cop (FERC) off the beat while the gougers were taking our money. Analysts[1] have estimated that Enron was a party to 40% of the transactions in the California market during the height of the crisis when the big money was made. No one will ever know for sure because they had no obligation to tell.

It is worth pointing out that the decline in Enron's fortunes coincides rather closely with California's programs that Governor Davis and the Legislature put in place that brought prices under control. I refer to the construction of new power plants, massive conservation, long-term contracts and in June 2001 getting some controls when President Bush appointed Chairman Pat Wood and Nora Brownell to be FERC commissioners. Obviously Enron had many other problems, but it is beyond dispute that as a trader (with no power of its own to sell) Enron made money buy-

[1] Robert McCullough—Testimony before the House Subcommittee on Energy and Air Quality, February 13th, 2002.

ing and selling when market prices were high, and as prices settled down so did their profits.

The open question then is whether the policies that Enron successfully engineered will be continued. That question is very real for California.

After belatedly recognizing last June that keeping a just and reasonable lid on prices was their statutory duty, those controls finally established in June 2001, are set to expire on September 30 of this year. The FERC has not found and cannot find that the wholesale market in California is competitive enough to produce just and reasonable rates. The reason is simple. The market is not competitive.

Despite California's progress, we haven't yet achieved enough of a surplus. California is still vulnerable. The serious test is whether the new Commissioners, who helped California last year, will recognize that the Federal Power Act doesn't expire on September 30 and they are duty-bound to keep the controls in place. The FERC must extend their controls until such time as they can conclude that a competitive market exists that produces just and reasonable rates. Otherwise the situation that Enron so blatantly promoted will linger on.

In California we are continuing a strong conservation effort, we are encouraging private investment in new power plants which are being added, and we are promoting renewable energy projects as well. And we have created a California Power Authority that can step in if private companies fail to keep up with future demand.

There are some fundamental lessons to be learned from this experience:

- Electricity really is different and the system of public utilities with a duty to keep the lights on at just and reasonable rates set by regulators served this country rather well during most of the 20th century.
- Competition thrives in a surplus. But the private generators thrive in a shortage.
- It would be a mistake to assume that Enron was unique and its demise means that deregulation is "cleansed" and there are no remaining concerns.

The Congress should recognize that consumers of all sizes cannot be well served by blind faith in the market. Any market for electric power generation must be combined with sufficient governmental participation to assure that the lifeblood of our society doesn't operate in ups and downs. Such volatility and shortages may be acceptable for oranges or stocks but society simply can't tolerate it for electricity.

I thank you for this opportunity to testify before a committee that brings back fond memories to me. I will be glad to try to answer any questions.

Senator DORGAN. Mr. Freeman, thank you very much. Next, we will hear from Ms. Wenonah Hauter, the Director of Critical Mass Energy & Environment Program from Public Citizen.

STATEMENT OF WENONAH HAUTER, DIRECTOR, CRITICAL MASS ENERGY & ENVIRONMENT PROGRAM, PUBLIC CITIZEN

Ms. HAUTER. Thank you, Mr. Chairman and Committee members, for having me testify today.

Public Citizen has worked on electricity issues since the mid 1970's, and I've watched Enron since the early 1990's when I first read about it in the trade press when the debate up to the Energy Policy Act of 1992 was occurring. And Enron, of course, had been formed from two natural gas companies. Under Ken Lay's leadership, it acquired too many assets and was nearing bankruptcy and hired Jeffrey Skilling, who came up with the great idea of a gas bank and energy commodity trading.

And so I think that from observing Enron for many years, that we've been very concerned that the company didn't use the tried and true business strategy of incorporating innovations and improving the delivery of a product at a competitive price. And, instead, they increased their profits over the last decade by 1,750 percent, by basically speculating and treating the market as if they were a drunken gambler in a giant casino.

And central to this strategy was removing the government oversight that the previous speakers have talked about, but I think that it's worth going through some of the history of how they did that, because Enron was the most aggressive promoter of electric utility deregulation from the passage of the 1992 Energy Policy Act, when they lobbied for transmission—wheeling provisions, and after that time, when they were very active in all of the meetings and the debate that happened in electricity circles, like at the National Association of Regulatory Utility Commissioners where they basically advocated this really reckless scheme for deregulating electricity markets under the guise of competition.

We all know competition is good, but the scheme that they were promoting isn't competition. It's basically rigging the market. And we were very concerned when, in 1996, A.B. 1890 passed in California. In fact, I put out a press release that day, because we had watched Enron's tactics in lobbying for that legislation and were aware that they were basically not telling the truth about electricity markets.

So after the 1992 Energy Policy Act was passed, they were very influential with the Commodity Futures Trading Commission that was chaired by Dr. Wendy Gramm. And just a few days before she left office, she pushed through the Commission an exemption for Enron's trading of future contracts that really began to help revolutionize the way energy could be traded.

Then, in 1994, Enron became the first power marketer to become exempted by the Securities and Exchange Commission from the Public Utility Holding Company Act. And they continued to push at the federal level for deregulation and at the state level. Many states where we were present—in fact, I testified in Pennsylvania—there would be an Enron lobbyist. They would send somebody from Houston, and then they'd hire a local law firm to go in and to advocate for the most type of radical deregulation.

Then Enron continued to push to escape government oversight for its speculative activities by successfully using their relationship with Senator Phil Gramm to muscle a bill through Congress that deregulated energy derivatives. Then they were in a position aided both by this deregulation of electricity and derivatives, to command significant market share and to coordinate the purchase of large volumes of short-term future electricity contracts with spot control over key transmission capacity and natural gas supplies.

And the way they would do this, for instance, is in California—the company would negotiate with an owner of a power plant to buy electricity at a guaranteed price at a time very near to the future delivery, like the day before or a few hours before.

And because they were entering this market and into these contracts in a recently deregulated over-the-counter market, Enron was in a very good position to manipulate and to control a chunk of the market, just as Ms. Lynch has described. This enabled them to predict and to set short-term and spot energy prices for the Western electricity market.

And we should be clear that Enron wasn't alone in this scheme, and that other companies, like Dynegy and Williams and Reliant were using some of the same tactics. But what's different is that Enron's exact role is just a lot more difficult to clarify because the documentation just isn't there. Enron didn't own power plants or the physical infrastructure.

And you know how a traditional utility market share is determined. It's by how many power plants a company controls in a given market. But with a power marketer like Enron, there's a big loophole, because there's no way to really tell what the market power is because the power marketer is free to negotiate as many wholesale contracts as they wish. And there's no government oversight. In a competitive market, competition doesn't exist if you don't have oversight and if the rules are rigged.

So attempting to really look at their role in California is hard, because they left this web of just thousands of trades that's already been referred to in earlier testimony.

But what's really clear is that Enron, through their lobbying, through their relationships with federal agencies, at the state level, was basically trying to escape scrutiny and to purchase enough electricity contracts a day ahead on the spot market to secure a large part of the market share so that they could set prices.

And Ms. Lynch has already talked about the information that's available. The forms that are given to the Securities and Exchange Commission, the Derivative Study Center has calculated that Enron claimed a $500 billion electricity and natural gas derivatives business in the months before the company declared bankruptcy. And, of course, we know that many of the reasons for this were the aggressive accounting games that were being played.

But the disclosure forums that can be accessed on FERC's website show that there is an alarming missing amount of data from the forms. And I think what's really important to remember, and I know that this is a sensitive area, but the division—Enron's Energy Services—was headed by Secretary of the Army Thomas White, until May of 2001. And this particular division was best known for its retail end of services. They were providing electricity to retail clients like Quaker Oats and Saks and U.S. Army installations. And this particular subsidiary was not doing well. And Enron Energy Services controlled about 25 percent of the wholesale market by trading electricity contracts.

So in the first three months of 2001, electricity prices went way up, as Ms. Lynch indicated, and there were rolling blackouts. And that's the time that this 11 million megawatts of electricity in the market alone was traded by this division, and 98 percent of these trades were with other Enron divisions and at astronomical prices.

So by what we can extrapolate from this is that by selling power to itself at inflated prices, Enron helped both push up prices in California's deregulated energy market and to accomplish two other goals. First——

Senator DORGAN. Let me ask that you summarize, Ms. Hauter.

Ms. HAUTER. Yes, I am. I'm almost done.

By trading such large volumes of electricity at high prices, they made the prices go up. And, second, Enron was able to move money from its profitable division of the Power Marketing Division to the unprofitable division of Enron Energy Services and make it seem as if the company were more stable.

And so it's important to note that, if there had been proper disclosure and scrutiny at FERC, this could all have been prevented.

And so our recommendation is that, at the very minimum, Congress must mandate that the FERC immediately investigate regulation of power marketers and that in the short-term it would be very prudent for FERC to evoke market-based rates authority for all power marketers until there's been a very thorough investigation of these types of practices.

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

[The prepared statement of Ms. Hauter follows:]

PREPARED STATEMENT OF WENONAH HAUTER, DIRECTOR, CRITICAL MASS ENERGY & ENVIRONMENT PROGRAM, PUBLIC CITIZEN

Good morning. Mr. Chairman and Members of the Committee, my name is Wenonah Hauter. I am Director of Public Citizen's Critical Mass Energy & Environment Program. Public Citizen is a national consumer rights organization founded in 1971. As Director of the energy program since 1997, I have spearheaded Public Citizen's investigations into the problems and abuses of electricity deregulation. Due to Enron's early, active and prominent role pushing for deregulation, the company became a focus of our research.

Deregulation not only allowed Enron to become one of the most powerful corporations in the world, but it also directly led to the company's downfall. Deregulation of both energy markets and commodity trading allowed Enron to escape price regulations—a key factor in the company's meteoric, 1,750 percent increase in revenues over the past decade. Enron could not attribute its brief success, therefore, to such traditional models as incorporating innovations to improve the delivery of product at competitive prices. Rather, Enron's business model was built entirely on the premise that it could make more money speculating on electricity contracts than it could by actually producing electricity at a power plant. Central to Enron's strategy of turning electricity into a speculative commodity was removing government oversight of its trading practices and exploiting market deficiencies to allow it to manipulate prices and supply. So when FERC finally fully re-regulated the California market in June 2001, Enron's business model was soon invalid and the company bankrupt.

Enron spearheaded electricity deregulation, lobbying heavily for the transmission wheeling provisions of the Energy Policy Act of 1992 that allowed the company to gain a foothold into the wholesale market by registering as a power marketer. Weeks later, Enron embarked on its strategy to transform itself from an energy producer to an energy trader when it was the first company to petition Wendy Gramm's Commodity Futures Trading Commission asking that agency to not regulate energy trading contracts (five weeks after granting Enron the exemption in January 1993, Wendy Gramm joined the company's board at the request of Ken Lay). Enron was the first power marketer, on January 5, 1994, that the Securities and Exchange Commission exempted from the Public Utilities Holding Company Act. Enron successfully lobbied for the continued deregulation of over-the-counter energy derivatives trading when long-time Enron supporter Senator Phil Gramm helped muscle the act into law (and Gramm leads current efforts to oppose re-regulation of derivatives trading). In between, Enron spent millions of dollars influencing deregulation plans on the state level—most notably in California.

But before FERC enacted the price controls which saved California but suffocated Enron's revenue stream, the company had inflicted severe damage on west coast consumers by manipulating supplies to drive prices up. How did they do this in California, even though the company never owned any power plants in the state?

Aided by deregulation of both electricity and derivatives, Enron was able to command significant market share simply by coordinating its purchases of large volumes of short-term future electricity contracts with spot control over key transmission capacity and natural gas supplies. Because Enron was entering into these electricity and natural gas contracts in the recently deregulated over-the-counter market, Enron was in a strong position to engage in trade-based manipulation by controlling a significant chunk of the market, thereby enabling the company to predict and set short-term and spot energy prices for the Western electricity market.

While Enron played a significant role in helping to manipulate supplies and prices in California, it is important to note that the company was not alone. Indeed, the Federal Energy Regulatory Commission (FERC) has already levied fines and ordered refunds on several occasions totaling tens of millions of dollars to be paid by other energy companies, such as Dynegy, Williams, Reliant and Mirant, for their role in manipulating prices in California. More fines and investigations by FERC are forthcoming, as are separate state lawsuits. FERC has not yet issued a refund order to Enron, although one is likely imminent. But Enron's exact role in manipulating prices in California has been harder to track due to its business structure that was far more opaque than other energy firms. In contrast to other energy companies, Enron did not own any power plants or other physical infrastructure, leaving only a complex web of thousands of trades with multiple partners—including significant trading between Enron subsidiaries—leaving practically no trail for investigators to follow.

Enron worked this way in California: the company would negotiate with an owner of a power plant to purchase the electricity generated from the facility at a guaranteed price at a time very near in the future (usually the next day). Traditionally, a company's electricity market share has been measured by the number of power plants the company owns in a given market (that's why Southern California Edison, PG&E and San Diego Gas & Electric sold most of their power plants—so the utilities would not still control the wholesale market under deregulation). But power marketers represent a huge loophole: they have been free to negotiate as many wholesale energy contracts as they wish with little to no government oversight. So Enron was able to escape scrutiny and purchase enough electricity contracts in the day ahead and spot market to secure significant enough market share, where the company was in a strong position to set prices. Indeed, before the energy crisis hit the state in May 2000, Enron paid a $25,000 fine to the now-defunct California Power Exchange in May 1998 for the company's early attempts at manipulating the day-ahead wholesale electricity market. But after that, either government regulators were no longer interested in holding energy firms accountable or Enron became more sophisticated in its ability to manipulate markets, because FERC failed to intervene until it was too late.

From the scant information Enron makes available in its disclosure forms to the Securities and Exchange Commission, the Derivatives Study Center calculates that Enron claimed a $500 billion electricity and natural gas derivatives business in the months before the company declared bankruptcy. Of course, among the many reasons the company was forced into bankruptcy was that its executives played aggressive accounting games, utilizing so-called "mark-to-market" bookkeeping, where Enron booked much of the revenue for long-term contracts up front—providing the company with inflated revenues.

Therefore, additional documentation is necessary to shed some light into how the company played a role in controlling supply and prices of energy in the California market. The only detailed publicly available information is contained in *Power Marketer Quarterly Reports* that Enron and other power marketers file four times a year with FERC. These disclosure forms are intended to force regulation-shy power marketers to disclose the volume and price of their trades, along with whom the trades are conducted.

But in reality, FERC does a miserable job of enforcing its disclosure requirements, as the Power Marketer Quarterly Reports are a poor excuse for government oversight. FERC allows power marketers to exclude so many crucial details about these trades that the porous disclosure forms raise more questions than they answer. Nonetheless, these disclosure forms provide enough of a window on Enron's operations to highlight significant problems.

The documents indicate that Enron's western trading operations focused entirely on the California market. This contradicts multiple public statements the company made during the California energy crisis, when company representatives argued that Enron's California operations were minimal.

Enron was making 100 percent of its west coast trades at four delivery points: COB (California-Oregon border); Path 15 (northern California); Palo Verde (California-Nevada border); and ZP26 (central California, near Bakersfield). According to many different reports, Enron was engaged in a certain amount of transmission capacity manipulation at all of these points at key times during the California energy crisis. The Nevada Public Utilities Commission has been investigating allegations that Enron was gaming the daily capacity auctions at the Palo Verde delivery point. And although Enron only had limited firm transmission rights over COB, Path 15 and ZP26, trading insiders allege that Enron was able to manipulate capacity enough to leverage its wholesale energy trading activities. By utilizing their dominance over the Palo Verde capacity (connecting CA to Nevada) with complicated spot clogging of capacity at ZP26 and Path 15, Enron's power marketing subsidiaries were better able to utilize its day ahead positions to charge inflated prices.

Enron had four registered power marketing divisions: Enron Power Marketing, Enron Energy Marketing Corp, The New Power Co, and Enron Energy Services. All were engaged in heavy trading all across the country. Because of FERC's poor regulatory requirements, however, Enron was able to hide significant details. For example, the *Quarterly Reports* for Enron Power Marketing are unintelligible; the division lumps trades conducted in every region of the country, so it is impossible to isolate their California trading operations from their New York trades.

But disclosure forms submitted by Enron Energy Services provide region-specific data that is alarming. This division, headed by President Bush's Secretary of the Army Thomas White until May 2001, was better known for its high profile retail contracts with such clients as Kaiser Permanente, Saks, Quaker Oats, JC Penny, Owens-Illinois, and U.S. Army installations. But Enron Energy Services controlled as much as 25 percent of the California wholesale market by trading electricity contracts. In the first three months of 2001—at the height of skyrocketing prices and rolling blackouts—White's division traded more than 11 million megawatts of electricity in the California market alone, making nearly 98 percent of these trades with other Enron divisions at astronomical prices—up to $2,500 a megawatt hour (the standard price at the time was less than $340 a megawatt hour). By selling power to itself at inflated prices, Enron helped skyrocket prices in California's deregulated market. Economists refer to this manipulation as *transfer pricing*.

By trading such large volumes of electricity at such high prices, White's division was able to accomplish two goals. First, trading electricity at high prices with other Enron divisions allowed the company to charge California utilities and consumers astronomical prices, thereby contributing to the Western electricity crisis. Federal and state regulators found it very difficult to trace Enron's trades, since the company had four separate divisions interacting in the wholesale and retail markets, and *with each other*. Second, engaging in transfer pricing allowed these various Enron divisions to overstate revenue and contribute to the accounting gimmickry that inflated the company's share price.

These prices were far above what other power marketers were charging at the time, and far above what Enron had been charging prior to May 2000 (when the crisis began). It is important to note that at the same time that White's Enron Energy Services division was manipulating the California energy market by charging inflated prices, Enron paid the D.C. lobbying firm Quinn Gillespie more than half a million dollars in the first 7 months of 2001 to lobby the "Executive Office of the President" on the "California electric crisis" according to the lobbying disclosure report filed with Congress on April 10, 2001. Ed Gillespie, former communications director at the RNC, was a top Bush campaign advisor and ran the U.S. Department of Commerce for the first 30 days of the Bush presidency. Enron was lobbying *against* bi-partisan efforts to re-regulate the Western electricity market by imposing price controls. And just as Enron was spending this money lobbying Congress and the White House against price controls, the Bush Administration aggressively took Enron's position. On numerous occasions, President Bush, Vice-President Cheney, their various spokespeople and cabinet officials took an aggressive stance against price controls.

At a minimum, Congress must mandate the Federal Energy Regulatory Commission to immediately investigate regulations of power marketers. Clearly, the current level of transparency allows companies to manipulate wholesale markets. If it were not for FERC's continued regulation of the Western electricity market, other power marketing firms would have incentive to pick up where Enron left off. Public Citizen urges Congress to make it clear to FERC that more scrutiny of power marketers must occur. In the meantime, it would be prudent for FERC to revoke market-based rate authority for all power marketers until a thorough investigation is concluded.

Senator DORGAN. Next, and finally, we will hear from Mr. Robert McCullough, Managing Partner, McCullough Research, in Portland, Oregon. Mr. McCullough, you may proceed.

STATEMENT OF ROBERT McCULLOUGH, MANAGING PARTNER, McCULLOUGH RESEARCH

Mr. MCCULLOUGH. Thank you, Mr. Chairman. Thank you, Senators of the Committee. I'll be very brief.

Our firm has had a leading role in looking at both the California crisis and the Enron collapse. We're practitioners, not policymakers like many other of the witnesses on the panel. I'm going to do a brief overview of the chronology and a couple of the facts.

I'm going to start a hundred years ago to note this is not the first time we've been through a critical issue in our infrastructure. It's always amusing how many of the same parties occur again and again. A hundred years ago, J.P. Morgan was attempting to monopolize the nation's railroads. That also was a critical infrastructure. We did not, in fact, nationalize the railroads to fix it. What we did was we imposed regulatory controls over market power, and it's worked very well.

FERC came out of a 1932 collapse of a company almost identical to Enron, the Insull Trust. Again, we did not throw the baby out with the bath water. We imposed controls, many of which Enron worked hard to eliminate over the past few years.

In 1986, we had the merger of two not very exciting companies. From the beginning, Enron was cash poor. All through their history, they had a ruinous run of bad luck in investments. They failed in oil trading. They failed in emission control fuels. They failed in foreign investments. In a sense, their investment history was like a gambler that continued to double down.

There were a couple of serious techniques that they used throughout all of this. Partial spinoffs to subsidiaries that would then, in fact, be used for valuation to support their financials started all the way back in 1994 with Enron Global Power and Pipelines. Now, we've seen that go all the way through. That was the model for Nighthawk, their methodology in 1997. Then for the infamous Raptors of the last year or two. We saw this same series of techniques support what appear to have been a failing enterprise.

