



*Final Report on
Price Manipulation
in Western Markets*

Docket No. PA02-02-000

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Federal Energy Regulatory Commission

March 26, 2003

Introduction



On February 13, 2002 the Commission ordered a Staff investigation into the potential manipulation of electricity and natural gas prices.

Staff found evidence of manipulation of both electricity and natural gas markets.

Staff proposes a series of generic and company-specific remedies for the market flaws and abuse found in the Investigation.

GAS



Spot gas prices at the California border reflected extraordinary basis differentials that far exceeded the cost of transportation

Dysfunctions in the natural gas market fed off misconduct, including gas transaction misreporting and wash trading

There was a misperception that the Topock delivery point was a liquid market

In fact, a single trader at Topock engaged in rapid-fire trading for volumes many times the company's needs

That single trader's actions led to an increase in the daily average price of gas of \$8.54/MMBtu in December 2000

GAS



Market participants attempted to manipulate published price indices through epidemic false reporting

Spot gas prices were not the product of a well-functioning competitive market

Spot gas prices for the California Refund Proceeding therefore should be replaced. Staff recommends producing-area prices plus transportation for setting the clearing price, thereby reducing gas costs by \$7.03 in southern California and \$4.18 in northern California, or about \$5.60 on average over the 9 month refund period

Generators should be able to recover their costs on a dollar-for-dollar basis, but the California gas indices should not be used to set the market-clearing price.

ELECTRIC



The Cal ISO's and Cal PX's filed tariffs have contained anti-gaming provisions since the Cal ISO's Operations Date

These provisions identify various abuses and misconduct, such as taking unfair advantage of market rules, excessive pricing or bidding, and behavior that is not consistent with competitive markets and provide for the imposition of sanctions and penalties

The Enron trading strategies, economic withholding, and inflated bidding all violate the Cal ISO and Cal PX tariffs' anti-gaming provisions

Staff recommends the issuance of a number of show cause orders to determine the appropriate remedies for such violations

ELECTRIC



Staff recommends that over 30 entities be directed to show cause why their behavior did not constitute gaming or other anomalous market behavior in violation of the Cal ISO and/or Cal PX tariffs and why they should not disgorge any unjust enrichment related to their misconduct

These companies include AEP, Aquila, Avista, BPA, Coral Power, Duke, Dynegy, Enron, Idaho Power, LADWP, Mirant, PG&E, PacifiCorp, Portland General, Powerex, Reliant, Sempra, Sierra Pacific, Southern California Edison, and Williams

ELECTRIC



Staff recommends that Reliant Energy Services and BP Energy be directed to show cause why their market-based rate authority should not be revoked in light of their apparent manipulation of electricity prices at the Palo Verde trading hub

Staff recommends that Enron be directed to show cause why its power marketers' market-based rate authority and its gas marketers' blanket marketing certificate should not be revoked in light of Enron's numerous apparent instances of gaming, manipulation of gas prices, and failure to disclose changes in market share

ELECTRIC



Staff recommends that certain sellers in the California spot markets be directed to show cause why their bidding behavior did not constitute economic withholding and inflated bidding in violation of the Cal PX's and Cal ISO's tariffs and why they should not disgorge any unjust enrichment related to their misconduct

These companies are Enron, BPA, Dynegy, Idaho Power, LADWP, Mirant, PowerEx, Reliant and Williams



ELECTRIC

Western Long-Term Contracts

Market Dysfunction in California short-term markets affected long-term contracts

Analysis shows that spot power prices correlate with long-term contract prices, especially 1-2 year contracts

Spot prices in the Northwest during January-June 2001 appear considerably out of line with input costs

Staff recommends using the analysis in the Report to inform ongoing long-term contract proceedings and other complaints that long-term contracts are not J&R.

Other Staff Recommendations



Amend Sections 284.284 and 284.402 of the regulations to provide explicit guidelines or prohibitions for trading natural gas under Commission blanket certificates.

Consider a generic proceeding to develop appropriate reporting and monitoring requirements for sellers of natural gas under the Commission's blanket certificates.

Condition all electric market-based rates and natural gas blanket marketing certificates on the companies providing complete, accurate, and honest information to any entity that publishes the price indices.



Other Staff Recommendations

Natural Gas and Electricity Price Indices:

Require that only actual trade data be used to construct the price indices.

Require that data sent to firms publishing price indices be provided by the risk management office of the company, not the trading desk or a trader, and be certified by the chief risk officer.

Encourage standard product definitions for published natural gas and electricity price indices and standard methodologies for calculating the price indices.



Other Staff Recommendations

Require Dynegy, Aquila, AEP, El Paso Merchant Energy, Williams, Reliant, Duke, Mirant, Coral, CMS, and Sempra Energy Trading to demonstrate that they have ceased selling natural gas at wholesale or that:

- Those employees, including trading desk heads and managers, who participated in manipulations or attempted manipulations of the published price indices have been disciplined
- The company has a clear code of conduct in place for reporting price information
- All trade data reporting is done by an entity within the company that does not have a financial interest in the published index (preferably the chief risk officer)
- The company is cooperating fully with any government agency investigating its past price reporting practices

Other Staff Recommendations



Wash Trading, Monitoring and Record Keeping

Establish specific rules banning any form of prearranged wash trading and prohibiting the reporting of any affiliate trading activities through industry indices.

Condition blanket gas marketing certificates, as well as electric market-based rates, to require that sellers who use trading platforms use only those trading platforms that agree to provide the Commission with full access to trade reporting and order book information for the trading systems and agree to adhere to appropriate monitoring requirements.

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