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COMMENT

COMMODITY FUTURES
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Lou Volberding, CPA

July 8, 1998

Brooksley Born, Chairperson
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street N.W.
Washington, D.C. 20580

Dear Ms. Born,

I am writing to express my personal views on the pending controversy regarding regulation of OTC derivatives. As a practicing CPA, energy industry investor, and former corporate accountant for an oil major, I have been involved with hedge accounting and disclosure for more than a decade. I submitted comment letters to both the SEC and FASB early on in their deliberations leading up to the financial rulemakings which were recently adopted. During the past year I traded periodically in exchange listed futures contracts and relied on the regulations which your organization administers to assure liquidity and faithful counterparty performance.

Over the past few years I have observed several developments which I believe lend urgency to the task you presently face. First, there was the "hedge-to-arrive" fiasco a couple of years ago where so-called unsophisticated hedgers chose to abrogate their obligations to deliver grain when the market moved against them. While I had nothing personally or professionally at risk, I read with great interest about the community rifts resulting from non-performance and resulting attempts at contract enforcement. I suspect that the fallout from this problem may, in part, be driving your present initiatives and, if so, I applaud your perseverance. More recently, contract abrogation in the nascent electric power derivatives marketplace (*NY Times* July 7 article enclosed) highlights the dangers to ratepayers as well as shareholders of dealing with undercapitalized trading firms. I recall several years ago (in the wake of deregulation of natural gas prices and more open access to pipelines) that natural gas marketing firms were setting up shop in Oklahoma, reportedly with little more than a cell phone and a pick-up truck (pardon the hyperbole). I honestly don't know how much damage these outfits caused to producers and consumers before dropping out of the business.

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Another reason I have for supporting your initiative is that the current attempt to suppress your inquiries bears striking resemblance to the financial service industry's ill-fated attempts to block the FASB in their drive to promulgate full and fair accounting and disclosure of derivatives activities in connection with issuers' financial reporting obligations. As best as I can tell, the SEC remained on the sidelines during that debate while the financial service industry and their boosters at the central bank attempted to influence (inappropriately in my view) the FASB's process. Why the SEC has elected to come down on the side of the regulated broker/dealers on this issue is a mystery to me. Clearly, the OTC derivative broker-dealers would prefer to operate without any regulatory oversight, but I cannot see how this is in the public's best interest. While their threat to migrate trading operations offshore is probably not an empty one, I believe that in the long run hedgers will choose to trade with dealers they can rely on. While the Exxons and Royal Dutch/Shells of the world can no doubt look after their own interests satisfactorily, the independent and closely held producers that I now work with will likely benefit from orderly derivatives markets. Successful efforts of the CFTC in this regard would certainly make the auditor's job more manageable than the present situation where reliable information for valuing and disclosing derivatives positions is difficult to obtain.

If you would like to discuss any of the above issues, please feel free to call or write. Keep up the good work.

Yours very truly,

Louis H. Volberding, Jr.

Enclosure

cc: Robert Rubin, Treasury Department
Arthur Wyatt, Securities and Exchange Commission
Representative Steve Largent, First District of Oklahoma

Utilities Suffer Huge Losses as Demand Surges

By AGIS SALPUKAS

Two Midwestern utilities, Firstenergy Corp. and Illinova, said Monday that they had suffered huge losses from having to buy power on the open market during the recent heat wave when prices surged. The companies said the losses would result in much lower earnings.

Other utilities have also reported large losses after they were caught short on supplies of electricity when a heat wave swept the Midwest late last month, causing a surge in demand. The utilities had to scramble to find extra supplies from other regions or be forced to black out some of their customers.

The utilities turned to a young market that trades electricity as contracts in crude oil and other commodities are traded. But the heavy demand drove spot prices for electricity as high as $7,000 a megawatt-hour; the price range is usually from $30 to $50 a megawatt-hour.

Prices went up also because of a default by a major trader of power, Federal Energy Sales of Rocky River, Ohio. The default made some utilities that had extra power to sell reluctant to enter the open market, tightening supplies further because they feared that other traders could also default on power contracts.

As deregulation has begun to take hold, many utilities have set up units to trade electricity contracts. Utilities, however, are clearly still learning about the risks. Some utilities have asked the Federal Energy Regulatory Commission, which oversees the industry, to see why prices went up so much and so suddenly.

Firstenergy, which is based in Akron, Ohio, said it expected that second-quarter earnings would be reduced by $53 million, or 24 cents a share, mostly from trading losses.

The company also said it had set aside $27 million for bad debts that could result from a contract with suppliers that had defaulted on delivering power in the June heat wave. It added that it might also be forced to cut its dividend.

Illinova, which is based in Decatur, Ill., said it might break even or post a loss for this year because it was forced to buy the high-priced power. The company had been expected to earn about $1.70 a share according to analysts surveyed by IBES International. The company plans to take charges of $113 million for the first half of the year.

Lawrence Altenbaumer, the chief financial officer of Illinova, said that the company would pay its 31-cents-a-share dividend scheduled for August but that it was reviewing whether to pay dividends for the rest of the year.

The utilities joined other companies that said their earnings would be lower because of trading losses.

Pacificcorp, a utility based in Portland, Ore., said its earnings for the second quarter would be 30 percent below estimates.

Tuesday, July 7, 1998
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