At the beginning of the decade of the 1990's, they were averaging earnings and cash-flow of approximately ten percent of revenues. That's not an unusual amount. That makes good sense. By the end of the decade, they were down to ½ of one percent. Now, that represents a company that was running twice as fast simply to stay where it was.

In 1995, they invested in Dabhol, one of the largest and most controversial power plants in the history of the world. Oh, and by the way, I left an important date out—1994. We've seen now two years of explanation that California's environment policies blocked energy production and caused this crisis. It's important to remember 1994 was our last drought—71 percent of flows—a reserve margin in the WSCC of 15.4 percent. That, by the way, is at the edge of the practical level. David Freeman, who's run more utilities than, I think, any other man in America, can talk to that number. At 15 percent, you begin to get worried.

In 1998, they went to Azurix and Elektro—those were failing investments in England and Brazil—2000, Broadband—it's, in fact, too polite to even call that a failing investment, because we're not even certain there was any real business transacted.

Then the critical issue for this Committee—we're in the winter of 1999/2000. LJM2, one of these partnerships, a financial partnership, reaches out from Houston, comes to Portland, Oregon, and proposes transacting a power plant. In all of these transactions, the financial end of these don't own power plants. Why would Andy Fastow want a power plant in Eastern Oregon? They approached the Oregon PUC. They asked for exemption from traditional regulation. The Oregon PUC, with all of our compliments, refuses to ask for a large part of this transaction if it occurs.

Now, the important thing is in that winter, a power plant was not a good investment. Enron's own internal documents indicate such an investment could not have returned more than 12 percent at the prices we saw before May 22, 2000. However, LJM2's documents indicate that they were going to return 22 percent. Now, clearly, either LJM2, a group of financial experts in Houston, were much smarter than the electric industry as a whole, or, number two, they had some insight into May 22, 2000. Now, that, of course, was the first of 125 emergencies we saw over the next 14 months.

We were astonished. Flows in the summer of 2000 were 92 percent of normal. The reserve margin was 22.9 percent. All of those, by the way, are official numbers coming directly from the Bonneville Power Administration or the Western Systems Coordinating Council. We now have these as historical numbers. There are no calculations. There are no debates. There are no special models. These are the actual historical facts.

Over the period from May 22, 2000, to June 3, 2001, we saw a 5,812 average megawatt reduction in thermal generation in California, below what we would have expected from traditional mathematical models.

By the way, after the last emergency, those models returned to having almost a 100 percent correlation with client dispatch. Once FERC had eliminated the abilities to gain this market with their must-offer rule and their price caps, the markets returned to normal dispatch. And, of course, in August, Skilling resigns.

The bottom line of this short story is very simple. This was a company with a tremendous need to succeed. They had gone to more than doubling down. They had financial schemes that were going to explode in their faces in 2003. The entire Whitewing structure was going to cash out at this point, leaving them with billions of dollars of exposure. The Raptors also had an explicit time limit. There had to be a success.

Looking through their risk-management assets, we notice that they were very prepared for the May 22 crisis. In fact, they were the only entity that I know of that was prepared and made money in those risk-management assets over that period.

And the interesting side is that with the shift in FERC policy, they took a loss in risk-management assets almost as great as the profits they had made before. Interestingly, they were more able to predict the unpredictable than the simple political response.

Thank you very much, Mr. Chairman.

PREPARED STATEMENT OF ROBERT MCCULLOUGH, MANAGING PARTNER, MCCULLOUGH RESEARCH

Thank you for your invitation to testify today.

The year 2001 witnessed two surprising events. First, California, the leading example of electricity deregulation, experienced rolling blackouts during the winter (2000–2001)—a season when electric loads are normally at their lowest. Second, Enron, the leading proponent of electricity deregulation, in a matter of months shifted from exponential growth to massive collapse. We now know that California's electricity market was deeply flawed. A complex and secretive structure provided the ideal framework for the exercise of market power. Contrary to the extensive public affairs campaign waged by the beneficiaries of the California energy crisis, actual data shows neither a resource shortage nor the presence of underlying cost changes. We now understand that Enron itself was a paper tiger. Its impressive show of trading strength masked more than a decade of bad business decisions and accounting legerdemain.

It is natural to sense a connection between these two events and to conclude that Enron used its considerable clout to manipulate Western electricity prices. As Hal Bernton of the Seattle Times has asked, "How far down in Enron do you have to go to find ethical behavior?"

However, the institutional structure and opacity that made the California market easy to manipulate also makes tracing Enron's activities difficult. Certainly, Enron had the means, motive, and opportunity. Twenty-three months after the onset of the California crisis and ten months after it suddenly ended, we still have little access to the relevant data. Two of the California investigations have only recently received access to basic discovery. FERC finally began its investigation into the broader implications just two months ago.

Our public policy response to these two events has been slow and faltering. FERC still finds it difficult to apply its rate-making powers. Recent requests for Federal Power Act 206 review of long term contracts forced upon purchasers during the crisis have not been granted.[1] The onslaught by marketers who continue to argue for the withdrawal of data from the public eye continues.[2] And despite substantial questions about the theories that underlie centralized markets administered by the California ISO, FERC continues to support the development of similar institutions throughout the U.S. and Canada.[3] At the current rate, the commodity market in electricity will continue to be both the most troubled and the most secretive for years to come.

Moreover, the analysis of the issues posed by the California crisis and Enron's collapse has been drawn into a deeper debate about the appropriateness of consumer choice in electricity. This debate is often confused with how to maintain the currently uneasy balance between business and consumer interests.

While the costs borne by California's residential ratepayers were high, even higher costs to the economy have been shouldered by major industrial customers throughout the western U.S. and Canada. Outside of California many, if not most, large industrial customers have enjoyed open market access to electricity, based upon the natural gas model of simple bilateral trading arrangements. When prices suddenly increased without notice in California, it directly raised prices throughout the region, shutting down major industries from Washington to Utah. Even ten months after the California crisis, many of these industrial facilities remain padlocked. Some of these industries will never reopen.

The debate about the lessons of California and Enron is really about protecting our economy against the exercise of market power. As Theodore Roosevelt said:

> "Combinations in industry are the result of an imperative economic law which cannot be repealed by political legislation. The effort at prohibiting all combination has substantially failed. The way out lies, not in attempting to prevent such combinations, but in completely controlling them in the interest of the public welfare."[4]

We should not abandon our efforts to create a wholesale electricity market. Nor should we ignore our responsibility to both consumers and business. However, if the goal of equitable restructuring is to be realized, FERC must vastly improve its record of monitoring, preventing, remedying, and punishing market power abuse.

The facts are this simple. At the onset of the crisis in California, if FERC had implemented its order of May 16, and its June follow up a year sooner, industries throughout the Western U.S. would not be closed today. If FERC had exercised its review powers on long term contracts that are priced at two and three times the cost of the new resources required to serve them, the lingering effects of California would soon fade away.

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[1] In addition to California, a number of utilities in the Western U.S. have asked FERC to review one sided contracts forced upon them during the crisis. FERC has not yet responded to these requests.

[2] Moves are still underway at FERC, the Energy Information Administration, and the North American Electric Reliability Council to restrict market information from the press, public, and policy makers. Ironically, the participants, themselves, now have access to almost all "market" data through FERC cases and ongoing litigation.

[3] The California ISO operates a number of centralized markets for capacity and energy. This same basic model has been adopted in the regional transmission organizations mandated by FERC across the continent. The contradiction in terms—open competition only within highly centralized and opaque administered markets—has seemingly been lost on FERC and the advocates of these schemes, despite problems in California, New England, Pennsylvania and Alberta.

[4] Theodore Roosevelt at Ossawatomie, Kansas, August 31, 1910.

This isn't a partisan issue. When the events of 2000 destroyed paper mills in Washington, as well as other paper, chemical, and metals industries throughout the West, our country took its first steps into the current recession. Like regulation of the market power of railroad trusts at the turn of the century, the question is efficient pricing, not the elimination of a customer's right to choose.

The California Crisis

Twenty-three months ago the California market erupted in a fourteen-month long series of emergencies, price spikes, and financial crises. For a short while, a well-fueled public relations campaign had much of the world convinced that the state had run out of electric generating capacity as a result of its own unrealistic environmentalism.[5] Now that the storm has seemingly passed, the more dispassionate view that this was market failure rather than resource shortage is gradually gaining the upper hand.

From the beginning, the electric industry was poorly prepared to handle a major market failure. The Western Systems Coordinating Council (WSCC), the body tasked with the electric reliability of the West Coast of Canada, the U.S., and Northern Mexico, never did take an effective role in the crisis. Indeed, most of the debaters never even noticed that the West Coast had a reliability council that had been studying electric reliability issues since 1967.

The crisis in California ended with a whimper, not a bang. Although predictions for the summer of 2001 were catastrophic, the last California emergency took place soon after the implementation of a regional price cap. Simply stated, the crisis turned out to be a problem in institutions and not resources.

California's restructuring was characterized by six words—"bad design, bad incentives, bad results."

AB–1890, the law that launched California on this path, was complex and difficult to understand. Its unanimous passage was evidence that every interest group had gotten its every desire. When every party to a negotiation leaves the table happy, there is a strong implication that they have been promised far more than can be delivered. It is useful to remember the optimistic language of the law:

> It is the intent of the Legislature that a cumulative rate reduction of at least 20 percent be achieved not later than April 1, 2002, for residential and small commercial customers, from the rates in effect on June 10, 1996. In determining that the April 1, 2002, rate reduction has been met, the commission shall exclude the costs of the competitively procured electricity and the costs associated with the rate reduction bonds, as defined in Section 840.[6]

Reality proved far more complex.

The basic design involved turning all power decisions over to an hourly market. This decision was so audacious and so mis-informed, that regional utilities and industries are still having to explain to FERC that the hourly market has little to do with the industry years after the design failed. Further, reliability, the historical strength of the North American supply system, was only considered as an afterthought.

The crisis started with the announcement of a Stage 1 and Stage 2 emergency on May 22, 2000.[7] The crisis ended on July 3, 2001 with the final emergency declarations. The catastrophic summer of 2001 actually saw declining prices and increased thermal generation. Every warning that price controls would reduce generation and contribute to the crisis turned out to be wrong.

Politically, the response to the onset of the crisis was like a scene from a frontier bar in an old western. Once the first punch was thrown, every interest group leaped into the fray with its own two fisted agenda. Generators launched preemptive attacks on air pollution agencies, the California governor accused marketers and generators of price fixing, Secretary Richardson moved to seize scarce Pacific Northwest reservoirs, and municipals like L.A. and federal agencies like the Bonneville Power Administration were accused of profiteering. Within minutes, the bar was a roiling mass of punching, kicking, and screaming special interests. Policy responses were

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[5] The phrase, "Ten years of rapid load growth without new resources," was a hallmark of an excellent public affairs campaign waged by marketers and generators in the California crisis. Interestingly, both parts of the phrase were strikingly untrue. The West Coast had a better load resource balance in 2000 than in previous years and peak loads actually were lower in the ISO's control area than they had been since 1997.

[6] Section 220(a) of AB 1890.

[7] The ISO issues emergency notices when its forecasted hourly reserves fall below set levels—7% for Stage 1, 5% for Stage 2, and 1.5% for Stage 3. In practice, this mechanism has never worked. Emergency declarations have tended to reflect the need for additional operational rights for the ISO rather than hard and fast standards.

especially hopeless. The ISO spent months tinkering with price controls that always contained fatal loopholes. FERC dithered in appalled indecision for seven months, only to gun down one of the victims of the crisis—the California Power Exchange—on December 15. Governor Davis' contribution was to negotiate deals with the marketers and generators that effectively fixed the unfair prices for years to come while simultaneously assailing them for price fixing. Only after the composition of FERC was changed, were substantive steps taken—the adoption of a must offer rule and WSCC-wide price caps.

While pundits from San Diego to Maine opined daily during the crisis, the truth is that under the California ISO's rules, no one was certain exactly where the region stood. The WSCC had published, as they had done for the preceding thirty-three years, a summer load/resource appreciation that indicated that while California supplies for the summer might be tight, that there was no immediate cause for alarm if 1,642 megawatts were available for import during June.[8] In May, for example, they projected a reserve margin of 29.2% for California.

When the California ISO announced its first emergency on May 22, the industry was completely taken off guard. Under the complex structure of the California system, an emergency did not require a true shortage. The definition of an emergency is when the capacity offered the previous day in the computerized markets of the Power Exchange and Independent System Operator was less than 107% of forecasted demand. At the time, the ISO had no mechanism in place to determine if they were actually facing an emergency, or whether the phone had just stopped ringing.

For some time the WSCC had been constructing a real time generator data base. The data from the WSCC (supplied to them from the ISO) did not support the hypothesis that California plants were out of service. Instead, the data showed that the plants tended to be operating during the ISO system emergencies, but were not being fully dispatched—even during the hours when actual emergency operating conditions were in place.

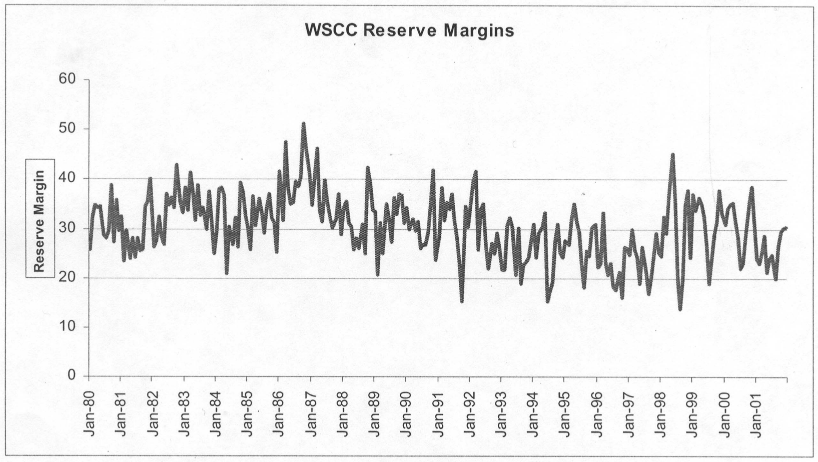
We were very surprised to learn that overall thermal operations in the California ISO's control area were running at levels far below the levels of comparable plants elsewhere in the WSCC. Comparing the dispatch rates with price data, our preliminary conclusion was that the California PX and ISO had suffered a one time supply curve shift of 8,000 megawatts leftwards towards the origin. In simpler words, the crisis looked like 8,000 megawatts had simply been removed from service. Eighteen months later, this is still our conclusion.

Enough time has passed that we now know that the WSCC was not facing a capacity shortage at the time. On an annual basis the WSCC publishes a ten year forecast of resource sufficiency. This forecast is usually named the "10-Year Coordinated Plan Summary." One important part of the report describes the ratio between resources and loads for the previous year.

The following chart shows this data from the WSCC reports from 1980 to 2001.[9]

[8] Assessment of the Summer 2000 Operating Period, Western Systems Coordinating Council, Spring 2000, page 3.

[9] Since the 2002 report isn't available, we have used the forecasted levels from last year's report for 2001.



In describing this chart to the House Energy and Commerce Committee, I used the metaphor of assuring a happy household by ensuring that the ratio of snacks to teenagers always stayed high. In the utility industry, this ratio is called the reserve margin. A reserve margin of 15% means that the area has 15% more resources than requirements. This level—15%—is generally regarded as an acceptable margin, since one power plant in six would have to fail for an interruption in service to take place.

As the chart shows, the WSCC has fallen near to this level frequently in the past decade. From 1991 through 1998 reserve margins routinely fell below 20% during the summer. In each case actual interruptions of service were unnecessary, since we always had enough resources to meet load.

The situation in 2000 was far better than the situation that the WSCC faced from 1991 through 1998. In 2000 it was able to get through the summer with a reserve margin above 20%.

Pundits have identified the real problem in 2000 and 2001 as the serious drought that afflicted the Pacific Northwest during this period. As it turns out, this argument is wrong theoretically (reserve margins are always calculated assuming drought conditions) and factually (the serious drought started in 2001, not 2000.)

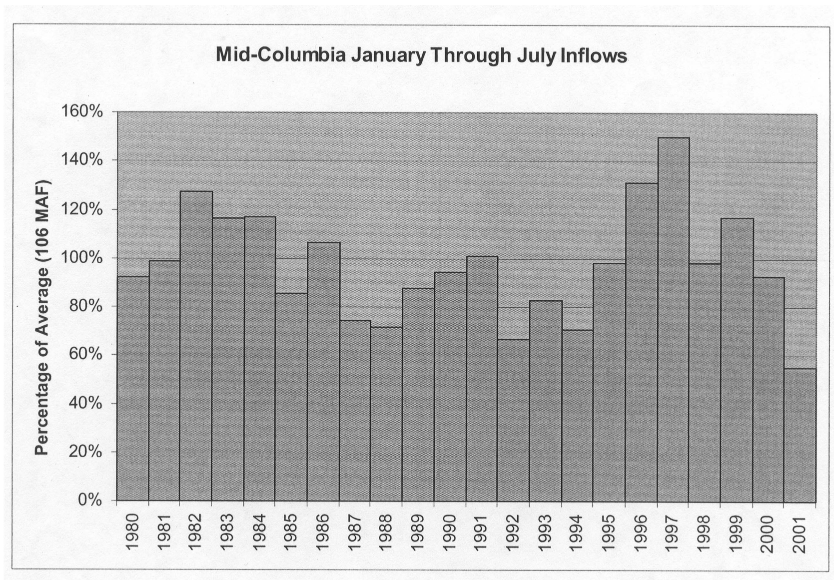
It would not be prudent to announce an ability to meet load that could not be delivered during a drought year. In 1974, the WSCC recognized this fact by issuing instructions that the capacity of hydro-electric projects should always be calculated assuming drought conditions.[10]

Thus, the reserve numbers reported above have *always* assumed drought conditions. Even if the flows on the Columbia River were only at 92% of normal, this would not have affected its ability to meet peak loads.

As it happens, Columbia River flows during 2000 did not represent a drought. Flows in 2001, did. The emergencies within 2000 took place during a period of roughly average water. Put succinctly, there was a drought, but it started after the first summer of the California crisis. When the California crisis ended, the WSCC was in the grip of a major drought.

The following chart shows the January through July flows on the Columbia since 1980.

[10] Criteria for Uniform Reporting Of Generator Ratings, Western Systems Coordinating Council, June 20, 1974.



The very straightforward conclusion that comes from the reserve margin chart when combined with the Columbia River flows is that 2000 was both a better year in terms of resources—22.9% reserve margin compared with 15.4% in June 1994—and Columbia River inflows—92% of normal compared to 71% in 1994. If these facts explained the emergencies in 2000, how did the lights stay on in 1994? The answer is that the organization of the industry rewarded meeting load in 1994. In California's complex structures, this incentive had been changed in 2000 and 2001.

The major difference between the relatively stable conditions we experienced in 1994 and the emergencies in 2000 was in large part the difference in the operations of traditional utilities and the structure of the California market. In 1994, the generating plants belonged to the utilities. In 2000, the generating plants were dispatched according to the complex incentives hidden in the rules of AB–1890.

Starting in 2000, the WSCC had established a database showing the hourly plant operations of many of the plants on the West Coast. The California ISO provided plant data to the WSCC which, in turn, provided it to any interested WSCC member. While secrecy of operating data is a cornerstone of the California market design, the practice of secrecy at the ISO was unusual. The ISO provided this secret data in contravention of its FERC-filed tariff throughout the summer and fall of 2000.[11] Any market participant equipped with this data would be able to easily adjust its operations to accentuate the California ISO's problems during an hour when demand was high. Curiously, Portland General Electric, Enron's subsidiary, did not contribute data to the database. Enron had access to the data of others, but did not welcome access to its own plant operations.

