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Calls are growing for more transparency in California's energy markets. Gov. Gavin Newsom just signed his bill shining a light on gas prices at the pump. But when it comes to the recent surge in natural gas prices that jolted electricity and gas bills this winter, the next step is murkier. Regulators at the California Public Utilities Commission say they have opened an investigation. And Gov. Newsom has formally requested the Federal Energy Regulatory Commission do so too. I asked Prof. William Boyd, faculty co-director of the Emmett Institute, to explain the regulatory options. Here's our conversation, edited for brevity and clarity. We started with how natural gas prices are determined…

The problem with natural gas pricing is that it's not transparent. The wholesale spot market price for natural gas is typically tied to price indexes that are created by third-party price reporting agencies owned by private companies. They essentially call around and ask gas traders what they're buying and selling gas for at a particular hub, and they use that to construct a price index that becomes the pricing term in the contracts for natural gas in the wholesale and retail markets.

Why is the CPUC investigating when it doesn't regulate natural gas producers?

The concern is that California consumers–residential, business, commercial, and industrial consumers, including power plants that burn natural gas to generate electricity–are all paying inflated prices for natural gas. So, their retail prices, which *are* regulated by the CPUC, might be inflated if they are based on inflated wholesale prices of natural gas. I think the CPUC and Gov. Newsom are probably correct to ask, 'Was there potential manipulation of these price indexes?' given that we just experienced a moment of extreme demand as well as high volatility in the market.

What can the Federal Energy Regulatory Commission do?

FERC has a duty to examine downstream effects of prices in the wholesale markets and a duty to ensure this is all "just and reasonable." But FERC has its own challenges, because it's made a policy decision to essentially defer to the price-reporting agencies when it comes to wholesale gas prices. I think this begs the question, "How can FERC possibly know if these prices are just and reasonable if it does not understand the details of these indexes?" At a minimum FERC needs to understand much better on an ongoing basis how these indexes are being constructed. I'd argue that FERC could also use its authority under the Natural Gas Index to create a public index if it finds that there are problems with the current set-up.

How would that work?

This goes all the back to the California Energy Crisis of 2000-2001. Back then when California electricity prices and natural gas prices went through the roof and the whole California market experiment in electricity imploded–there was manipulation from Enron and others and a whole bunch of problems with market design–but one of the big problems was that misreporting, or false reporting, to the price indexes by the natural gas traders was (in the words of FERC) "epidemic." People who trade natural gas were basically lying to the index publishers, driving those indexes up, which then benefited other downstream transactions they had priced at index. Congress came in and looked at this in and gave new powers under the Natural Gas Act to FERC to improve price transparency and liquidity in the natural gas markets. FERC has the power to intervene and create its own price index if it finds that the current indexes are not getting the job done, but it's never made that finding and never moved in the direction of a public index. But with all the volatility in natural gas markets and given how tightly coupled the natural gas and electricity markets are, maybe FERC should consider experimenting with a public index at hubs where there's very little reporting happening and see how it goes. Short of that, FERC could move to require more information from those companies that are reporting to the index publishers and raise a broader set of questions and concerns about these ways of price making. This is, incidentally, exactly the same kind of problem that we saw with the London Interbank Offered Rate or LIBOR after the financial crisis. Because these benchmark prices are so important to the broader economy—that is, they are "systemically significant" because they affect pricing in all sorts of other transactions—regulators need to be paying close attention.

Do you see a trend with Gov. Newsom's oil law and these separate calls for more transparency around natural gas prices?

I sure hope so. As people recognize that prices are not just the product of supply and demand alone, it's really important to understand how those prices are made in specific markets to determine whether or not they are fair. There are specific devices and ways of price-making that are at the heart of these markets that sometimes can become out-of-whack or can become objects of manipulation and we need to be paying close attention to that, particularly if the prices that result are these kinds of systemically significant prices that can ripple through the economy and particularly when they involve prices for primary social goods that people can't live without – these are necessities.