Preface

Section 205(a)(2) of the Department of Energy Organization Act (Public Law 95-91) requires that the Administrator of the Energy Information Administration (EIA) carry out a comprehensive program that will collect, evaluate, assemble, analyze, and disseminate data and information relevant to energy resources, reserves, production, demand, technology, and related economic and statistical information. Federal law prohibits EIA from advocating policy.

In February 2002 the Secretary of Energy directed the Energy Information Administration (EIA) to prepare a report on the nature and use of derivative contracts in the petroleum, natural gas, and electricity industries.[1] Derivatives are contracts ("financial instruments") that are used to manage risk, especially price risk. In accord with the Secretary's direction, this report specifically includes:

- A description of energy risk management tools
- A description of exchanges and mechanisms for trading energy contracts
- Exploration of the varied uses of energy risk management tools
- Discussion of the impediments to the development of energy risk management tools
- Analysis of energy price volatility relative to other commodities
- Review of the current regulatory structure for energy derivatives markets
- A survey of the literature on energy derivatives and trading.

Derivatives transfer risk, especially price risk, to those who are able and willing to bear it; but, how they transfer risk is complicated and frequently misinterpreted. This report provides energy policymakers with information for their assessment of the merits of derivatives for managing risk in energy industries. It also indicates how policy decisions that affect energy markets can limit or enhance the usefulness of derivatives as tools for risk management.

[1]Memo from Secretary of Energy Spencer Abraham to Acting EIA Administrator Mary J. Hutzler (February 8, 2002).