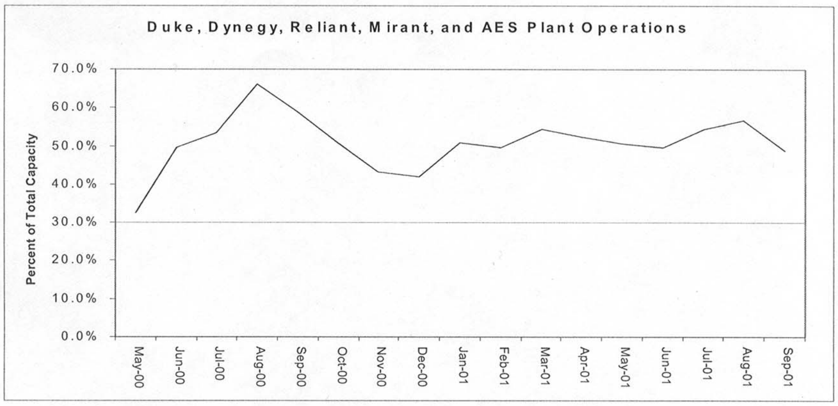
The California ISO has provided numerous charts that show that as its system approached peak, supplies offered to the California PX would begin to drop off. The resulting deficit would become an operating problem at the ISO. Once emergency conditions were declared, prices would skyrocket and supplies would reappear.

Ironically, the hourly data is public outside of California—even today—as part of the EPA's emissions database. Unfortunately for consumers and policymakers in California, access to this data is usually delayed from three to five months.

The following chart shows the monthly operations of the units owned by Duke, Dynegy, Mirant, Reliant, and AES over this period. While plant operations in the rest of WSCC reached 100%, plant operations for the groups who have primarily profited from the crisis averaged 50.3% from May 2000–June 2001. Interestingly,

[11] California ISO Information Availability Policy, originally dated October 22, 1998, modified November 1, 2001.

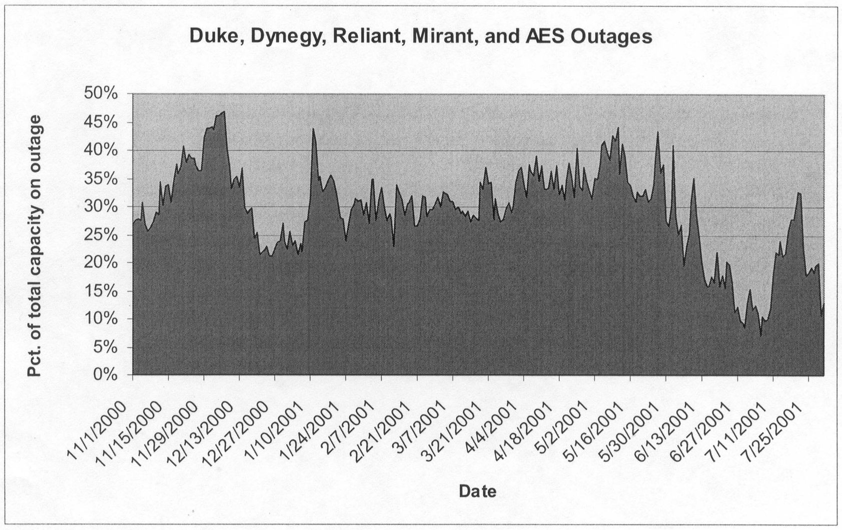
plant operations were actually slightly higher for the three months that followed price controls, even though market prices were significantly lower.[12]



We have been unable to explain the hourly operations of these five generators even after enormous effort. Frequently, plants went undispatched during system peaks and even during ISO declared emergencies. Whistleblowers from the plant operations staff have indicated that their directions from management were inexplicable. Operations at plants outside of California have shown none of these problems. In fact, outside of the plants in the chart above, operations have been as close to 100% of capacity as the owners could reach.

Many analysts break the California crisis into two periods. The first, economic withholding, represents the period when generators either did not bid resources into the PX and ISO or made bids at unrealistic prices. A second period—physical withholding—took place from November through June. While it is possible that the decision to take 50% of California's thermal units down simultaneously for planned outages was simply coincidental, an alternative explanation is also possible. After the ISO stopped providing operating data to the WSCC, generators may have simply switched to communicating their operating levels through planned and forced outage announcements. Regardless of the explanation, operations in the second part of the crisis roughly mirrored operations during the first portion.

[12] This chart was based on data provided by the EIA. The EIA has faced substantial pressure to reduce the amount of such data available to public, as has FERC, the WSCC, and the North American Electric Reliability Council.



From November until the onset of price controls, the five generators reported massive plant outages. The ISO did not reliably solicit or record plant outage data until 2001, so it is difficult to compare the outages in November 2000–May 2001 with previous years for the same plants. Detailed historical data on the performance of similar plants—by age, size, technology, and fuel—are accumulated by the North American Electric Reliability Council. Its data shows vastly lower outage rates on similar equipment.[13]

While predictions of widespread blackouts were common through the spring of 2001, FERC's decision to implement a WSCC-wide price cap appears to have had a significant impact on plant outages, short-term prices, and long-term prices in the late spring.

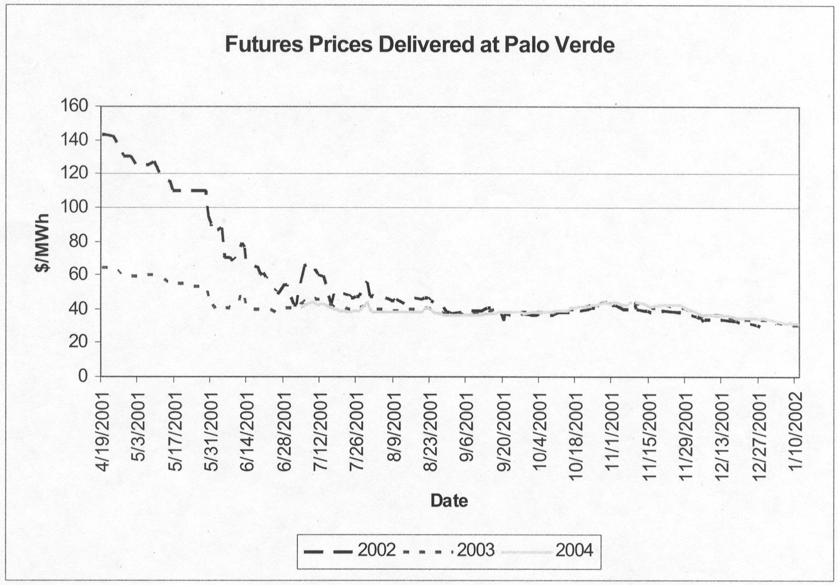
As always, shifts in long-term prices are the most interesting, since they are not affected by weather or other operating problems.

The onset of price caps in June led to the larger of the West Coast's two long-term price reductions in 2001. The second major price reduction—in percentage terms—took place over the weekend Enron declared bankruptcy.

The success of the price caps can be seen immediately. The presence of a counterweight to California's fragile power markets almost immediately returned long-term prices to the levels we have seen for the past twenty years. As FERC's recent report notes, "the average price (both simple and weighted) at which the Western utilities sold power in the daily spot market was significantly below the price cap of $92/Mwh."[14] This is quite an understatement—by the end of June, prices had fallen to $43/MWh at Palo Verde.

[13] NERC's Generation Availability Data System (GADS) can be used to review the history for any type of plant. It is available on NERC's web site.

[14] The Economic Impacts on Western Utilities and Ratepayers of Price Caps on Spot Market Sales, January 31, 2002, page 4.



While price caps are unlikely to work in a competitive market, the California market was hardly competitive. The incentives under AB–1890 rewarded shortages. Once the ISO entered an emergency, it offered prices five to thirty times higher than normal levels for emergency supplies. Once FERC eliminated the ISO's ability to pay such distorted prices, generators in California were rewarded by producing more rather than less electricity. All of the data indicates that once the incentives were repaired, plant operations improved and prices fell.

The shift in generator behavior is even more significant when each plant's operations are modeled on an hour-by-hour basis from January 1, 1997 through December 31, 2001. The following table shows the forecasted operations of the plants based on market prices for energy, natural gas, and NO_x RECLAIM credits.[15]

	Northern California	Southern California (Outside of SCAQMD)	SCAQMD	Total
Forecasted				
Jan–97 to Mar–98	125.63	467.31	486.69	1,079.63
Apr–98 to Apr–00	2,097.07	2,145.22	2152.96	6,395.24
May–00 to Jul–01	4,055.36	4,623.28	4812.76	13,491.40
Aug–01 to Dec–01	2,504.16	2,524.25	1202.37	6,230.78
Actual				
Jan–97 to Mar–98	973.99	1,157.25	1060.72	3,191.96
Apr–98 to Apr–00	1,250.30	1,349.55	952.43	3,552.28
May–00 to Jul–01	2,603.83	2,665.89	2408.84	7,678.57
Aug–01 to Dec–01	2,351.52	2,031.62	2163.14	6,546.27
Difference				
Jan–97 to Mar–98	848.37	689.93	574.03	2,112.33
Apr–98 to Apr–00	(846.77)	(795.67)	(1,200.52)	(2,842.97)
May–00 to Jul–01	(1,451.53)	(1,957.38)	(2,403.92)	(5,812.83)
Aug–01 to Dec–01	(152.64)	(492.63)	960.77	315.50

[15] The model uses heat rates derived from EPA hourly generation and fuel use data, MWh/No_x data from the same source, and market natural gas and electric prices. RECLAIM prices are the monthly average for coastal and inland markets.

Actuals are significantly lower than forecasted levels from May 2000 through July 2001—the duration of the California crisis. After FERC's intervention in the market the deviation between actual operations and forecasted operations changed from an under-generation of 5,813 megawatts to a slightly higher than predicted production of 315 megawatts.

Overall, the standard model of economic dispatch of these plants fits very well before the crisis and after the crisis. During the crisis, the plants generated 5,813 megawatts less than a market model would have predicted.

Motive, Means, and Opportunity: Enron's Role in the Market

From its inception, Enron, the combination of the Houston Natural Gas and the InterNorth pipeline companies, was a turbulent and troubled entity. While the public relations skill of Ken Lay and the financial skills of Jeff Skilling portrayed the company as a surging force in energy markets, the revelations of the past year indicate that it had lurched from failure to failure. The cycle of Enron triumphs—optimistic announcements followed by accounting adjustments, temporary boosts by artificial valuations, and finally closure or sale—was repeated time and time again. After each cycle, the deadweight loss of previous disasters placed a heavier burden on the next announced triumph to overcome.

Year	Enterprise	Outcome
1988	Oil trading	Large scale embezzlement caused the abandonment of the business.
1990	Long Term Natural Gas Contracts	Shifts in natural gas pricing made many early transactions uneconomic.
1994	Brazil	A variety of Brazilian projects including the pipeline from Bolivia to Brazil and associated power plants were delayed, cancelled, or eventually devalued by Brazil's economic problems and a persistent drought.
1995	Dabhol	Enron's one sided contracts faced every possible obstacle from the state of Maharashtra.
1997	PGE	While PGE has retained its value, Enron's high purchase price depended upon proposals to free valuable assets from Oregon regulation. None of these were approved by the Oregon PUC.
1998	California Retail Markets	Enron withdrew from the retail market after a month at a cost of hundreds of millions of dollars in startup costs.
	Azurix	Enron's troubled investment in England is followed by failed water investments throughout the world.
	Elektro	Enron purchases a Brazilian distribution utility now troubled by drought, devaluation of the Brazilian currency, accounting investigations, and devaluation.
2000	Broadband	Enron's broadband revenues prove largely illusionary.

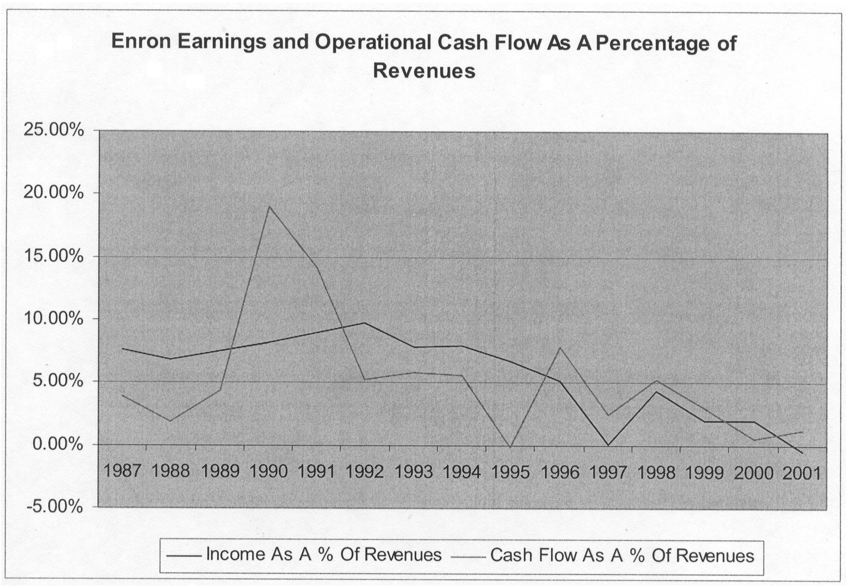
Year	Enterprise	Outcome
2001	EnronOnline	Enron's business to business web site achieves $195 million dollars in notional transactions in its final quarter—roughly four times Enron's total revenues. No impact on actual revenues, earnings, or cashflows is apparent.
	TNPC	Enron spins out a troubled retail operation and profits through the complex mechanics of Raptor 3. Actual revenues are low and earnings are non-existent.

The central theme in Enron's growth was its desperate search for purchasers in its schemes. Each cycle promised enormous growth. Each cycle faltered on the absence of realistic markets. Each cycle fell to creating buyers where none really existed. We now know that many of Enron's past failures involved—in one way or another—the creation of artificial demand for their commodities and assets.

From the beginning of the decade when Enron began to treat asset sales as "merchant investments" to the mid-1990s when an increasing proportion of Enron's earnings began to be based on questionable "mark to market" estimates, the actual quality of Enron's earnings have faltered badly.

Since 1994, Enron has always obscured its frequent market setbacks with affiliated entity transactions. From 1994 through 1997 the major buyer for many of these troubled assets was Enron Global Power and Pipelines. In 1997, the buyer was Nighthawk. Nighthawk evolved into Whitewing in December 1997. As Enron's problems expanded, the affiliated entities also expanded in number. By 1999, Whitewing was joined by a variety of structures including Sundance, Hawaii, LJM1 and LJM2, not to mention the infamous Raptors.[16]

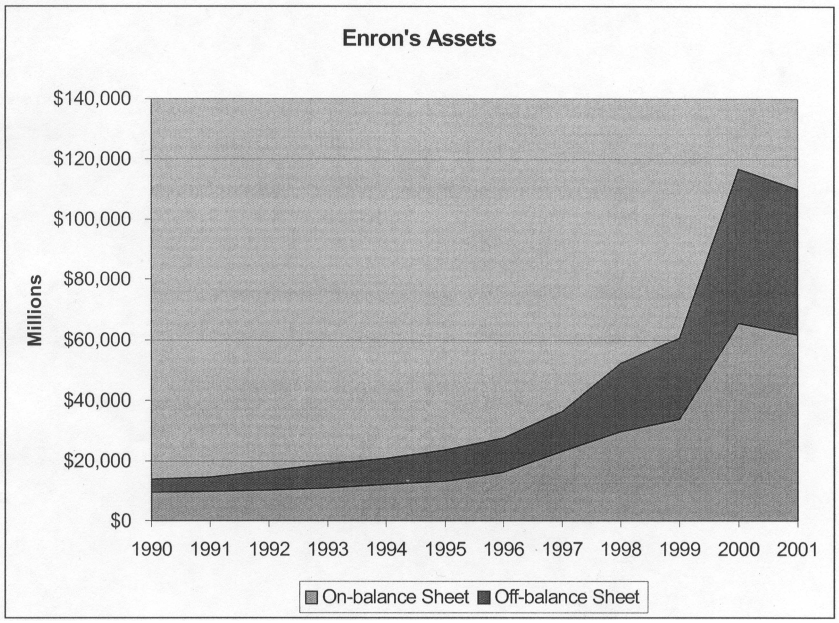
The chart below summarizes fifteen years of Enron's announced earnings and operational cashflows as a proportion of announced earnings.



Even these figures are amenable to manipulation. The relatively strong figures for the early 1990s depended upon the sale of future receivables—another example of borrowing from Peter to pay Paul.

[16] Understanding Whitewing, McCullough Research, January 20, 2002, and Understanding LJM, McCullough Research, February 2, 2002.

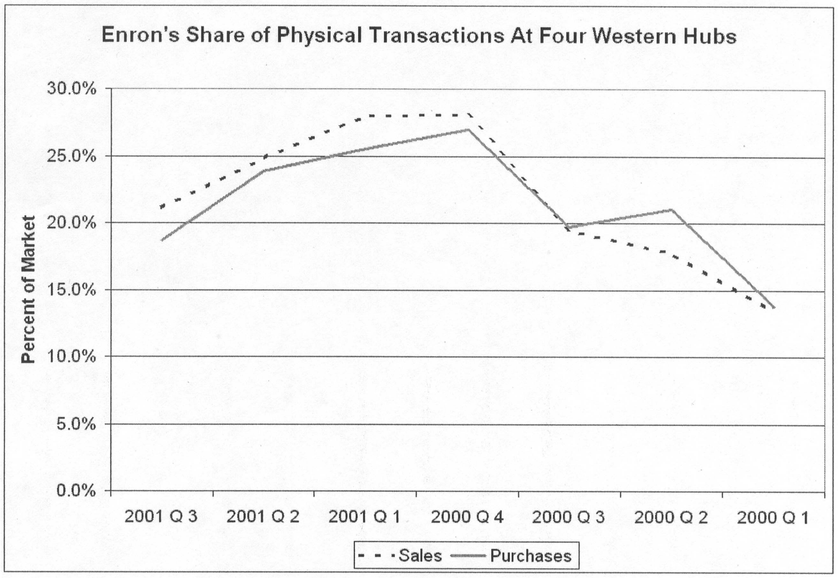
Ironically, some of the most important evidence we have on Enron's deteriorating financial position over time comes from materials only made available to the partners of LJM2. The following chart represents data on off-balance sheet assets provided to select limited partners:



By any standards, Enron entered into 2000 in desperate conditions. We now know that earnings in 2000 and 2001 were primarily taken from financial maneuvers like LJM2's Raptor subsidiaries and comparable affiliated party transactions like Osprey and Sundance.

Clearly, enormous concentration in California markets was required for Enron to affect prices. FERC does not accumulate the data necessary to show the degree of concentration on a systematic basis. FERC does require energy marketers to file quarterly reports. Enforcement of this provision is weak. Some marketers fail to file their reports. Others file their reports in illegible or illogical formats. Still others, like Enron, do not specify any detail on the hubs where they bought and sold electricity.

The following chart shows Enron's share of the major California hubs over time. The data used to generate this chart was taken from sales and purchases of major Enron trading partners who do show where Enron's transactions take place.



This chart matches our detailed research on Enron's trading activities.[17] Enron's market share—for both sales and purchases—increased dramatically in 2000. By the fourth quarter of 2000, the evidence from FERC's quarterly marketing reports indicated that its sales were nearly 30% of the market. As Enron entered 2001, the growth of its wholesale operations appears to have stalled. Overall statistics indicate that Enron's physical sales declined after 4th quarter 2000.

In almost any other commodity market a 30% market share is clearly sufficient to exercise price leadership. Pacific Gas and Electric's share of California wholesale markets before April 1, 1998 was similar and its ability to use its scale to affect prices had long been observed.

Enron's sales directly to the California ISO were not large. Enron's sales at the hubs were vastly greater than its sales to the ISO. This may simply reflect the fact the market leader need not show up in every transaction. Price leadership sets the prices for all participants. Each transaction would reflect the price leader's price even though the price leader only had 30% of the market.

Enron's transactions with Pacific Northwest generators may have tended to obscure its sales to the ISO. During the California crisis, Enron approached a number of Pacific Northwest utilities offering to purchase ancillary services for sale to the ISO. Disentangling these transactions may be difficult.

Do we know whether Enron exercised its market power in an attempt to increase prices during the market crisis that occurred between May 2000 and July 2001? No.

Publicly available data simply isn't that detailed. And while the California ISO continues to restrict availability of such data through its aggressive use of confidentiality agreements, the public debate will not become much clearer. The irony of the situation is that the ISO, the victim, has restricted market information to the market participants since they must have access to participate in the FERC refund cases and ongoing litigation, but has taken the same data out of the hands of the public, the press, and policy makers.

If arrogance was a clue to the exercise of market power, Enron's behavior during this period was legendary. During one transaction we were involved in, a junior Enron trader simply hung up on a senior executive of a Fortune 500 company because he could not move fast enough. This is market power with a vengeance.

