**Testimony of**
**Pat Wood, III**
**Chairman, Federal Energy Regulatory Commission**
**Before the Committee on Agriculture, Nutrition and Forestry**
**United States Senate**
**July 10, 2002**

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to submit testimony on regulation of over-the-counter derivatives and whether additional oversight of these derivatives is needed to prevent fraud and market manipulation. I am not an expert on derivatives or the existing regulatory authority of the Commodity Futures Trading Commission (CFTC). Thus, in many respects, I will defer to the testimony of the other witnesses on these issues. However, as Chairman of the Federal Energy Regulatory Commission (FERC), I will offer my perspective on regulatory oversight of energy-related derivatives and its effect in promoting transparency, stability and confidence in energy markets.

The attention now being paid to energy-related derivatives began with two major crises. The first was the energy crisis in California and Western States. In May 2000, prices for wholesale electricity in the West increased significantly. Later that year, prices for natural gas in the West also increased significantly. Energy prices stayed at extremely high levels for over a year, finally subsiding in Summer 2001. The total cost to companies and customers in these States was enormous. Many factors, including an imbalance of supply and demand, appear to have contributed to this crisis, and the lack of transparency has hindered the ability of the market (and public policy makers) to make a timely assessment of the problems.

The second crisis was the collapse of Enron Corporation. Late last year, accounting irregularities at Enron, and the resulting loss of stockholder confidence in the corporation, forced Enron into bankruptcy. Investors and employees lost billions of dollars, and thousands of employees lost their jobs.

Subsequently, some alleged that Enron had been using its role as the nation's largest energy trader to manipulate wholesale energy prices, through derivatives and otherwise. FERC's staff is now investigating whether wholesale energy markets were manipulated by Enron or other sellers and, if so, the effect of such manipulation on market prices. In investigating these issues, FERC's staff is working with staff from the CFTC, leveraging each agency's strengths in its sphere of expertise.

More recently, other energy companies have disclosed "round-trip" trades. These disclosures have further eroded confidence in wholesale energy markets.

In response to these developments, a number of energy companies have reduced or eliminated their trading operations. Others have stopped or delayed construction of power plants, for lack of capital or to strengthen their balance sheets. In the short term, the loss of confidence in energy markets is hurting energy companies; but, in the long term, the decline of investment in energy production and infrastructure will hurt energy customers across our Nation.

One way to improve confidence in these markets is to enhance transparency. Energy customers, investors and regulators should have access to the broadest range of useful market information. Information on financial as well as physical transactions is a key part of market transparency. Billions of dollars are now at stake in energy markets. Greater transparency can help FERC and financial market regulators and players to better monitor individual companies' participation and diminish the ability of any individual player to misbehave or misrepresent in the marketplace.

FERC has taken steps to improve transparency in energy markets. For example, FERC has improved its reporting requirements to ensure that prices for all wholesale power trades are reported to FERC (and, ultimately, the public) in a "user-friendly" electronic format. However, to date, FERC generally has asserted jurisdiction only over wholesale power transactions that involve physical delivery of electricity, not over financial transactions involving energy-related derivatives. FERC does not have any direct authority under the Federal Power Act or the Natural Gas Act over energy-related derivatives.

Legislation has been proposed by Senator Feinstein and others to enhance regulatory oversight of energy-related derivatives by the CFTC. I have previously stated that federal oversight of such trading is appropriate, and that effective oversight over critical energy derivatives can ensure greater transparency and provide an early warning signal to those charged with protecting the public interest. Disclosure of relevant information regarding such transactions would complement the FERC's recently-adopted reporting requirements, which are having the unintended (but welcome) benefit of providing comparable and substantive market data necessary to evaluate various aspects of the power business. This improves confidence in markets.

Adequate oversight is vital to restoring stability and confidence in energy markets and will benefit energy customers over the long term. It is critical for customers to have access to the broadest range of useful market information to make informed decisions about energy choices.

As always, I will be happy to provide any further information you may need and offer the services of my colleagues and staff to the Committee's efforts.

Thank you.