

STAFF REPORT

PRICE MANIPULATION IN WESTERN MARKETS

FINDINGS AT A GLANCE

- The staff-level fact-finding investigation was formally launched Feb. 13, 2002, by order of the Commission, to determine whether Enron Corp. or any other sellers manipulated electricity and natural gas markets in California and other Western states in 2000 and 2001.

- Staff concludes that supply-demand imbalance, flawed market design and inconsistent rules made possible significant market manipulation as delineated in final investigation report. Without underlying market dysfunction, attempts to manipulate the market would not be successful.

- Markets for natural gas and electricity in California are inextricably linked, and dysfunctions in each fed off one another. Spot gas prices drove electricity prices, and manipulation of price indices apparently drove, at least in part, dysfunctions in the natural gas market. The report makes recommendations for steps the Commission can take to assure price indices accurately reflect market prices.

- Staff concludes that large-volume, rapid-fire trading by a single company at Topock, a California border trading hub that was incorrectly thought to be liquid, substantially increased natural gas prices throughout California.

- Because of concerns about manipulation of price indices, the final report reiterates the staff's recommendation that the Commission alter the natural gas pricing methodology in the California Refund Proceeding. Rather than rely on published index prices, the staff recommends FERC calculate the refunds by valuing gas based on the prices at producing

hubs plus transportation costs. Use of the alternative gas price inputs would result in higher refunds for electricity.

- Staff found that many trading strategies employed by Enron and other companies violated the anti-gaming provisions of their FERC-approved tariffs for the California ISO and PX markets. Staff recommends the Commission initiate proceedings to require companies to disgorge profits associated with these tariff violations.

- EnronOnline gave Enron knowledge of market conditions unavailable to its competitors. This informational trading advantage from EOL was highly lucrative for Enron, which could absorb losses in physical markets because of its profits in financial markets. Enron manipulated thinly traded physical markets to profit in financial markets. Staff estimates Enron's profits from EOL exceeded \$500 million in 2000 and 2001. EOL was a primary driver of wash trading, which created a false sense of liquidity, which can cause artificial volatility and distorted prices.

- Electricity prices in California's spot markets were affected by economic withholding and inflated price bidding, in violation of tariff anti-gaming provisions. Staff recommends proceedings to require disgorgement of profits associated with these tariff violations.

- Staff found no support for allegations that Williams Energy Marketing & Trading Co. cornered the market for natural gas in California. Williams bought gas in proportion to its needs and had a small share of the market.