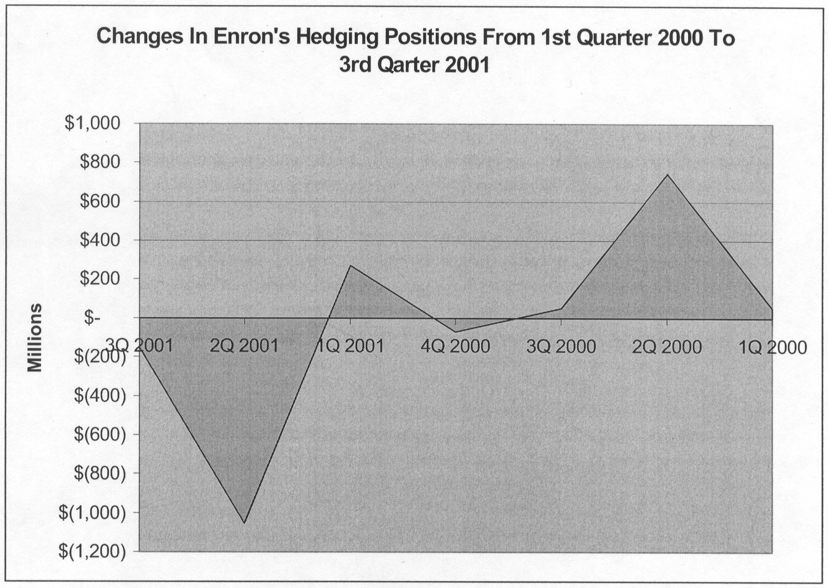
What little evidence we can access concerns Enron's "price risk management activities." This typically elliptical phrase was used by Enron to describe its hedging activities. Enron's 2000 Annual Report describes this area of its business as:

[17] Deconstructing Enron's Collapse, McCullough Research, January 10, 2002.

Enron engages in price risk management activities for both trading and non-trading purposes. Instruments utilized in connection with trading activities are accounted for using the mark-to-market method. Under the mark-to-market method of accounting, forwards, swaps, options, energy transportation contracts utilized for trading activities and other instruments with third parties are reflected at fair value and are shown as "Assets and Liabilities from Price Risk Management Activities" in the Consolidated Balance Sheet.[18]

If Enron had knowledge of market power in advance, we would have expected its hedging operations to be quite profitable. If not, the surprising and unanticipated events of May and June 2000—2nd Quarter 2000—should have posed a substantial economic risk.

Enron's financials show a dramatic shift in the net value of price management assets in the 2nd Quarter of 2000. This would be consistent with foreknowledge of the onset of the California crisis:



This chart also provides ample reason for Enron's energetic attempts to postpone the advent of price controls in the 2nd Quarter of 2001. As prices fell, Enron faced enormous losses in the net value of their hedging assets.

On a smaller scale, at least one of the investments of LJM2 shows the same canny prescience on future events. In the winter of 1999, six months before the onset of the California crisis, Enron approached the Oregon Public Utilities Commission with the proposal to sell a minor PGE asset in the market while reserving much of the profit for Enron. PUC staff reviewed the proposal carefully and successfully preserved the majority of the profits from the transaction for Oregon ratepayers.

A number of aspects of the transaction were not known to Oregon regulatory staff at the time. Significantly, LJM2 took a major role in this transaction, receiving a difficult to understand $3.5 million profit in the transaction.[19] Even more surprisingly, LJM2 planned to take a 50% ownership in asset.[20]

Enron's testimony before the Oregon Public Utilities Commission on August 14, 2000 showed that its market perceptions *before* the crisis was that such investments would have been unable to earn even a 15% return on the investment.[21] LJM2's internal documents indicated a 22% return on this investment. LJM2 apparently was

[18] 2000 Enron Annual Report, page 36.
[19] Powers Report, page 147.
[20] June 14, 2000 letter from Kathy M. Lynn to LJM2's limited partners, page 4.
[21] Understanding Recent Power Prices, August 14, 2000, page 15.

able to either operate in the same markets with vastly more expertise than Enron, or LJM2's estimate showed foreknowledge of the events to come.

Both sets of evidence—the larger picture of Enron's hedging position and the smaller example of a single plant transaction—seemingly indicate that Enron was prepared for the explosion on May 22, 2000. If so, it was among a very select group. As mentioned above, May was not considered a month in which an emergency was even remotely possible.

The California Crisis and Enron's Collapse

Were these two events related? Enron had means, motive, and opportunity. Substantial evidence now exists that Enron was able to exercise market power in forward markets. The firm had the means. We now understand the motive very well. Enron stood on the brink of bankruptcy. Jeff Skilling's unanticipated exit from Enron soon after the end of the California crisis is powerful evidence on how dangerous FERC's imposition of price controls were to Enron. Finally, they had opportunity. If the firm's market share was as high as FERC's quarterly market reports indicate, it was in an excellent position to affect hourly markets.

Data also suggests that Enron's management were able to plan ahead for the onset of the crisis. The event they could not predict was a shift in the regulatory climate that brought the crisis to a close years ahead of the schedule the firm had predicted.[22] The FERC orders that ended the California crisis may well have spelled the end to the last gamble to preserve Enron from bankruptcy.

While we know that the California crisis did not reflect market fundamentals, the final word on Enron's role in the crisis will depend on investigations now underway. We can draw lessons from the crisis even before the final word on Enron arrives.

> First, secrecy and opacity are simply too expensive. Open markets require open information.
>
> Second, market power is always a problem in commodity markets. Steps are underway to reverse many of the exemptions that Enron received from regulatory controls.
>
> Third, FERC's role is more important in a deregulated market than it ever was before. Arguments that FERC should surrender its power to review long term contracts and avoid an active regulatory role are as wrong today as they were at the turn of the century when the U.S. faced the same arguments concerning the railroads.

Thank you for this opportunity to appear before you.

Senator DORGAN. Mr. McCullough, thank you very much. Ms. Lynch, I understand that you have to depart at 11:30. Is that correct?

Ms. LYNCH. Yes, Senator.

Senator DORGAN. Why don't we begin a series of questions. I also have to go to an Appropriations Committee at the request of Senator Byrd at 11:15. I'm going to ask Senator Boxer to chair at that point.

Let me begin. Let me try to ask about the 11 million megawatts. I think two or three of you have discussed this issue, 11 million megawatts being traded. Ms. Lynch, could you amplify on that again so that we can ask some questions about that?

Ms. LYNCH. Certainly. We studied one quarter's worth of trades by Enron and its trading affiliates, and that is the fourth quarter of 2000. And what we found was of the trades that Enron and its affiliates, over 11 million megawatt hours, almost 12 million megawatts, were actually trades among its own entities. And, in fact, certainly 30 percent of the trades that Enron accomplished in that fourth quarter were with itself or its related entities so that it inflated the market, essentially.

[22] "Tim Belden of Enron, a major energy marketer, predicted that prices would remain high for another two to four years as demand approaches the region's capacity to produce electricity." Experts Try To Explain Run-Up In Energy Costs, Associated Press, July 19, 2000.

Senator DORGAN. Now, those are not arms-length transactions, as you suggest. That's why you call them "sham transactions," right?

Ms. LYNCH. Exactly.

Senator DORGAN. Well, let me try to understand. I understand that more will be traded than will be used in order to provide liquidity in the marketplace. But if you have a marketplace that is obscure, you can't see who the participants are or what the participants are doing, and a company like Enron has partnerships that are trading with each other and creating an artificial price, was there not a mechanism in California that could determine this and take action to prevent it?

Ms. LYNCH. Not that I know of. California had essentially handed off its price controls, because these were trades in the wholesale electric market, and those would have been covered by FERC.

Senator DORGAN. Now, all of you have made the point that Enron was hip deep in the proposition of how California would restructure. And they had a powerful influence on how the restructuring occurred. Every company, every citizen has a right to be involved in the political process by which they nudge or urge or try to force decisions in a certain direction. But creating the groundwork on which one may be able to cheat is actually different than actually cheating and I want to get to the question not of whether Enron was a big political player in California and in Washington in helping restructure, for example, California in an image that it wanted, but did it then use that in a manner that bilked or cheated or rigged the game against California consumers? And if so, why were there no mechanisms? Is FERC the only mechanism available to deal with that? I mean, I understand that—I said it at a couple of Energy Committee hearings that FERC was doing its best imitation of a potted plant. And it finally seemed to come alive from the neck up and took some action, but it just essentially sat on its hands and did nothing for a long period.

The question is, if one believed that a company came into the marketplace and began rigging the marketplace, were there no mechanisms and no handles at all, save for FERC making an ultimate decision at some point to resolve this on behalf of the consumer?

Senator Dunn.

Senator DUNN. Mr. Chairman, thank you. I'll take the first crack at that one. I want to underscore, however, that I agree with you that certainly it's everyone's right to lobby for a particular new set of laws, or statutory layout. Remember, however, that the promise of deregulation, as it was pushed at both here and Washington, D.C., and at every state level, was to bring in a deregulated format and the consumers will receive lower prices.

The fact of the matter is the internal documents for most of these companies show that was never the intent, although that was the promise that was made in virtually every legislative and regulatory body, including by, in California, Mr. Lay and Mr. Skilling directly, starting in testimony before the CPUC in 1994.

But getting specifically to the question of whether, in fact, they manipulated the market, the first evidence of that, although the question is whether they did it before it, that's still outstanding, but the first evidence surfaced in May 1999 when Enron artificially congested one of the transmission lines in California. That resulted in about a $6 million hit on the California consumers at the time.

And the California ISO attempted to take action. They found that there were many obstacles in their way, including the enormous political legal power of Enron in preventing its taking aggressive response to this and ultimately it resulted in a settlement agreement of which I believe fined Enron $25,000.

Unfortunately, every time any, in my view at least, any time any California regulatory body, be it ISO, the PX, the CPUC, has attempted to take aggressive action in that wholesale market, they've been stopped by FERC as a result of the industry's request of FERC to prevent further regulatory activity at the state level.

Senator DORGAN. Mr. Freeman.

Mr. FREEMAN. Mr. Chairman, I just want to make clear that California did not sit idle and do nothing. We were a hundred percent in the spot market in January of 2001, and FERC has exclusive jurisdiction over that spot market, but we moved to enter into long-term contracts, even though they had us over a barrel at the time, but we got a lot of the power out of the spot market with long-term contracts. We initiated the most effective conservation program in the history of this country. And it was the combined actions of our long-term contracts, our conservation program, and, finally, in June, FERC beginning to do its job that brought this tiger under control, so to speak. So we did everything we could do, including building new power plants and completing them as fast as we can. We completed almost 3,000 megawatts of new plants over the last year.

But the part of the job that the state has no authority to deal with is the sale of electricity at wholesale in interstate commerce, and that's been FERC's responsibility for decades, and they've exercised it for decades. And this business of all of a sudden deciding unilaterally, without any findings, that they can kind of go home and not do their job—to my mind, lobbying for new laws is one thing, but lobbying agencies not to enforce the law that's on the books is something else.

Senator DORGAN. You're correct about it, that's quite different.

Mr. COHEN. Mr. Chairman?

Senator DORGAN. Yes?

Mr. COHEN. Just in response to your question about whether FERC was the only agency that could have done anything. Actually, the Commodity Futures Trading Commission also has——

Senator BURNS. Excuse me. Who are you?

Mr. COHEN. I'm sorry. Gary Cohen. I'm General Counsel for the CPUC.

Senator BURNS. Thank you very much.

Mr. COHEN. And the Commodities Future Trading Commission issued proposed rules in June of 2000, and then final rules in December 2000, which were to become effective in February in 2001 that would have regulated the online trading that Enron was conducting. But when Congress passed the Commodities Futures Modernization Act amending the Commodity Exchange Act, those rules were withdrawn. So during this time period that we've been talking about, there were no rules in effect whatsoever that governed the online trading that Enron was engaged in.

Senator DORGAN. Thank you very much.

Let me make a point, ask one additional question, and then I'll call on Senator Burns.

Senator Dunn, you talked about the lack of cooperation that your committee has received from Enron. Let me tell you that we have experienced the same with respect to Enron.

Senator DUNN. I'm sorry to hear that, Mr. Chairman.

Senator DORGAN. This Subcommittee has been involved in an investigation. We have, for example, repeatedly asked for records dealing with partners, the investors, and all of the partnerships. We hear from the corporation that they want to cooperate. Their attorneys say they want to cooperate. But the fact is, they never do cooperate. And I have spoke to the Chairman and the Ranking Member of the full Committee about issuing additional subpoenas, but we have experienced exactly the same thing. A little cooperation would go a long way here.

Senator DUNN. Agreed.

Senator DORGAN. But we've received precious little.

Now, let me ask a final question. There is a criminal investigation ongoing. We know that. There are congressional investigations ongoing with respect to Enron. I said when I started, the reason that we are focusing on Enron today with respect to this hearing and we're not tackling the larger question of restructuring and, you know, California's mistakes in restructuring, et cetera, et cetera, is we're trying to understand, did people who ran the Enron corporation and cheated their Board of Directors and cheated investors—that comes from the Board of Directors' own report—did they also cheat consumers in California and consumers in the West Coast by manipulating prices and creating sham trades and so on and so forth? Because that is a very serious question and is not petty crime. We're talking about billions of dollars. These are big issues.

I'm wondering, are any of you aware of, for example, FERC investigators investigating out in California the questions that we're tackling today, are you aware of investigators from the Justice Department who are engaged in a criminal investigation of Enron in California, looking at these questions with respect to Enron?

Ms. Lynch.

Ms. LYNCH. I know that FERC has an open investigation proceeding regarding the generation market in general, and I have had several conversations with Chairman Wood about how we could assist in a joint state/federal effort. Those have not borne fruit.

Senator DORGAN. In your judgment, is the FERC investigation an active, aggressive investigation?

Ms. LYNCH. I just don't know. I haven't seen them where we've gone. I haven't seen them where Senator Dunn has gone. I haven't seen them where the Attorney General has gone, because we are coordinating with the California Attorney General. That doesn't mean they're not there. I would hope that we could coordinate more effectively with the federal investigators.

Senator DORGAN. Is there any evidence that FERC is involved in an active, aggressive, robust investigation? Ms. Lynch.

Ms. LYNCH. I haven't seen it.

Senator DORGAN. Senator Dunn.

Senator DUNN. If I may, Mr. Chairman, just add on to Ms. Lynch's testimony, we actually called before our committee one of the FERC commissioners early last summer. They resisted and instead sent one of their litigation counsel to testify before our committee, an individual by the name of Robert Pease. He was very cooperative, very open. I was very impressed with his testimony.

We asked him that very question. But now we're dealing with mid-summer of last year. The best that Mr. Pease and—outside of the—at direct testimony that we've been able to gain is when there was suspicions about planned—or, excuse me, outages that were done deliberately to create a shortage, FERC indicated that it would investigate. And it did, by making several phone calls to a few of the plant operators asking them if they turned down their plant in an effort to manipulate the market. The answer was no. FERC concluded there was no manipulation of the market.

Since that time, at least as far as our committee is concerned, we have seen, to be perfectly frank, Mr. Chairman, zero from FERC in its investigation in California.

Senator DORGAN. Senator Dunn, I am disgusted by those who would take advantage of consumers. And we're talking now about the Enron Corporation in this investigation. But I'm also disgusted about that group I call the "grateful dead" that assumed public office in a regulatory role and failed to regulate. They do no service to this country. Best, in my judgment, they not accept a role in public service if they're not interested in using the opportunities they have on behalf of the American people to make sure the marketplace is a fair marketplace and people are not cheated.

So I shouldn't even disrespect the name of a band in this country by calling them the "grateful dead," but I was so angry with FERC during this period when they were running up prices and everyone understood something was amiss, and FERC nonetheless sat and sat and sat and did nothing. And finally they took action, and I suppose we should not fail to be grateful for small favors. But having taken action billions of dollars late, I think many people in California and on the West Coast wonder if they need to say thanks to someone who took action that late.

But, at any rate, let me call on my colleague, Senator Burns, for questions.

Mr. FREEMAN. Chairman Dorgan, could I just thank you for your anger and hope that you will persist in the question that you asked, because having worked at the predecessor to FERC, these agencies do respond to the Congress, and I believe that you and your colleagues, if you persist, can have an influence that's in the public interest, and I thank you for this hearing and for that interest.

Senator DORGAN. Well, rest assured that we're going to try to build a fire, and I'm going to be one carrying wood.

Senator Burns.

Senator BURNS. Thank you very much. That's a bad illustration of the Grateful Dead. I can remember in 1994, they came to Montana to play a big fund raiser for my opponent.

[Laughter.]

Senator BURNS. They had come up there and done a big concert for my opponent.

Mr. FREEMAN. And he was grateful, even though he wound up being dead, in terms of——

[Laughter.]

Senator BURNS. He knocked him out.

Mr. FREEMAN. Apparently, Mr. Burns, it wasn't good enough.

Senator BURNS. He didn't make it.

Enlighten me a little bit on the California law whenever you deregulated the power industry. You deregulated transmission. Is that correct?

Mr. FREEMAN. Not exactly, Senator. The transmission was restructured—but it's still a cost-plus regulatory——

Senator BURNS. OK. How about generation?

Mr. FREEMAN. It was. Yes, sir. It was—that was the part of the industry that was clearly deregulated.

Senator BURNS. How about the prices that could be passed on to the consumer?

Mr. FREEMAN. Well, the retail rates are still under the jurisdiction of President Lynch and her colleagues, so they're still regulated.

Senator BURNS. I would—I'm just looking over things. You had other companies there that showed great profits, too, and I'm not—this whole thing with Enron is fascinating to me as to how they put that all together. And there's no doubt about it that there's going to be some people go to jail and ought to go to jail. There is no question about that.

But there's also some flags along the way those who are serving in our legislature—now, I didn't vote for deregulation here, and I've always been sort of leery of it, because you cannot dereg an industry when you have not—when you do not have a national grid to where you can move power to anywhere you wanted to go. In other words, we, in Montana—now, we've heard a lot of bad things said about cooperatives and REA and, you know, and they wanted to take those in, but I'm one of the guys that believe it had not—'cause I'm come out of agriculture—had it not been for the REA, we'd be watching television by candlelight out there on the ranch.

And when you talk about being hammered by big companies, I'm telling you what. You want to come and try to sell grain or fat cattle? Now, that's a perishable product, just like electricity is. I mean, it's those things—and we fight those battles every day, and we've fought it under every administration, every Justice Department, and whatever we could look at it.

But here it looks like that you piecemealed deregulation and it caused this mischief to happen. Because those costs, in a purely deregulated market, could not be passed on to the user who usually is the people that demand regulatory or legislative people to take action. The consumer of California.

As long as they had the protection of their PUC, and that could not be passed on to them, everything was going on back here behind them, they didn't worry about it. The public really didn't worry about it. The only thing they worried about was reliability. But it wasn't coming out of their billfolds until it was done blanketly among everyone through taxes—increased taxes.

Now, tell me if I'm wrong there, Mr. Freeman, and put me on the right track. But this just seems like I'm——

Mr. FREEMAN. Well, the one thing that you're certainly right on is the REA, because I grew up in the Tennessee Valley. We had the first co-op in the country there. And, if it weren't for the co-ops, there wouldn't be electricity in rural America.

Senator BURNS. That's right.

Mr. FREEMAN. So that's a fundamental point. Frankly, the people of California and the California legislature did not and could not repeal the Federal Power Act. And we had every right, every reason, to believe that the wholesale price would not have gone through the ceiling. President Lynch, in her commission, would pass on reasonable wholesale rates. They do. That was not the problem. The problem is the Federal cop just went off the beat and let those wholesale prices go up to the sky and turned their back on it. That was the nub of the problem.

And, frankly, I don't think anybody thinks that deregulation was a great and wonderful thing. Matter of fact, if it weren't for the honor of it all, we'd just as soon skip the whole last four years, but——

[Laughter.]

Senator BURNS. Well, I'd go for that. I'd go for that. But it just looks like, to me, that you had all this area of mischief, and it could not—and you just hit a wall as far as passing some of those costs along of that mischief. Now, that mischief would have gone away as soon as the public—whenever they start writing those high power checks, there would have been something happen, I think. Maybe I'm wrong here.

Mr. FREEMAN. Senator Burns, President Lynch is perfectly capable of defending her commission, but I want to say that they did raise the rates. They raised the rates a healthy three cents a kilowatt hour. And Californians are paying rates that are among the highest in the nation. So——

Senator BURNS. Well, you affected my state, too, you know. I'm——

Senator DUNN. This myth that somehow California consumers have not felt the impact of these rate increases—they're the ones that are paying these outrageous rates. They're the ones that got ripped off. And they know it.

Mr. FREEMAN. If I may, Senator Burns.

Senator BURNS. You bet.

Mr. FREEMAN. Let's drive the point home with three quick figures. And those three quick figures are the last year in which we experienced regulated wholesale rates, or at least the tail of it, was 1999. The entire cost of wholesale electricity in the state of California in 1999 was $7 billion. The first real year of wholesale deregulation, 2000, or at least when its impact was first—most experienced, that year, when demand from 1999 to 2000 only went up four percent. Calendar year 2000, the cost of wholesale electricity in the State of California was $27 billion.

Now let's go to calendar year 2001, when demand has actually gone down from 2000 to 2001. Now, while the figures are still being calculated, it's roughly in the neighborhood of $50 billion. All of that, not due to increased demand. One thing—increased wholesale cost. And the call early on was simply to pass on those high wholesale costs to the retail customer. When you go from $7 billion to approximately $50 billion, you can imagine the impact on the average retail payer, whether it's residential or small, medium, or large businesses. That would have been fatal, not only to the California economy, but elsewhere, as well, Senator Burns.

Ms. LYNCH. Senator, nonetheless, we did pass on some of those costs. In May of 2000, the costs started to rise in San Diego. And San Diegans, throughout 2000, experienced those higher prices, until the state legislature stepped in and stopped the hemorrhaging. And then last March, a year ago March, my commission raised retail rates to a historic level in California. So we have been passing those costs on. But I agree with Senator Dunn, a sevenfold increase in electric costs month over month or year over year would not have been able to be sustained by the California economy.

Ms. HAUTER. Senator Burns, I'd like to address your issue around deregulation, because we're skeptical as to whether even good regulation by FERC could really prevent higher prices for residential consumers. One of the reasons that we've been skeptical about the state deregulation bills is that the way the bills have been crafted, it puts large industrial customers who can buy a lot of energy in the driver's seat and in a position to buy energy cheaper. And when you take those large industrial customers away from the other sellers of energy, then costs go up. And small consumers, small businesses, don't have the market power to go out in the market and compete. And, in fact, Enron, in California, promised a vigorous retail market, that they would sell to small consumers. And they almost immediately pulled out, because they recognized that they weren't going to make enough money. So that cherry picking is one of our concerns.

Senator BURNS. I would agree. I would agree with your premise on some of those. And I thank the chairman for holding this hearing. I've got to go to the same place he's got to go. But I'm going to go through this testimony, and I'll probably write you some questions or something, you know, if you would, but—and I noticed there were some other folks that made terrific profits this year also that we should look at. You know, you had Dynegy in there, Duke was in there, Reliance, Williams, AES, West Coast Power, all those people were profiting from this same situation, and I'd—you know don't whether it might be a situation of Lucy playing—pulling away the football or something, but I thank you for coming today, and I thank you for your testimony.

Thank you.

Senator DORGAN. Senator Burns, thank you. Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman.

Just one current matter for you, Mr. Dunn. You described evidence of willful destruction of documents. I'd like to know if you can tell us anything about what documents you believe were destroyed, and particularly whether you believe any of those documents involved matters affecting Oregon, whether they come from the Portland trading floor, that kind of thing. What can you tell us, based on what you now know, with respect to the destruction of the documents?

Mr. DUNN. Senator, I will zero in specifically on the disks of e-mails that I referenced as opposed to the Arthur Andersen——

Senator WYDEN. Right.

Senator DUNN.—and the reports of late last fall of Enron's own destruction. We had requested, after January, when we moved for contempt again and voted for the criminal referral of Enron for its destruction of documents, Enron came to us and said, "Look, Senator, we want to get out from under this contempt and this criminal referral. We'll open our doors to you, save attorney-client privilege documents. But other than that, we're in bankruptcy, we're exiting the market, we don't care about trade secrets anymore, and all the other traditional privileges which could be used to be prevent the production of documents."

We were really after two broad categories from Enron and other companies, as well. First, what we call their policy documents or their strategy documents in setting up—my editorial now—their attack on California and elsewhere, as well as the micromanipulation, the trading manipulation. That would have primarily occurred in their facility in Portland, Oregon.

When we went after the larger, more macrostrategic documents, we wanted all of Mr. Lay's, Mr. Skilling's, Mr. Kean—and for those unfamiliar with Mr. Kean, Steve Kean is the head of their governmental affairs department on a national basis based in Houston, an individual by the name of Jeff Dasovitch, who's based in San Francisco, takes care of all the Western U.S. government relations for Enron, or did—he has since departed—as well as some key other governmental affairs individuals.

We asked for all e-mails associated with those individuals that relate to anything relevant to the Western United States energy markets, particularly their lobbying efforts, their business designs for that area of the country, et cetera. It was those requests that led to the production of approximately nine disks of information in which they assured us that all the documents, save attorney-client privilege, were contained on those documents.

We then—first, you're dealing with an individual who's not the most computer-literate person in the world. We retained an IT team to go in who has tremendous expertise, as I know much of the committee's expertise in that area as well.

They spent, as oftentimes experts in IT do, about four straight days, 24 hours a day, analyzing those nine disks, breaking through all kinds of codes and other—what they believe were deliberate obstacles for us gaining access to the actual documents on those disks.

Once we got through all of those obstacles, we began to review the various e-mails from Mr. Lay and Mr. Skilling and Mr. Kean, et cetera. And it was through that review that the IT team discovered what they referenced as certain mechanisms that were utilized to blank out key e-mails from each of those individuals that they said could not have been done in any way but a deliberate manner to block out those e-mails.

Now, the first blush would be, well, maybe that was attorney-client privilege. No. We were referenced that all documents on those disks were non-attorney-client privilege, so that we should have had access to all of them.

We'll be frank with you, Senator. Our IT team is trying to break through those deliberate efforts to eliminate the documents. We're having some success.

We are not demanding of Enron—as a result of this conduct—absolute, complete, unfettered access to the main hard drives and the other information that we need to go through at our discretion to really get to the core of this, because this is just one other example, in my view and the committee's view, of Enron's deliberate attempt to preclude us from gaining access to the information we consider critical.

Back to your very basic question: Does it also involve the State of Oregon? Yes, unfortunately, Senator, it does.

Senator WYDEN. Well, I thank you for that information, for your thoroughness. I would also ask that you make that information available to Oregon's Attorney General and Oregon's U.S. Attorney, certainly in a fashion that doesn't compromise your inquiry. And my assumption is, already, the Attorney General and the U.S. Attorney of your state are looking at is, and I think that we ought to maximize our efforts with our two states. That's what Senator Boxer and I have sought to do on this Committee. And we appreciate your thoroughness.

A question for your, Mr. McCullough, with respect to LJM2 and their efforts to get into the State of Oregon. LJM2, as you know, is one of the most questionable of the whole operation surrounding Enron that led to the restatement of Enron's earnings and basically the house of cards started falling. And my sense is, and I'd like to get your sense of this as well, that when you look at the LJM2 effort to get into Oregon, it indicates that Enron knew prices were going to go up or that they were working actively to try to raise the prices. And this goes, of course, right to the heart of what we need to know in this investigation.

And let me begin by saying you point to Enron's efforts to sell off one of the plants as evidence that Enron had reason to expect that prices would be going up. Can you tell us which one of PGE's plants Enron approached the Oregon Public Utility Commission about selling?

Mr. MCCULLOUGH. Yes, Senator Wyden. In the early 1990's, a power plant was built in the eastern part of the state called Coyote Springs I. The practice in the industry is to build the infrastructure, water and fuel delivery, for two plants so you get a synergy. You would halve the cost of that infrastructure. Coyote Springs II was on the boards since that date. Because power prices were lower than the trigger required to start Coyote Springs II, the plant had simply sat on the drawing boards from the early 1990's to the winter of 1999. At that point, Enron approached the PUC and said, "We can sell this. So pull the plant out from the utility, turn it over to us, and we'll be able to make a profit from it, and we'll provide a small margin back to the ratepayers."

Senator WYDEN. Well, we now understand that LJM2 was going to be a partner to the transaction with a 50 percent stake of the equity. We know that they were expecting a return of substantially more than one would expect in this area.

And I just want you to know very much first that we appreciate your expertise. The questions that I asked you at the earlier hearing with respect to the precipitous market drop did more than anything in my view to finally get FERC off the sidelines to look at this. We're going to ask you some more questions, perhaps in writing, with respect to LJM2, but I thank you particularly for your analysis on that point.

One other question for you, Mr. McCullough. Before the onset of the huge price spike, Enron was also seeking to sell off PGE to Sierra Pacific Resources, having filed applications with the SEC and FERC in February and March of 2000. Are there any documents associated with that proposed sale of PGE to Sierra Pacific that, again, indicate Enron had some advanced knowledge that these West Coast electricity markets were going into the stratosphere?

Mr. MCCULLOUGH. I had my staff review that, and we've not found anything clear in that, though the complexity of those calculations are so great that I wouldn't call the book closed.

Senator WYDEN. Alright. Ms. Hauter, you state in your written testimony that Enron divisions paid up to $2,500 per megawatt hour for electricity markets when market prices were less than $340. Why in the world, short of the kinds of more ominous analyses that suggest circumstantial evidence of manipulation—why in the world would Enron's traders, these very sophisticated people, have paid such high prices to buy from their own company when they could buy the same power at cheaper prices on the market?

Ms. HAUTER. Well, I think that the circumstantial evidence is very good that their motives were to really cause a price increase, because then they would make more of a profit in their other trading divisions, and because with their energy services division doing so poorly, that they could hide its financial difficulty in more of their accounting tricks. I mean, that's the only—obviously, this is circumstantial evidence, but this is the only rationale that we can come up with.

Senator WYDEN. Now, Ms. Hauter, in the spring of 2000, Enron filed an application with the SEC to enable it to compete in what's called the Qualifying Facility Market and an application that would allow them to compete even before the sale of PGE was completed. If the proposed sale of PGE was approved, Enron would no longer be a holding company under the Public Utility Holding Company Act and obviously out from under a number of regulations. But even before the sale was approved and Enron was no longer under the Public Utility Holding Company Act, Enron was seeking to get out from under the holding company restrictions in order to compete in this particularly lucrative market, the qualifying facility market.

At the time Enron was saying it expected the PGE sale to be completed in the second quarter of 2000, but it appears Enron wanted a bigger than 50-percent share of the ownership and profits from qualifying facilities investments, and it wanted it now. It didn't want to go through the regular process.

Do you see any connection between Enron's urgent interest in this precipitous effort to get into qualifying facility investments in the spring of 2000 and this overall West Coast energy crisis?

Ms. HAUTER. Well, again, an educated guess based on circumstantial evidence is that they wanted to make use of that baseline power, that power that would be there all the time and available to them, so that when they were doing trading on the spot market, that they would have it as a backup, as a protection, so to speak.

Senator WYDEN. Madam Chair, I know my time is up. I would like to just make two points. First, I'd like to submit for the record a letter dated April 13th, 2000, from Enron's attorney to the SEC about Enron's interest in getting expedited approval of its application for exemption from the qualifying facility restrictions so it could compete in the Qualifying Facility Market before the second quarter of 2000 when the sale of PGE was expected to occur.

Senator Boxer [presiding]: Included in the record.

[The information referred to follows:]

LEBOEUF, LAMB, GREENE & MACRAE L.L.P.
Washington, DC, April 13, 2000

CATHERINE A. FISHER,
Assistant Director,
Office of Public Utility Regulation,
Division of Investment Management,
Securities and Exchange Commission,
Washington, DC.

RE: *Enron Corp. Application under Sections 3(a)(3)/3(a)(5)*

Dear Cathie:

I am writing to provide some background information with respect to an application ("Application") that Enron Corp. ("Enron") is filing under Section 3(a)(3) or, in the alternative, Section 3(a)(5) of the Public Utility Holding Company Act of 1935 (the "1935 Act" or "Act"). Briefly stated, Enron is seeking relief, similar to that granted AES Corporation, to enable it to compete effectively in the developing QF market, pending completion of the sale of Portland General Electric Company ("Portland General") to Sierra Pacific Resources, Inc. ("Sierra Pacific").

Enron is currently a holding company that claims exemption pursuant to Rule 2 under Section 3(a)(1) of the Act, by reason of its ownership of all of the outstanding voting securities of Portland General. As you know, Enron has entered into a definitive agreement to sell Portland General to Sierra Pacific Resources, Inc., and applications for approval of that transaction were filed with this Commission on February 3, 2000 (SEC File No. 70–9619) and with the FERC on March 3, 2000. The Sierra Pacific/Portland General transaction, which is subject to customary regulatory approvals, is expected to close in the second half of 2000. Upon completion of the sale, Enron will cease to be a holding company within the meaning of the Act.

Pending Commission action on the Sierra/Portland General transaction or issuance of a final order on the instant Application, Enron will rely on the good-faith exemption granted by Section 3(c) of the 1935 Act as a means of obtaining relief from the QF ownership restrictions under the Public Utility Regulatory Policies Act of 1978 ("PURPA"). Briefly stated, the regulations under PURPA generally limit an electric-utility holding company to no more than 50% equity interest in a QF.[1] There is, however, an exception (relied upon by AES) for holding companies that are exempt "by rule or order" under Section 3(a)(3) or 3(a)(5) of the 1935 Act.[2] The Federal Energy Regulatory Commission ("FERC") has interpreted this language to apply as well to entities that have filed a good-faith application for exemption under Section 3(a)(5) and, by extension, Section 3(a)(3) of the 1935 Act. *Doswell Limited Partnership and Diamond Energy, Inc.,* 56 F.E.R.C. ¶ 61,170 (July 31, 1991) (a copy of the order is [not] attached).[3]

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[1] A QF cannot be owned by a person primarily engaged in the generation or sale of electric power. 16 U.S.C. § 796(18)(B) (1996). The PURPA regulations provide that a facility "shall be considered to be owned by a person primarily engaged in the generation or sale of electric power, if more than 50 percent of the equity interest is held by an electric utility, or utilities, or by an electric utility holding company or companies, or any combination thereof." 18 C.F.R. § 292.206(b) (1999).

[2] 18 C.F.R. §§ 292.206(c)(1) and (c)(2) (1999).

[3] The FERC explained: "Although section 292.202(n) specifically utilizes the phrase "rule or order," reliance on the statutory PUHCA section 3(c) "safe harbor" is not inconsistent with our regulations. In our view, treating a pending good faith SEC application differently than the SEC "rule or order" language in the regulations concerning granting an exemption would be incon-

As explained more fully in the Application, Enron believes that it is entitled to an exemption under either Section 3(a)(3) or 3(a)(5), based on the precedent, the nature of its primary nonutility business and the relative and absolute size of its utility operations. Indeed, if the Sierra Pacific/Portland General transaction were to fall through, Enron would ask the Commission to rule on the merits of the Application. We do not anticipate any problems, however, with the Sierra Pacific/Portland General transaction and so, would simply rely on the good-faith exemption provided by the instant filing (as it affects Enron's QF ownership rights), pending the outcome of the Commission's review in File No. 70–9619.

To address any concerns during the pendency of this Application, we would offer the following additional safeguards for the public interest and the interest of investors and consumers so long as Enron continues to own Portland General:

- Enron, which is currently exempt pursuant to Rule 2 under Section 3(a)(2) of the Act, will undertake to continue to file Form U–3A–2 during the pendency of the exemptive Application or until Portland General is divested.
- Enron will not rely on the temporary good faith exemption to facilitate the growth and extension of a holding company system. Once the sale of Portland General is complete, Enron will cease to be a 1935 Act-jurisdictional entity and so, will withdraw the instant Application.
- Finally, in the event that the sale of Portland General is not completed in a timely manner and if it appeared that it would ultimately be determined that Enron was not entitled to an order of exemption under either Section 3(a)(3) or 3(a)(5), Enron would undertake to restructure its QF interests within a reasonable time and thereafter withdraw the request for exemption.

We would be happy to meet with you and to provide any additional information. If you have any questions, please call me at (202) 986–8281.

Sincerely,

JOANNE C. RUTKOWSKI.

Senator WYDEN. And, I will also say, Madam Chair, and I think it's going to be interesting to talk to some of the Californians, as well, about Enron's interest in getting into the qualifying facility business, because clearly this is another area where certainly there is substantial circumstantial evidence indicating that this is another effort to hot-wire the market and get in and make cash profits quick without having to go through the regulations. And hopefully we can get into that on another round.

The only other point that I wanted to mention—Ms. Hauter, I want to thank you for the support that you've given me in this effort to get a strong ratepayer advocate in the Justice Department to deal with these issues. As you know, given the fact that FERC has been on the sidelines for so long, the biggest and most constructive force for consumer and ratepayer advocacy comes from the states.

The states have no authority, folks, over virtually everything you all have been talking about this morning. And one of the things that we can do in the energy bill, because our proposal was accepted, is set in place a ratepayer advocate within the Justice Department with subpoena power, with full power to get at these interstate transactions. And I thank you for the support you've given us and look forward to examining particularly the qualifying facility issues in the future.

And I thank you, Madam Chair.

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sistent with the intent of section 292.202(n)." The FERC noted that it had made a similar finding with respect to a company's filing of an application under Section 2(a)(3) of the 1935 Act, and the pendency of the exemption from the definition of "electric utility company" during the pendency of a good faith application. *See Long Lake Energy Corporation,* 51 F.E.R.C. ¶ 61,262 (1990).

Senator BOXER. Thank you so much, Senator. It is just most unfortunate that we have to go in that direction. I'm supporting you, because FERC is supposed to do all this. And so it's a little unnerving that they're not.

I'm really sorry that Senator Fitzgerald had to leave, because he said that he didn't think Enron had anything to do with the California crisis, and I want to make sure that I heard you all loud and clearly. I believe all of you said they did play a role, a pretty large role. And if I could summarize it—tell me if I did not summarize it correctly.

For the record, what you basically told our Subcommittee—and, by the way, I want to welcome Senator McCain, because he has been so strong in his efforts to protect consumers, and we really were at a crunch time whether this Committee was going to move forward with these kind of hearings, he was the voice to say yes. I want to thank him publicly for that.

The message that you gave us was that, in fact, you felt that Enron did play a large role in our crisis in this way. First, in working aggressively to change the regulatory environment at the state level and at the federal level. And then when there was only one regulatory agency left, FERC, they worked very hard to stop them from doing anything for quite a long time and, third, by manipulating the market. Does that sum up what I heard? Does anyone disagree with that summary?

OK, because what I want to hone in on is this. I have a total grip on what they did to get themselves out of regulation. I understand what they did with FERC, and I've put a lot of documentation in the record, Senators, on how they actually staved off any move by FERC for almost a year. And, as Mr. Freeman told us, that was the only thing that could have been done to save us. And, finally, when they acted, they did save us. And we have a good market, a good functioning situation right now in California.

And I'm going to ask about what should happen if they don't renew the order, the must-offer order and the cost-based pricing in a moment. But I want to make sure senators understand and I understand the way they manipulated the market. And all of you spoke to that. But I've picked up a few ways, but then I want you to tell me if I'm missing some of the ways.

One, they kept selling the same electricity over and over again driving up the price along the way until it finally got to the consumer. I suppose you call that "derivatives." Senator Feinstein tried to get a handle on that. We were unsuccessful in our reform measure on the floor of the Senate, but we'll fight another day on it. But that's one way. They kept selling the same electricity and upping the price along the way. The reasons for it, Ms. Hauter and I think Mr. McCullough also said they wanted to get—make that look like a profit-making operation to hide other problems. But, be that as it may, the California consumer was hit, and hit hard. One way.

The second way, and we didn't talk about it, but, Senator Dunn, you do have it in your testimony is that they jammed, they had a way of jamming transmission lines. So when they jammed the transmission lines, it set off a crisis. And I want you to explain, any one of you who understands it, how that would push up the costs when they did that.

And the third thing I didn't hear anyone say, and I—my understanding is this happened. I don't know if Enron was involved in it or not, but more and more plants were taken offline for quote/unquote "maintenance" then we ever saw before. I have the charts, and I wonder whether that was—if any of you know that that was used.

So I've come up with three ways the market was manipulated by Enron and others. I wonder if any of you have any thoughts about whether I'm wrong on any of those three, and what other ways was the market manipulated. Ms. Lynch, I'll start with you.

Ms. LYNCH. Certainly. I completely agree with you, Senator Boxer, that Enron would trade among itself so that it could drive the price up. And not only would it drive the actual price of the electricity it was trading among itself on, but its internal trades could also affect the market indices on which other people traded. So if they kept trading essentially in sham transactions, the indices would reflect that, thereby allowing other people to start trading at that level, as well.

Senator BOXER. They pushed the price up.

Ms. LYNCH. Exactly. Because the prices that are paid to generators and suppliers in some transactions are tied to those indices, so when they went up, everybody else's prices went up and it was just a race to the top.

Certainly, in terms of transmission congestion, the internal trading could affect that. Enron company one could trade power to company two, supposedly transferring where that power was going to go. So from North to the South or they could trade the power so that a southern entity would have to send it north creating congestion.

The interesting thing would be, then they would be paid to eliminate the congestion, but the congestion was always phantom congestion to start with. It never was going to go from the North to the South, because they were trading among themselves.

Senator BOXER. Who paid them to eliminate the congestion?

Ms. LYNCH. The ISO would then pay——

Senator BOXER. Oh.

Ms. LYNCH.—an additional price to eliminate the congestion, which was called phantom——

Senator BOXER. So that upped the price more and more.

Ms. LYNCH. It would up the price more and more. And, in fact, I believe that Enron was one of the earliest, if not the earliest, creators of phantom congestion in California's lines.

Senator BOXER. Phantom congestion.

Ms. LYNCH. Yes.

Senator BOXER. Wonderful way to explain it.

Ms. LYNCH. And as to the power outages, we certainly have been tracking the physical withholding of power in California, as you know, although in 2000 we had 45,000 megawatts of power that could be produced by California power plants. In the winter of 2000, up to 16,000 of those megawatts were off line. So a third of the power in California that could have been produced, wasn't produced. We haven't yet come to the bottom of how Enron was involved in that.

Senator BOXER. OK. Anybody else? Yes, Senator?

Senator DUNN. Senator, I'd like to add a fourth area.

Senator BOXER. Please.

Senator DUNN. And that's what has come to be known as "megawatt laundering." What occurred under those circumstances is that when the Cal ISO imposed price caps in the year 2000, one of the exemptions from those price caps was power coming from out of state. And so many of the market participants, including Enron, who had legal control over many of the megawatts would, in a theoretical sense, transfer them out of state, or legal ownership out of state, then resell them back into California unrestricted by the price caps that the ISO had put in place in the year 2000.

Senator BOXER. You call that "megawatt laundering."

Senator DUNN. Correct.

Senator BOXER. This is good. We're having a whole new lexicon here. Before we get to you, Mr. Freeman, do you have anything else. Those were four ways that——

Mr. FREEMAN. Yes, ma'am.

Senator BOXER. Yes?

Mr. FREEMAN. Enron—I negotiated longer-term contracts with many of these generators to try to get out of the spot market. Enron was the company I could not come to an agreement with. And they—among all of the folks that were taking advantage of us, they just would not agree to a long-term contract. And the irony of it all was, they questioned our credit. Their argument was——

Senator BOXER. Oh.

Mr. FREEMAN.—that our credit was not good enough. That was their excuse. They made out in the secrecy of the short-term market where there was no evidence of what went on. And, of course, many of the transactions did not even have their name on it, because they simply brought together someone in the marketplace that had power to sell and someone who bought it. They made their profits off of the volatility. And it's very interesting, and I think Mr. McCullough and others have pointed out, that as we brought things under control in California, Enron's profits came under control——

Senator BOXER. Oh, yeah.

Mr. FREEMAN.—and their demise. The other point I want to make is, this issue of transmission is a huge issue. Just think of the highways. If you have gridlock on a highway, then people would obviously pay to get by. And if you have gridlock, on the transmission system, it creates higher costs.

Now, you have going on at the FERC today what I would say the, kind of the remains of the Enron syndrome where there is a concerted effort to turn transmission over to merchants, to the same people that were marketing generation. And if they are able to buy up pieces of the transmission system, you've got a new set of problems on our hands throughout the country. That needs to be nipped in the bud before it really gets rolling. But that is the big issue that Ken Lay was pushing. It was the subject of his conversations about the new FERC employees, and it's one that deserves the attention of this Committee.

Senator BOXER. Ms. Hauter?

Ms. HAUTER. Yes, I wanted to address that issue of phantom congestion, because we've been looking at the FERC rims site and these disclosure forms that are really a disgrace. And there were basically four paths where Enron was making a hundred percent of its West Coast trades. And one of those paths was between Nevada and California. And the Nevada Public Utilities Commission is investigating the allegations around Enron's daily capacity auctions at this Palo Verde place where there would be congestion. And I think that FERC—these forms—we'd be happy to make them available to you——

Senator BOXER. Please.

Ms. HAUTER.—really demonstrate how outrageous the lack of information is.

Senator BOXER. Thank you. Mr. McCullough, did you have something to add? And then I'm going to call on Senator Nelson and then Senator McCain.

Mr. MCCULLOUGH. I'd like to comment on two of the issues that you've raised and then add a fifth.

The first is on the spot pricing and potential sham transactions. We don't have much transparency in this market. In fact, what little transparency we have now comes from third-party indices. And President Lynch made this point, but it needs to be made more clearly.

The principal one is the Dow Jones indices. If one can add transactions to the Dow Jones indices in the proper way, one raises the price by contract from one end of the West Coast to the other—literally from Alberta to Mexico. This goes far beyond California. Most of the industries outside of California actually had their rates tied to this. So every one of those transactions had an impact, and those transactions directly were the cause for paper mills closing in Washington, metals firms throughout the Northwest, chemicals. So there was a tremendous opportunity in that one area. And there has been no oversight in that.

On outages, John Robinson, at FERC, as you noted, did his study early in the process. We've really not had a return to that study. The plants in California, the ones that were averaging a 50 percent outage rate, as you noted, they're not unusual in the U.S. In fact, we have a data base run by the North American Electric Reliability Council that follows that type of plant by age, by fuel, by size. They average an 80-plus availability rate everywhere, outside of these few short months in California when they averaged a 50 percent availability rate. And that was something FERC never addressed and probably should revisit.

But last and most importantly is long-term contracts. California focused on hourly markets. That surprised most of us who had spent our lives in the industry, because most end-user supplies are monthly or yearly contracts. With the California crisis, the number of players fell dramatically. The market power of those players increased dramatically, and that left a trail of high-power, long-term contracts that are of vastly more value than the day-to-day hourly transactions. In fact, those are the ones that are going to last for the next ten years. Moreover, those contracts are currently being sold quietly by Enron today. The auction starts next week. And that's one of the primary sources of value left in the shell of Enron.

Those are incredibly valuable long-term assets that came out of this, and that's what, of course, has been the fight. Your constituents and constituents elsewhere throughout the West Coast have been fighting to get FERC to review.

Senator BOXER. Of course, we are deep in that fight. I have to move on to Senator Nelson and then to Senator McCain, and then I will come back for another round.

STATEMENT OF HON. BILL NELSON, U.S. SENATOR FROM FLORIDA

Senator NELSON. Thank you, Madam Chairman. Madam Chairman, I remember the crisis in California. It affected virtually every one of your constituents. Everyone was outraged. The state government had to step in and start doing all kinds of things—and I assume the state legislature, as well—and ultimately your state got the price caps.

Now, what I'd like to ask is, under that kind of crisis atmosphere, how could this kind of manipulation have been disguised so that it was not discovered back in the middle of the crisis?

Ms. LYNCH. Senator, I'd like to note that there was no regulation at the federal level of either the online trading, although the—certain commissions were trying to regulate it, but Enron was really fighting that. There was no regulation at the SEC. And, frankly, although there should have been, there was no regulation at the Federal Energy Regulatory Commission.

So because it was happening in the wholesale market, which is the responsibility of the federal government, the states could not even get access to information. For instance, one of the tariffs that our independent systems operator has filed at the FERC is a confidentiality tariff which requires the ISO to fight document requests by state government. So when we, the PUC, and the Attorney General and I believe the Senate, tried to get documents, we had to formally subpoena them. We fought with this non-governmental entity that was answering to FERC, not the state.

So for the first year, the state was severely handicapped by both the lack of regulation, the lack of documentation, and affirmative confidentiality tariffs which required that non-governmental entity to operate in the best interests of the market participants and not state governments.

Senator DUNN. Senator, if I could add real quickly——

Senator NELSON. Please.

Senator DUNN.—as well. I want to give credit to a certain number of individuals. Mr. McCullough is one of them. The other one is state Senator Steve Peace in California. There are a number of individuals who, from the very beginning of this alleged competitive market, as dysfunctional as it is, that raised red flags from the very beginning.

But in the political process—I wasn't there in 1996, but I certainly understand, as an elected official representing almost a million constituents, that there really was an earnest desire on every elected official across the political spectrum to deliver to their constituents lower rates for electricity. And that was the promise. And it was only the industry and, save a handful of individuals, like Mr. McCullough, that really had the sophistication to understand that what was being set up was, in fact, not to the benefit of consumers but to the detriment of consumers.

Mr. FREEMAN. Senator Nelson, if I could just add, I was there with the Governor during this crisis. And as an elected public official, I'm sure you understand when the house is on fire, your job is to put the fire out. The legislature was up until 3 o'clock in the morning passing bills to put the state in the business of buying electricity, because the utilities were out of money, and we were facing massive blackouts. The last thing in the world was that we had any time to be investigating what FERC ought to be doing, except we just kept blasting away that they needed to get back on the job. And it was—I would imagine that the Governor, the state, and the members of the legislature spent on the average of 18 hours a day working on this subject all through those months. And, frankly, we just didn't have the resources or the data to figure this out at that time.

Senator NELSON. So the solution to this problem is more disclosure at the federal level so that this kind of non-disclosure shenanigans can't go on in the future. Is that the solution?

Ms. LYNCH. But also limiting or eliminating trades between affiliates for no other purpose than to raise the price.

Senator NELSON. Were the other utilities in California doing the same thing as Enron? Was there any complicity there, or was this just Enron?

Ms. LYNCH. It's certainly not just Enron. Enron was kind of the best at it and the earliest. But there were other market participants and other merchant generators and sellers who were doing the same thing. And the unregulated affiliates of PG&E were also doing the same thing.

Senator NELSON. Which affiliates?

Ms. LYNCH. Unregulated affiliates. So the trading arm of PG&E, the unregulated utility, its sister subsidiary, was engaging in the same kinds of behavior.

Senator NELSON. Have you, as the Public Service Commission, called to answer PG&E?

Ms. LYNCH. Well, actually, the unregulated—well, the non-state-regulated trading arm is, in fact, regulated by FERC, because it trades in the wholesale market and is not the regulated utility. So they answer to FERC, not the PUC.

Senator NELSON. But they're owned by PG&E.

Ms. LYNCH. They're owned by PG&E, the holding company, not PG&E, the utility.

Senator NELSON. Boy, I'd see if you couldn't get the long arm of control some way through the Public Service Commission there. Senator.

Senator DUNN. I just want to add one thing, Senator, to be fair. If you called before this Committee representatives of the major traders and generators and asked them the question about whether the primarily three California utilities—PG&E, Edison, and SDG&E—contributed to the dysfunction that beset the California wholesale market, they would, of course, answer that question yes. And what they will say is, as they have said to our committee, is that early on in the newly deregulated market, each of those three utilities had an incentive to see higher costs for purposes of recovering what's called their stranded costs, and that, as a result, they accuse those three investor-owned utilities in California of attempting to manipulate the market early on in the formation of that new market.

Senator NELSON. When you look at all of this unconscionable activity that affected every Californian, do you find in the management—let's take in the case of Enron—do you find a particular person who holds the smoking gun of this manipulation?

Mr. FREEMAN. Well, I'm just an old-fashioned guy that believes the top dog needs to take responsibility.

Senator NELSON. Well, that would be Ken Lay. He was the Board Chairman and the CEO, and it seems to me that he's the responsible person. I don't know whether he broke any laws or not, but he was certainly the leader or the poster child, in terms of deregulation, and he and his people were there every step of the way urging us to give them maximum freedom from any oversight and maximum secrecy and no responsibility and, at the same time, making the pitch here in Washington to persuade the law enforcement agency, FERC, not to enforce the law. That's what so galling about it.

Senator BOXER. Senator McCain.

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

Senator MCCAIN. I want to thank the witnesses for being here today, and I want to thank you for this hearing, Senator Boxer.

There are many aspects of this issue that average citizens and average senators don't understand. So maybe I could just ask some simple questions. Ms. Lynch, what do you mean by saying that Enron was trading amongst themselves?

Ms. LYNCH. We had a packet of slides where we used, as an example, in the fourth quarter of 2000 all the Enron related affiliates which had substantially the same personnel, so their directors were the same, the chairman was the same, their officers were the same——

Senator MCCAIN. I understand the chart.

Ms. LYNCH. Right, all those——

Senator MCCAIN. But I'd like it in English.

Ms. LYNCH. That all the related Enron affiliates were trading energy with each other, and so they traded over 11 million megawatt hours of electricity in the California market.

Senator MCCAIN. How much money did it come to?

Ms. LYNCH. You know, we don't know, because we only know the ranges at which it was traded. It traded at prices up to $3,300 a megawatt hour. But since they don't have to report that data to the FERC, we don't know how much money they made among themselves, just driving the price up and affecting the market indices that then drove the price up throughout the West.

Senator MCCAIN. Senator Dunn, was the original legislation, that was passed by the California legislature and signed by the Governor, a bad piece of legislation?

Senator DUNN. Senator McCain, in retrospect, it was.

Senator MCCAIN. Why?

Senator DUNN. I don't imply an ill will on behalf of any legislature at that time. As I had stated before, the California legislature trusted the industry in how to craft those rules to really achieve a free and competitive market. Fortunately, there were many tricks of the trade buried in that language that was proposed directly by the industry.

Senator MCCAIN. Senator Dunn, suppose that they can't renegotiate those contracts, that are so expensive. Let's just assume worst case. How much does that cost the State of California?

Senator DUNN. I'll probably leave it to Mr. Freeman, who actually negotiates those.

Senator MCCAIN. Either Mr. Freeman or Ms. Hauter could answer that question.

Mr. FREEMAN. Well, the total dollar of revenue from all these contracts is about $43 billion. Those contracts are all in a state of intensive renegotiation. They also are before the FERC on a just and reasonable basis. In other words, those contracts were entered into at the height of the crisis because we were paying 35 cents a kilowatt hour, and we got long-term power for about seven. We certainly had to get that much of a reduction. The seven, though, was not based on costs, and it reflected the market power they had at the time.

We're in the process of both renegotiating and suing, going to FERC because we have a right to. And the excess profits in those contracts, you know, I wouldn't want to just throw a number around, but it's obviously some percentage of a $43 billion number. I think, as Senator Dirksen used to say, "a billion here, a billion there, pretty soon it's real money."

Senator MCCAIN. Well, a rough number would be $15 billion or $20 billion?

Mr. FREEMAN. That would be a rough number. Yes, sir.

Ms. LYNCH. Senator, we have actually put a number down on the table at FERC.

Senator MCCAIN. What is it?

Ms. LYNCH. The PUC sued on those contracts and alleged 17 to 20 billion dollars of excess profits that are unjust and unreasonable.

Mr. FREEMAN. The Senator's math is really quite good, then, isn't it?

[Laughter.]

Senator MCCAIN. Mr. Freeman, suppose it's a matter of record that Enron was lobbying FERC not to intervene.

Mr. FREEMAN. Oh, yes, sir. That's off the record, on the record, and in the record.

Senator MCCAIN. Is it a matter of record that FERC eventually reversed its previous positions?

Mr. FREEMAN. Yes, and I want to give credit to President Bush, who put two new people on the FERC, Pat Wood and Nora Brownell, who came in with Mr. Massey and, finally, in June, provided some orders that they must sell and some cap—they didn't call it a cap, and that's fine—but a mitigation. And it is to those two people and—those three people that I'm appealing to their integrity that they continue to help us.

Senator MCCAIN. What was the time delay?

Mr. FREEMAN. Well, it was the six-month period where we got taken to the cleaners, sir.

Senator MCCAIN. So, that period of six months was really a critical time when the Governor felt that he had to sign long-term contracts because of FERC's unwillingness or inability to act. Is that your view?

Mr. FREEMAN. Well, certainly. Getting the prices down from 30 to 35 cents down to 7 was an improvement even though the 7 was higher than what it ought to be. We had the equivalent of a gun to our head, and we were also faced with rolling blackouts, and the cop just wasn't on the beat.

We mounted a massive conservation program in addition to the long-term contracts. We started building power plants. We've actually completed a number of them, 3,000 megawatts this year. We're doing everything we can. But the Federal Energy Regulatory Commission, which had a crucial role to play, just copped out, if you'll pardon the expression.

Senator MCCAIN. It's hard to understand, isn't it?

Mr. FREEMAN. Hard to understand, from a public-interest point of view, but recognizing the seductive nature of the word "competition" and "deregulation." Remember, we deregulated the airline industry. We deregulated the telephone industry. And everybody——

Senator MCCAIN. Sort of.

Mr. FREEMAN. Sort of, yeah. But the word, in 1996 to 1997, is, "This is going to reduce the price." They promised a 20 percent rate reduction in 1996 when they lobbied this bill through. And, Senator, you know that when a bill is passed unanimously by any legislative body, there's something wrong.

[Laughter.]

Mr. FREEMAN. And the 1890——

Senator MCCAIN. I think there were only three votes against the Telecommunications Reform Act, But that's a different issue. Do you really believe that activity was carried out solely by Enron, or did they have——

Mr. FREEMAN. Oh, no, they——

Senator MCCAIN.—co-conspirators?

Mr. FREEMAN. Oh, they had fellow travelers, I guess is the way to put it. They were the leader. They were the poster child. But everyone in the generating business was kind of with them, in the sense that they all wanted to make a bunch of money. I mean, there's—we're not testifying that they were alone. We're testifying that they were the most persistent, the most active, the most contributory, if I might put it that way.

Senator MCCAIN. My time has expired.

Senator DUNN. Thank you, Senator McCain. I just want to—if I may add to Mr. Freeman's comments, the California ISO has both what's called the Department of Market Analysis and a Market Surveillance Committee. Both of these entities are primarily driven by economists whose sole role is to watch the behavior of market participants in the markets—in this case, the California Wholesale Electricity Market. Both of those entities, the Market Surveillance Committee and the Department of Market Analysis within ISO, have concluded from the very—almost the very beginning of this market in 1998 that there were numerous players, including the large generators and traders—in particular, them—that had been exercising market power since almost the very beginning of the market. There is little dispute, at least in my humble opinion, as to that fact. The real question is, from the generators and traders, when you ask them, "Were you exercising market power in the California Wholesale Electricity Market," their response is simply, "Well, how do you define market power?" That's their defense.

Senator MCCAIN. Thank you very much, Madam Chair.

Senator BOXER. Thank you so much.

Senator NELSON. Madam Chairman?

Senator BOXER. Yes.

Senator NELSON. I'd just be curious in the mathematical computation of what the average California electricity consumer lost by having to pay that 17 to 20 billion dollars extra that was as a result of running up the price.

Senator BOXER. Well, the bottom line of the way it worked was, we did have some increases in our prices, which we'll put in the record for you. But the state went into the power-buying business and it's the taxpayers of California that got stuck because their utilities went under. That's why we're fighting for Mr. Wood and friends to keep that price cap on. That's why we're fighting to make sure that there's a must-offer on the table, and that's why we're fighting for renegotiation of the contracts. But we'll give you the details. This is a multibillion dollar scam that hit the people in my state.

I want to just show—I'm sorry Senator McCain had to leave, but I was glad he was here—but I just wanted to say, what Mr. Freeman explained on the prices and maybe the media could take a look at this, because here's the wholesale price of electricity—Bill, can you see this?—in 2000 October. Here it is. And look at how it shoots up all the way there, and as soon as the rate caps went in, it came back down to normal. And it's eight months—eight months of sheer hell for the people of my state. And I want to make it clear, the Governor that signed that legislation was not Governor Davis. Am I correct?

Senator DUNN. That's correct.

Senator BOXER. It was Governor Wilson.

Senator DUNN. Right.

Senator BOXER. So I just want to make sure that people get it straight. I'm sorry. OK, you have to leave, Loretta, don't you? I know you have to catch a plane.

Ms. LYNCH. I apologize.

Senator BOXER. Senator Dunn, you have to leave? No, yes, you do? Let me just ask one question then, and then we'll excuse the Californian folks. This idea of making sure that we renew the cost-based pricing, I mean this is something we have to hone in on, because September 30, you know how life goes very fast when you're having fun, and it's going to go fast, and it's going to be September 30. If they don't renew this, we could be back in deep trouble. So I just want to say to Mr. Freeman, who was very complimentary of Mr. Wood, as well he should be, eight months late this FERC finally did something when Mr. Wood came on. OK? So they did nothing, which was disastrous. They finally did something.

This is a from a *San Diego Union-Tribune* article, February 23, "Federal price caps on electricity, which many believe played a role in taming California's power crisis, will expire as planned on September 30 if Pat Wood, head of FERC has his way. Speaking to a congressional subcommittee in Sacramento, Wood said the price controls need to expire to encourage market reforms in the state. 'The incentive is to get the market structure back in place,' Wood said. He could not be reached for followup comments."

Mr. Freeman, if this kind of attitude prevails, will you speak, because I know you're a straight shooter. Tell us what you see happening in our state or what could happen.

Mr. FREEMAN. Well, it is impossible for California alone to control how power plants throughout the West operate. And the fallacy in assuming that California can develop mitigation or rules to govern these out-of-state generators is, indeed, a fallacy.

Now, the Federal Power Act does not have a California exemption in it. We're still part of the United States. And it's been in effect, and there is nothing in the act that says that FERC can stop on September 30. And having put in place some controls over the market that have worked reasonably well, in the situation where everyone knows that the market is not inherently competitive all by itself, that those controls are needed, at the very least, there has to be a hearing on the record and some findings by this agency that the marketplace is competitively functional. They can't make those findings, because it's not true. And for them to have decided last summer that they're going to put the cop on the beat for a year is arbitrary, capricious, and, in my view, contrary to their duties under the Federal Power Act.

And, you know, for a while it looked like when we were yelling for price caps, we were whistling in the dark. But after a while, the folks, even in the White House, heard us. California is a big state. And it seems to me that Chairman Wood, Ms. Brownell, Mr. Massey are intelligent people, and they realize that their job is to keep the prices under reasonable control until there is real competition. They have done some good. They have no basis for stopping on September 30. And, quite frankly, I believe that their minds have to still be open. You know, I'm kind of an optimistic fellow. We kept plugging away last year and finally won, and I think if we're persistent in making the point that there's still a hope over there. You know, I remember in the Cold War when President Kennedy ignored the first letter from Khrushchev and just accepted the second letter, and it ended the Cuban Missile Crisis. So I'm willing to just ignore what Chairman Wood may have said in February and hope that he'll give us a better answer if we are persistent.

Senator BOXER. Senator.

Senator DUNN. Thank you, Senator Boxer. I want to just add the catch–22 we are now in in California. When the prices spike so high, as referenced on your chart, the private sector was very interested in building lots of new generation plants in California to maximize profits from those high prices. And, in fact, there was a hew and cry about us, at the state legislative level to reduce the environmental regulations, make it easy to permit these new generation units that were being planned because of the high prices.

As a result of the move by FERC last June, the long-term contracts, we now have a stable market. Many plants, the permits were granted. They started planning for construction.

Once the markets stabilized, they've walked away from all of—well, not all, but many of those planned plants for which they obtained permits because they can't get the high prices. Yet it's those new plants that will provide excess capacity that has the possibility of introducing true competition to that market.

Senator BOXER. Well—Ms. Lynch.

Ms. LYNCH. If the price caps come off on October 1 without further reform of the markets, it will endanger the health of the utilities. The utilities will not be able to get back into the power procurement business, and someone will need to continue to be the provider of last resort. The problem, of course, is too many of the generators and sellers have learned Enron's lessons very well. And Enron and its followers will roar back with a vengeance on October 1 and destabilize both the reliability of the market, meaning blackouts, and the prices, meaning price increases.

Senator BOXER. Well, let me thank our California witnesses, and I'm going to let you go in two minutes. I think you were absolutely terrific, all of you, this whole panel. You have shone a light on what happened on the ground in California while a lot of us were begging FERC for help, for that eight-month period when nothing was done, the billions of dollars that were transferred from ordinary folk, the taxpayers of our state, to these generators.

Mr. Skilling said, you know, "We were kind of like the Titanic, but when the Titanic went down, it had its lights on and we weren't going to have our lights on." Well, we have our lights on, and they went down. Let there be a lesson in that.

And you folks under the gun there day after day, just—you get my thanks. I know how hard it was for the whole legislature, Democrats and Republicans back there working 18 hours a day. I was on the phone to a few of them myself.

We will continue to put tremendous pressure on FERC. We are going to send them the transcript of today's hearing, because I think there are a lot of lessons learned. My colleagues leaned over to me during your testimony and said, "They're ready to keep the pressure on."

And so I want to thank all of you. The picture is really clear now of what went on there. Enron led the pack, got out of regulation, manipulated the market, and wined and dined FERC so they did nothing for too long a period of time. If there's anything I know it's that I'm going to try to make sure something like that never happens again.

I want to thank you for adding so many intelligent ideas and concepts and facts to the picture, to the story. Thank you very much, and we stand adjourned.

[Whereupon, at 12:09 p.m., the hearing was adjourned.]

APPENDIX

PREPARED STATEMENT OF HON. BOB FILNER
CONGRESSMAN FROM CALIFORNIA

Good morning. Thank you Senator Dorgan for welcoming my testimony. I also want to thank my California colleague, Senator Boxer, for pushing for this hearing to get to the bottom on Enron's manipulation of our California energy market.

When the whole Enron mess hit, my constituents and I were not surprised. We knew our energy markets had been criminally manipulated during the summer of 2000 and through the winter of 2001. Paying up to 10 times what they had for electricity in the months before was ludicrous and criminal. What would you think if you suddenly had to pay $20 for a loaf of bread?

The agency that was supposed to protect our consumers, the Federal Energy Regulatory Commission, FERC, did nothing. They found that the prices were "unjust and unreasonable" and continued to let the energy companies charge them. Why?

Could the $2 million in contributions that Enron contributed to Republican candidates from 1999 through 2002 have anything to do with FERC's inaction? It certainly seems suspect. It guaranteed Enron a place at Vice President Cheney's energy task force—not for one, but *seven* visits! And the result of this access and Enron's investment? Not only White House energy plans wholeheartedly supporting deregulation, under which Enron was reaping such huge windfall profits in California, but I suspect FERC's inaction.

You see, during the energy crisis, FERC investigated—or so they say—the situation, and they found no wrongdoing! Now that the spotlight is burning brightly on Enron, FERC has suddenly announced that they are going to look into this matter again. Why, if the first investigation was not just smoke and mirrors, do they say, "Let us look again"?

That is why I have introduced legislation calling for a special prosecutor to be named to look into the whole Enron mess. My legislation asks for a special prosecutor to look into the relationship between Enron and the manipulation of the stock market and its value per share; to look into the relationship between contributions by Enron to the President, the Vice President, Cabinet officers, other administration officials, and Members of Congress.

I am asking the prosecutor to look into the influence of Enron on Federal and State legislation, including, in particular, the effort to deregulate energy markets, both in States and in the Nation as a whole.

The legislation also asks for the prosecutor to look into the relationship between Enron and our whole Federal and State regulatory system.

This special, hopefully impartial, investigation is necessary to restore confidence in our political process and to clearly discern where Enron's tentacles were in the energy crisis that hit California in the summer of 2000. I hope that you will get closer to the truth in today's hearing. But we must involve a prosecutor who has the latitude to bring *criminal* charges.

The special prosecutor will look beyond the business scandal that screams for reforms of our auditing practices and the strengthening of the safety of pension plans. She or he must conduct a criminal investigation into the pervasive corruption of American politics.

I believe the prosecutor will find, and you may discover a hint of it today, that California's so-called electricity crisis, was not a problem of supply and demand, but in fact, a crisis resulting from the manipulation of our market. That criminal manipulation of our market resulted in the theft of anywhere between $20 billion and $40 billion from California ratepayers. Enron was not only making energy policy, it was carrying it out in California. The CEO of Enron, Ken Lay, personally submitted names and interviewed candidates to be members of our Federal Energy Regulatory Commission. Thus FERC became, in my words, the "Federal Enron Rubber-stamping Commission."

We know the connections, close connections, between this Administration and Enron and the people who came directly from Enron to work in this Administration.

It was those connections that caused this scandal, and it was the connections between Enron and State legislatures and State legislators and State regulatory commissions and Federal regulatory commissions that caused their success.

That is what I am asking you to investigate today and to join me in calling for a special prosecutor who can go even deeper into the sordid dealings of Enron. We must discover why Enron flew so high for so long and stole so many billions from so many people.

The American people do not want this investigation to stop with only a few business reforms instituted and maybe one or two folks thrown into jail. They are demanding the investigation of the whole corruption of our political system so we can discover who beyond Enron and a small group of energy insiders perpetrated the crime!

LEGISLATION SUBMITTED FOR THE RECORD BY HON. BARBARA BOXER, U.S. SENATOR FROM CALIFORNIA

II

107TH CONGRESS
1ST SESSION

S. 26

To amend the Department of Energy Authorization Act to authorize the Secretary of Energy to impose interim limitations on the cost of electric energy to protect consumers from unjust and unreasonable prices in the electric energy market.

IN THE SENATE OF THE UNITED STATES

JANUARY 22, 2001

Mrs. FEINSTEIN (for herself and Mrs. BOXER) introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

A BILL

To amend the Department of Energy Authorization Act to authorize the Secretary of Energy to impose interim limitations on the cost of electric energy to protect consumers from unjust and unreasonable prices in the electric energy market.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. INTERIM REGIONAL LIMITATIONS.

Title IV of the Department of Energy Organization Act (42 U.S.C. 7171 et seq.) is amended by adding at the end the following:

"SEC. 408. INTERIM REGIONAL LIMITATIONS.

''(a) DEFINITIONS.—In this section:

''(1) COMMISSION.—The term 'Commission' means the Federal Energy Regulatory Commission.

''(2) COST-OF-SERVICE BASED RATE.—The term 'cost-of-service based rate' means a rate, charge, or classification for the sale of electric energy that is equal to—

''(A) all the variable and fixed costs for producing the electric energy; and

''(B) a return on and of any invested capital.

''(3) INTERIM REGIONAL PRICE LIMITATION.—The term 'interim regional price limitation' means a price limitation on the rates charged for the provision of electric energy that—

''(A) includes a region-wide wholesale electric energy price limitation for a region comprising the Western Systems Coordinating Council; and

''(B) reflects load differentiated demand.

''(4) LOAD DIFFERENTIATED.—The term 'load differentiated' means the difference between price limitations by season, time of day, and other relevant usage patterns.

"(5) SECRETARY.—The term 'Secretary' means the Secretary of Energy.

"(b) AUTHORITY TO IMPOSE LIMITATIONS.—The Secretary shall impose, in any region of the United States, an interim regional price limitation, or cost-of-service based rate, on any sale of electric energy at wholesale rate in interstate commerce subject to the jurisdiction of the Commission under part II of the Federal Power Act whenever—

"(1) the Commission has determined that the rate, charge, or classification otherwise applicable to such sale is unjust, unreasonable, or unduly preferential or the Secretary determines that the rate, charge, or classification otherwise applicable to such sale exceeds the marginal cost of producing the electric energy by a significant amount or for a significant length of time; and

"(2) the Secretary determines that—

"(A) the continued existence of such rate, charge, or classification threatens public health and safety or the economy of any State or region; and

"(B) the Commission has otherwise failed to act to improve the situation.

For purposes of carrying out this section, the Secretary may exercise any authority vested in the Commission under the Federal Power Act for the fixing and enforcing of rates, charges, and classifications that are just and reasonable under Part II of that Act.

"(c) DURATION.—A regional price limitation or cost-of-service based rate imposed under subsection (b) shall remain in effect until such time as the market reflects just and reasonable rates, as determined by the Secretary.

"(d) AUTHORITY TO OPT OUT.—

"(1) IN GENERAL.—The Governor of any State within a region in which a regional price limitation or cost-of-service based rate is imposed under subsection (b) may waive the application of such limitation or rate to sales of electric energy to purchasers in that State by notifying the Secretary in writing at any time after imposition of the price limitation or cost-of-service based rate.

"(2) EFFECTIVE DATE.—Not later than 30 days after receiving a letter from a Governor of any State under paragraph (1), the Secretary shall waive the application of the price limitation or cost-of-service based rate to sales of electric energy to purchasers in that State.

"(e) PURPA FACILITIES NOT COVERED.—The authority of subsection (b) shall not apply to any sale of electric energy generated by a qualifying small power production facility or qualifying cogeneration facility (as defined in section 3 of the Federal Power Act) that is exempt in whole or in part from the Federal Power Act as provided in section 210(e) of the Public Utility Regulatory Policies Act of 1978.

"(f) EFFECT ON OTHER LAW.—Nothing in this section affects any authority of the Commission under the Federal Power Act (16 U.S.C. 791a et seq.) with respect to sales of electric energy forwhich no determination has been made under subsection (b).

"(g) EFFECTIVE DATE.—This section shall apply to contracts for the sale of electric energy entered into or renewed after the enactment of this section.".

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II

107TH CONGRESS
1ST SESSION

S. 80

To require the Federal Energy Regulatory Commission to order refunds of unjust, unreasonable, unduly discriminatory or preferential rates and charges for electricity, to establish cost-based rates for electricity sold at wholesale in the Western Systems Coordinating Council, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JANUARY 22, 2001

Mrs. BOXER (for herself and Mrs. FEINSTEIN) introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

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A BILL

To require the Federal Energy Regulatory Commission to order refunds of unjust, unreasonable, unduly discriminatory or preferential rates and charges for electricity, to establish cost-based rates for electricity sold at wholesale in the Western Systems Coordinating Council, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "California Electricity Consumers Relief Act of 2001".

SEC. 2. ADDITIONAL REFUND AUTHORITY UNDER FEDERAL POWER ACT.

Section 206 of the Federal Power Act (16 U.S.C. 824e) is amended by adding the following at the end thereof:

''(e)(1) The provisions of this subsection shall apply only to refunds of rates and charges in effect pursuant to a rule or order of the Commission providing for market-based rates and charges for a transmission or sale of electric energy subject to the jurisdiction of the Commission. The provisions of subsection (b) concerning refunds shall not apply to such rates and charges.

''(2) When the Commission has found, after notice and opportunity for a hearing, on its own motion or upon complaint, that any rate or charge referred to in paragraph (1) is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall order a refund of the portion of such rate or charge that exceeds the rate or charge that the Commission finds to be just, reasonable and not unduly discriminatory or preferential. Such refund shall include interest from the date on which the rate or charge was paid.

''(3) No order providing for a refund under this subsection may be issued with respect to amounts paid prior to the date 2 years before the date on which the notice referred to in paragraph (2) is published in the Federal Register.''

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall not apply to any complaint filed before August 1, 2000.

(c) SAVINGS PROVISIONS.—Nothing in the amendment made by subsection (a) shall affect any authority of the Commission (or of any court) existing before the enactment of this section, including any such authority to issue any rule or order relating to market-based rates, to approve or fix rates and charges, or to order refunds of any rate or charge.

SEC. 3. ESTABLISHMENT OF COST-BASED RATES FOR WHOLESALE SALES OF ELECTRICITY IN THE WESTERN UNITED STATES.

(a) EXERCISE OF AUTHORITY TO ESTABLISH MAXIMUM PRICES.—

(1) DETERMINATION ON ITS OWN MOTION.—The Federal Energy Regulatory Commission shall issue an order establishing the maximum price for electricity sold at wholesale subject to the jurisdiction of the Commission under the Federal Power Act in the Western Systems Coordinating Council for any period after June 1, 2000, if the Commission deter-

mines that any rates charged for such wholesale sales of electricity are unjust, unreasonable, unduly discriminatory or preferential under section 206 of the Federal Power Act. The Commission may make such determination on its own motion at any time. If the Governor of any State within the Western Systems Coordinating Council submits a petition to the Commission to make such determination with respect to any such rates, within 30 days after receipt of the petition, the Commission shall determine if such rates are unjust, unreasonable, unduly discriminatory or preferential under section 206 of the Federal Power Act.

(b) MAXIMUM PRICE.—The maximum price established by the Federal Energy Regulatory Commission pursuant to subsection (a) shall be a price based on the seller's costs, including a return of and on invested capital, established in accordance with part II of the Federal Power Act.

(c) REFUNDS OF PRICES PAID IN EXCESS OF MAXIMUM PRICE.—Any prices paid in excess of the maximum price established pursuant to this section shall be refunded pursuant to section 206 of the Federal Power Act, as amended by section 2 of this Act.

(d) PENALTIES.—Any person who violates any requirement of this section shall be subject to civil penalties equal to 3 times the value of the amount involved in such violation. The Federal Energy Regulatory Commission shall assess such penalties, after notice and opportunity for public hearing, in accordance with the same provisions as are applicable under section 31(d) of the Federal Power Act in the case of civil penalties assessed under such section 31.

(e) SAVINGS PROVISIONS.—Nothing in this section shall affect any authority of the Commission existing before the enactment of this section to approve or fix rates and charges, or to order refunds of any rate or charge.

SEC. 4. SEVERABILITY.

If any provision of this Act is found to be unenforceable or invalid, no other provision of this Act shall be invalidated thereby.

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I

107TH CONGRESS
1ST SESSION

H. R. 238

To amend the Department of Energy Authorization Act to authorize the Secretary of Energy to impose interim limitations on the cost of electric energy to protect consumers from unjust and unreasonable prices in the electric energy market.

IN THE HOUSE OF REPRESENTATIVES

JANUARY 20, 2001

Mr. HUNTER (for himself, Ms. ESHOO, Mr. CUNNINGHAM, Mr. ISSA, Mrs. CAPPS, and Ms. LEE) introduced the following bill; which was referred to the Committee on Energy and Commerce

A BILL

To amend the Department of Energy Authorization Act to authorize the Secretary of Energy to impose interim limitations on the cost of electric energy to protect consumers from unjust and unreasonable prices in the electric energy market.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. INTERIM REGIONAL LIMITATIONS.

Title IV of the Department of Energy Organization Act (42 U.S.C. 7171 et seq.) is amended by adding at the end the following:

"SEC. 408. INTERIM REGIONAL LIMITATIONS.

"(a) DEFINITIONS.—In this section:

"(1) COMMISSION.—The term 'Commission' means the Federal Energy Regulatory Commission.

"(2) COST-OF-SERVICE BASED RATE.—The term 'cost-of-service based rate' means a rate, charge, or classification for the sale of electric energy that is equal to—

"(A) all the variable and fixed costs for producing the electric energy; and

"(B) a return on and of any invested capital.

"(3) INTERIM REGIONAL PRICE LIMITATION.—The term 'interim regional price limitation' means a price limitation on the rates charged for the provision of electric energy that—

"(A) includes a region-wide wholesale electric energy price limitation for a region comprising the Western Systems Coordinating Council; and

"(B) reflects load differentiated demand.

"(4) LOAD DIFFERENTIATED.—The term 'load differentiated' means the difference between price limitations by season, time of day, and other relevant usage patterns.

"(5) SECRETARY.—The term 'Secretary' means the Secretary of Energy.

"(b) AUTHORITY TO IMPOSE LIMITATIONS.—The Secretary shall impose, in any region of the United States, an interim regional price limitation, or cost-of-service based rate, on any sale of electric energy at wholesale in interstate commerce subject to the jurisdiction of the Commission under part II of the Federal Power Act whenever—

"(1) the Commission has determined that the rate, charge, or classification otherwise applicable to such sale is unjust, unreasonable, or unduly preferential or the Secretary determines that the rate, charge, or classification otherwise applicable to such sale exceeds the marginal cost of producing the electric energy by a significant amount or for a significant length of time; and

"(2) the Secretary determines that—

"(A) the continued existence of such rate, charge, or classification threatens public health and safety or the economy of any State or region; and

"(B) the Commission has otherwise failed to act to improve the situation.

For purposes of carrying out this section, the Secretary may exercise any authority vested in the Commission under the Federal Power Act for the fixing and enforcing of rates, charges, and classifications that are just and reasonable under Part II of that Act.

"(c) DURATION.—A regional price limitation or cost-of-service based rate imposed under subsection (b) shall remain in effect until such time as the market reflects just and reasonable rates, as determined by the Secretary.

"(d) AUTHORITY TO OPT OUT.—

"(1) IN GENERAL.—The Governor of any State within a region in which a regional price limitation or cost-of-service based rate is imposed under subsection (b) may waive the application of such limitation or rate to sales of electric energy to purchasers in that State by notifying the Secretary in writing at any time after imposition of the price limitation or cost-of-service based rate.

"(2) EFFECTIVE DATE.—Not later than 30 days after receiving a letter from a Governor of any State under paragraph (1), the Secretary shall waive the application of the price limitation or cost-of-service based rate to sales of electric energy to purchasers in that State.

"(e) PURPA FACILITIES NOT COVERED.—The authority of subsection (b) shall not apply to any sale of electric energy generated by a qualifying small power production facility or qualifying cogeneration facility (as defined in section 3 of the Federal Power Act) that is exempt in whole or in part from the Federal Power Act as provided in section 210(e) of the Public Utility Regulatory Policies Act of 1978.

"(f) EFFECT ON OTHER LAW.—Nothing in this section affects any authority of the Commission under the Federal Power Act (16 U.S.C. 791a et seq.) with respect to sales of electric energy for which no determination has been made under subsection (b).

"(g) EFFECTIVE DATE.—This section shall apply to contracts for the sale of electric energy entered into or renewed after the enactment of this section.".

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I

107TH CONGRESS
1ST SESSION

H. R. 268

To require the Federal Energy Regulatory Commission to order refunds of unjust, unreasonable, unduly discriminatory or preferential rates and charges for electricity, to establish cost-based rates for electricity sold at wholesale in the Western Systems Coordinating Council, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

JANUARY 30, 2001

Mr. FILNER (for himself, Mrs. DAVIS of California, Mrs. NAPOLITANO, Mr. HONDA, Mr. STARK, Mr. MATSUI, and Ms. MILLENDER-MCDONALD) introduced the following bill; which was referred to the Committee on Energy and Commerce

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A BILL

To require the Federal Energy Regulatory Commission to order refunds of unjust, unreasonable, unduly discriminatory or preferential rates and charges for electricity, to establish cost-based rates for electricity sold at wholesale in the Western Systems Coordinating Council, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the ''California Electricity Consumers Relief Act of 2001''.

SEC. 2. ADDITIONAL REFUND AUTHORITY UNDER FEDERAL POWER ACT.

Section 206 of the Federal Power Act (16 U.S.C. 824e) is amended by adding the following at the end thereof:

"(e)(1) The provisions of this subsection shall apply only to refunds of rates and charges in effect pursuant to a rule or order of the Commission providing for market-based rates and charges for a transmission or sale of electric energy subject to the jurisdiction of the Commission. The provisions of subsection (b) concerning refunds shall not apply to such rates and charges.

"(2) When the Commission has found, after notice and opportunity for a hearing, on its own motion or upon complaint, that any rate or charge referred to in paragraph (1) is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall order a refund of the portion of such rate or charge that exceeds the rate or charge that the Commission finds to be just, reasonable and not unduly discriminatory or preferential. Such refund shall include interest from the date on which the rate or charge was paid.

"(3) No order providing for a refund under this subsection may be issued with respect to amounts paid prior to the date 2 years before the date on which the notice referred to in paragraph (2) is published in the Federal Register.''

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall not apply to any complaint filed before August 1, 2000.

(c) SAVINGS PROVISIONS.—Nothing in the amendment made by subsection (a) shall affect any authority of the Commission (or of any court) existing before the enactment of this section, including any such authority to issue any rule or order relating to market-based rates, to approve or fix rates and charges, or to order refunds of any rate or charge.

SEC. 3. ESTABLISHMENT OF COST-BASED RATES FOR WHOLESALE SALES OF ELECTRICITY IN THE WESTERN UNITED STATES.

(a) EXERCISE OF AUTHORITY TO ESTABLISH MAXIMUM PRICES.—

(1) DETERMINATION ON ITS OWN MOTION.—The Federal Energy Regulatory Commission shall issue an order establishing the maximum price for electricity sold at wholesale subject to the jurisdiction of the Commission under the Federal Power Act in the Western Systems Coordinating Council for any period after June 1, 2000, if the Commission deter-

mines that any rates charged for such wholesale sales of electricity are unjust, unreasonable, unduly discriminatory or preferential under section 206 of the Federal Power Act. The Commission may make such determination on its own motion at any time. If the Governor of any State within the Western Systems Coordinating Council submits a petition to the Commission to make such determination with respect to any such rates, within 30 days after receipt of the petition, the Commission shall determine if such rates are unjust, unreasonable, unduly discriminatory or preferential under section 206 of the Federal Power Act.

(b) MAXIMUM PRICE.—The maximum price established by the Federal Energy Regulatory Commission pursuant to subsection (a) shall be a price based on the seller's costs, including a return of and on invested capital, established in accordance with part II of the Federal Power Act.

(c) REFUNDS OF PRICES PAID IN EXCESS OF MAXIMUM PRICE.—Any prices paid in excess of the maximum price established pursuant to this section shall be refunded pursuant to section 206 of the Federal Power Act, as amended by section 2 of this Act.

(d) PENALTIES.—Any person who violates any requirement of this section shall be subject to civil penalties equal to 3 times the value of the amount involved in such violation. The Federal Energy Regulatory Commission shall assess such penalties, after notice and opportunity for public hearing, in accordance with the same provisions as are applicable under section 31(d) of the Federal Power Act in the case of civil penalties assessed under such section 31.

(e) SAVINGS PROVISIONS.—Nothing in this section shall affect any authority of the Commission existing before the enactment of this section to approve or fix rates and charges, or to order refunds of any rate or charge.

SEC. 4. SEVERABILITY.

If any provision of this Act is found to be unenforceable or invalid, no other provision of this Act shall be invalidated thereby.

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II

106TH CONGRESS
2D SESSION

S. 3093

To require the Federal Energy Regulatory Commission to roll back the wholesale price of electric energy sold in the Western System Coordinating Council, and for other purposes.

IN THE SENATE OF THE UNITED STATES

SEPTEMBER 21, 2000

Mrs. BOXER introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

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A BILL

To require the Federal Energy Regulatory Commission to roll back the wholesale price of electric energy sold in the Western System Coordinating Council, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Halt Electricity Price-gouging in San Diego Act" or "HELP San Diego Act".

SEC. 2. ROLL BACK OF WHOLESALE PRICE FOR ELECTRICITY IN WESTERN MARKET.

(a) CEILING.—The Federal Energy Regulatory Commission shall, by not later than November 30, 2000, issue an order establishing the maximum price for electricity sold at wholesale subject to the jurisdiction of the Commission under the Federal Power Act in the Western System Coordinating Council after June 1, 2000.

(b) MAXIMUM PRICE.—For purposes of this Act, the maximum price established by the Federal Energy Regulatory Commission shall be the lesser of—

(1) an average of the wholesale price for electric energy sold in the Western System Coordinating Council in the three-year period immediately before June 1, 2000, or

(2) a price based on a cost-based formula for wholesale rates established in accordance with Part II of the Federal Power Act.

(c) REFUND.—Any person selling electric energy at wholesale subject to the jurisdiction of the Commission under the Federal Power Act in the Western System Coordinating Council after June 1, 2000, who has received in excess of the maximum price for such energy shall promptly refund to the purchaser the full amount of such excess. Such purchaser shall promptly transfer such refund to the ultimate consumers of such electric energy, except that if such purchaser resold the electric energy at wholesale to any other wholesale purchaser, each such wholesale purchaser shall refund such amount to the person or persons who purchased such electric energy from such wholesale purchaser.

(d) PENALTIES.—Any person who violates any requirement of this Act shall be subject to civil penalties equal to three times the value of the amount involved in such violation. The Federal Energy Regulatory Commission shall assess such penalties, after notice and opportunity for public hearing, in accordance with the same provisions as are applicable under section 31(d) of the Federal Power Act in the case of civil penalties assessed under such section 31.

(e) SEPARABILITY.—If any provision of this Act is found to be unenforceable or invalid, no other provision of this Act shall be affected thereby.

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I

106TH CONGRESS
2D SESSION

H. R. 5131

To require the Federal Energy Regulatory Commission to roll back the wholesale price of electric energy sold in the Western System Coordinating Council, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

SEPTEMBER 7, 2000

Mr. FILNER introduced the following bill; which was referred to the Committee on Commerce

---

A BILL

To require the Federal Energy Regulatory Commission to roll back the wholesale price of electric energy sold in the Western System Coordinating Council, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the ''Halt Electricity Price-gouging in San Diego Act'' or ''HELP San Diego Act''.

SEC. 2. ROLL BACK OF WHOLESALE PRICE FOR ELECTRICITY IN WESTERN MARKET.

(a) CEILING.—The Federal Energy Regulatory Commission shall, by not later than November 30, 2000, issue an order establishing the maximum price for electricity sold at wholesale subject to the jurisdiction of the Commission under the Federal Power Act in the Western System Coordinating Council after June 1, 2000.

(b) MAXIMUM PRICE.—For purposes of this Act, the maximum price established by the Federal Energy Regulatory Commission shall be the lesser of—

(1) an average of the wholesale price for electric energy sold in the Western System Coordinating Council in the three-year period immediately before June 1, 2000, or

(2) a price based on a cost-based formula for wholesale rates established in accordance with Part II of the Federal Power Act.

(c) REFUND.—Any person selling electric energy at wholesale subject to the jurisdiction of the Commission under the Federal Power Act in the Western System Coordinating Council after June 1, 2000, who has received in excess of the maximum price for such energy shall promptly refund to the purchaser the full amount of such excess. Such purchaser shall promptly transfer such refund to the ultimate consumers of such electric energy, except that if such purchaser resold the electric energy at wholesale to any other wholesale purchaser, each such wholesale purchaser shall refund such amount to the person or persons who purchased such electric energy from such wholesale purchaser.

(d) PENALTIES.—Any person who violates any requirement of this Act shall be subject to civil penalties equal to three times the value of the amount involved in such violation. The Federal Energy Regulatory Commission shall assess such penalties, after notice and opportunity for public hearing, in accordance with the same provisions as are applicable under section 31(d) of the Federal Power Act in the case of civil penalties assessed under such section 31.

(e) SEPARABILITY.—If any provision of this Act is found to be unenforceable or invalid, no other provision of this Act shall be affected thereby.

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II

107TH CONGRESS
1ST SESSION

S. 287

To direct the Federal Energy Regulatory Commission to impose cost-of-service based rates on sales by public utilities of electric energy at wholesale in the western energy market.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 8, 2001

Mrs. FEINSTEIN (for herself and Mrs. BOXER) introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

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A BILL

To direct the Federal Energy Regulatory Commission to impose cost-of-service based rates on sales by public utilities of electric energy at wholesale in the western energy market.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. COST-OF-SERVICE BASED ELECTRIC ENERGY RATES.

(a) FINDINGS.—Congress finds that—

(1) prices in the spot market for electric energy have consistently stayed at rates that are multiples

of the prices that prevailed last year and the year before;

(2) the price increases began in California and spread throughout the western energy market;

(3) the Federal Energy Regulatory Commission, in an order issued November 1, 2000, found that prices in California and the western energy market are unjust and unreasonable; and

(4) the high and volatile prices for natural gas are reflected in the costs of producing electricity.

(b) DEFINITIONS.—In this section:

(1) COMMISSION.—The term ''Commission'' means the Federal Energy Regulatory Commission.

(2) COST-OF-SERVICE BASED RATE.—The term ''cost-of-service based rate'' means a rate, charge, or classification for the sale of electric energy that is equal to—

(A) all the variable and fixed costs for producing the electric energy; and

(B) a reasonable return on invested capital.

(3) PUBLIC UTILITY.—The term ''public utility'' means a person that owns or operates a facility that is subject to the jurisdiction of the Commission

under the Federal Power Act (16 U.S.C. 791a et seq.).

(4) WESTERN ENERGY MARKET.—The term ''western energy market'' means the States of Arizona, California, Colorado, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, and Wyoming.

(c) COST-OF-SERVICE BASED ELECTRIC ENERGY RATES.—Not later than 60 days after the date of enactment of this Act, the Commission shall impose cost-of-service based rates on sales by public utilities of electric energy at wholesale in the western energy market.

(d) DURATION.—A cost-of-service based electric energy rate imposed under this Act shall remain in effect until such time as the market for electric energy in the western energy market reflects just and reasonable rates, as determined by the Commission.

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II

107TH CONGRESS
1ST SESSION

S. 764

To direct the Federal Energy Regulatory Commission to impose just and reasonable load-differentiated demand rates or cost-of-service based rates on sales by public utilities of electric energy at wholesale in the western energy market, and for other purposes.

IN THE SENATE OF THE UNITED STATES

APRIL 24, 2001

Mrs. FEINSTEIN (for herself, Mr. SMITH of Oregon, Mr. BINGAMAN, Mrs. MURRAY, Ms. CANTWELL, and Mr. LIEBERMAN) introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

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A BILL

To direct the Federal Energy Regulatory Commission to impose just and reasonable load-differentiated demand rates or cost-of-service based rates on sales by public utilities of electric energy at wholesale in the western energy market, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. FINDINGS.

Congress finds that—

(1) prices in the spot market for electric energy in the western energy market have consistently re-

mained at levels that are multiples of energy prices prevailing before 2000;

(2) the price increases began in California and spread throughout the western energy market;

(3) the Federal Energy Regulatory Commission, in an order issued November 1, 2000, found that prices in California and the western energy market are unjust and unreasonable; and

(4) the high and volatile prices for natural gas are reflected in the costs of producing electricity.

SEC. 2. DEFINITIONS.

In this Act:

(1) COMMISSION.—The term ''Commission'' means the Federal Energy Regulatory Commission.

(2) COST-OF-SERVICE BASED RATE.—The term ''cost-of-service based rate'' means a rate, charge, or classification for the sale of electric energy that is equal to—

(A) all the reasonable variable costs for producing the electric energy;

(B) all the reasonable fixed costs for producing the electric energy;

(C) a reasonable risk premium or return on invested capital; and

(D) all other reasonable costs associated with the production, acquisition, conservation, and transmission of electric power.

(3) LOAD-DIFFERENTIATED DEMAND RATE.—The term ''load-differentiated demand rate'' means a rate, charge, or classification for the sale of electric energy that reflects differences in the demand for electric energy during various times of day, months, seasons, or other time periods.

(4) PUBLIC UTILITY.—The term ''public utility'' has the meaning given the term in section 201 of the Federal Power Act (16 U.S.C. 824).

(5) WESTERN ENERGY MARKET.—The term ''western energy market'' means the area within the United States that is covered by the Western Systems Coordinating Council.

SEC. 3. WHOLESALE ELECTRIC ENERGY RATES OF REGULATED ENTITIES IN THE WESTERN ENERGY MARKET.

(a) IMPOSITION OF WHOLESALE ELECTRIC ENERGY RATES.—Not later than 60 days after the date of enactment of this Act, the Commission shall impose just and reasonable load-differentiated demand rates or cost-of-service based rates on sales by public utilities of electric energy at wholesale in the western energy market.

(b) LIMITATIONS.—

(1) IN GENERAL.—A load-differentiated demand rate or cost-of-service based rate shall not apply to a sale of electric energy at wholesale for delivery in a State that, after the date of enactment of this Act—

(A) prohibits the State public utility commission from approving the passing through to retail consumers of cost-of-service based rates or load-differentiated demand rates approved by the Commission; or

(B) imposes a price limit on the sale of electric energy at retail that precludes a public utility (or any entity that is authorized to purchase electricity on behalf of a public utility or a State) from making a payment when due to any entity within the western energy market from which the public utility purchases electric energy for resale at retail within the western energy market.

(2) NO ORDERS TO SELL WITHOUT A REASONABLE ASSURANCE OF PAYMENT.—Notwithstanding section 302 of the Natural Gas Policy Act of 1978 (15 U.S.C. 3362), section 202(c) of the Federal Power Act (16 U.S.C. 824a(c)), or section 101 of

the Defense Production Act of 1950 (50 U.S.C. App. 2071), neither the Secretary of Energy nor the Commission may issue an order that requires a seller of electric energy or natural gas to sell, on or after the date of enactment of this Act, electric energy or natural gas to a buyer in a State described in paragraph (1) unless there is a reasonable assurance that the Commission determines is sufficient to ensure that the seller will be paid—

(A) the full purchase price when due, as agreed to by the buyer and seller; or

(B) if the buyer and seller are unable to agree on a price—

(i) a fair and equitable price for natural gas, as determined by the President under section 302 of the Natural Gas Policy Act of 1978 (15 U.S.C. 3362); or

(ii) a just and reasonable price for electric energy, as determined by the Secretary of Energy or the Commission, as appropriate, under section 202(c) of the Federal Power Act (16 U.S.C. 824a(c)).

(3) REQUIREMENT TO MEET IN-STATE DEMAND.—Notwithstanding any other provision of law, a State public utility commission in the western en-

ergy market may prohibit any utility subject to the jurisdiction of the State public utility commission from making any sale of electric energy to a purchaser outside the service area of the utility at any time at which the State public utility commission has reason to believe that delivery of the electric energy would impair the ability of the utility to meet, at or after the time of the delivery, the demand for electric energy in the service area of the utility.

(c) AUTHORITY OF STATE REGULATORY AUTHORITIES.—This section does not diminish or have any other effect on the authority of a State regulatory authority (as defined in section 3 of the Federal Power Act (16 U.S.C. 796)) to regulate rates and charges for the sale of electric energy to consumers, including the authority to determine the manner in which wholesale rates shall be passed through to consumers (including the setting of tiered pricing, real-time pricing, and baseline rates).

(d) REPEAL.—Effective March 1, 2003, this section is repealed, and any load-differentiated demand rate or cost-of-service based rate imposed under this section that is then in effect shall no longer be effective.

SEC. 4. NATURAL GAS RATES.

(a) INAPPLICABILITY OF WAIVER OF MAXIMUM RATE CEILING PROVISION TO TRANSPORTATION OF NATURAL

GAS INTO THE STATE OF CALIFORNIA.—Effective beginning on the date of enactment of this Act, paragraph (i) of section 284.8 of title 18, Code of Federal Regulations, shall not apply to the transportation of natural gas into the State of California from outside the State.

(b) DISCLOSURE OF COMMODITY PORTION AND TRANSPORTATION PORTION OF SALE PRICE IN BUNDLED NATURAL GAS TRANSACTIONS.—

(1) DEFINITION OF BUNDLED TRANSACTION.—In this subsection, the term ''bundled transaction'' means a transaction for the sale of natural gas in which the sale price includes both the cost of the natural gas and the cost of transporting the natural gas.

(2) DISCLOSURE.—Exercising authority under section 4 of the Natural Gas Act (15 U.S.C. 717c), not later than 60 days after the date of enactment of this Act, the Commission shall promulgate a regulation that requires any person that sells natural gas in a bundled transaction under which the natural gas is to be transported into the State of California from outside the State to file with the Commission, not later than a date specified by the Commission, a statement that discloses—

(A) the portion of the sale price that is attributable to the price paid by the seller for the natural gas; and

(B) the portion of the sale price that is attributable to the price paid for transportation of the natural gas.

SEC. 5. SENSE OF THE SENATE REGARDING THE BONNEVILLE POWER ADMINISTRATION.

It is the sense of the Senate that the Bonneville Power Administration should—

(1) take steps to reduce its wholesale electric power purchase needs in the rate period beginning October 1, 2001; and

(2) undertake other actions to minimize its potential wholesale electric rate increase due to take effect October 1, 2001.

SEC. 6. EFFECT OF ACT.

Nothing in this Act—

(1) affects any energy production that, as of the date of enactment of this Act, is not online and for which an application for a permit to produce electricity has not been filed;

(2) affects any contract for the purchase of electric energy except a contract for a spot market purchase; or

(3) prohibits a State or other entity from appearing in a Federal court in any instance in which it is alleged that the Commission is not enforcing the Federal Power Act (16 U.S.C. 791a et seq.).

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II

107TH CONGRESS
1ST SESSION

S. 1068

To provide refunds for unjust and unreasonable charges on electric energy.

IN THE SENATE OF THE UNITED STATES

JUNE 20, 2001

Mrs. BOXER introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

A BILL

To provide refunds for unjust and unreasonable charges on electric energy.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the ''Electricity Gouging Relief Act of 2001''.

SECTION 2. REFUNDS FOR EXCESSIVE CHARGES.

Section 206 of the Federal Power Act (16 U.S.C 824e) is amended by adding at the end the following:

''(e) REFUNDS FOR EXCESSIVE CHARGES.—

''(1) Notwithstanding any other provision of this section, the Commission shall, within 60 days after enactment of this subsection, order a refund for the portion of charges on the transmission or sale of electric energy that are or have been deemed by the Commission to be unjust or unreasonable. Such refunds shall include interest from the date on which the charges were paid.

"(2) The refunds ordered under paragraph (1) shall apply to charges paid between June 1, 2000 and June 19, 2001.".