Statement of Chairman Bart Stupak
Subcommittee on Oversight and Investigations
"Energy Speculation: Is Greater Regulation Necessary to Stop Price Manipulation?"
December 12, 2007

Of the 19 hearings this subcommittee has held this year, today's hearing is perhaps the most technical and complex. Americans don't sit around the dinner table and discuss futures markets, swaps, position limits, look-alike contracts and exempt commercial markets. What families do talk about is the cost of gas, oil, home heating oil, and propane. They talk about how the high energy prices are literally taking food off their table to pay for basic needs such as transportation and warmth. In one day we saw a 45 cent hike of gasoline prices in my district. In another energy spike example, one senior high rise in my district saw their natural gas bill jump from just over $5,000 in November 2005 to an astonishing $13,000 in December!

Futures contracts for energy are traded on the New York Mercantile Exchange (NYMEX), which is regulated by the Commodity Futures Trading Commission (CFTC). The unregulated ICE market was created by the "Enron Loophole" as part of the Commodity Futures Modernization Act of 2000.

Unregulated markets are known as "dark markets" because there is very little oversight of the trades. By trading on the dark ICE market, traders can avoid CFTC's rules which are in place to prevent price distortions or supply squeezes. This makes it difficult for regulators to detect excessively large positions which could lead to price manipulation.

Trading volumes on this dark market have skyrocketed in the past three years and are now as large or even larger in some months, than the volumes traded on the regulated futures market.

Chart 3 shows that the quantity of natural gas futures contracts on NYMEX and ICE are almost equal in 2006: 239 trillion cubic feet on NYMEX vs 237 trillion cubic feet on ICE. To put this trading volume in perspective, the total U.S. consumption of natural gas in 2006 (represented by the yellow horizontal line near the bottom) was only 21.6 trillion cubic feet. So why is trading on each market 10 times more than necessary to supply America?

Chart 4 shows that only 600,000 natural gas contracts were traded on the dark ICE market in January 2005, **but increased by 433%** to 3.2 million contracts by October 2007. Why?

The spiraling growth in commodity trading in "dark markets" has left regulators with a large blind spot and the public without information to track how noncommercial traders could be affecting energy prices. The CFTC has no control over the dark markets and they lack enough staff to police the regulated markets, let alone the unregulated dark markets. This lack of oversight means that traders who exceed limits or who shun openness of the futures markets will merely take their business to the dark markets.

Less than 1 percent of futures contracts ever result in physical delivery; thus, most futures trades are not interested in delivery of a product, they are interested in profit.

The Energy Information Administration recently observed that, "Oil markets have been drawing increased interest and participation from investors and financial entities without direct commercial involvement in physical oil markets."

A recent report from Lehman Brothers, *Frenzied Oil Futures Frustrate Fundamentals*, states, "The surge in oil markets to $90 – the mirror image of last winter's price fall – seems underpinned more by financial flows and political risk than by fundamental factors." Oil-and-gas trader Stephen Schork who publishes the Schork Report on energy markets wrote, "Factors other than supply and demand are now impacting the price. We now have to factor in how the speculators are going to affect the market, because they have different priorities in managing their portfolios."

Rather than a market that is serving a price discovery function, we have a market that is more and more driven by profits and excessive prices. Often it is speculation based on fear which leads to greed.

Because of the Enron loophole, several major energy companies and hedge funds have been charged with price manipulation.

In February of 2004, British Petroleum (BP) acquired 90% of all U.S. "TET propane" supplies. Once in control of the market, BP intentionally withheld propane from the market and charged buyers artificially inflated prices in a classic supply squeeze. In a recent court settlement, BP agreed to pay $303 million in penalties and restitution.

In July of this year, FERC and CFTC brought anti-manipulation cases against Amaranth - a Connecticut-based hedge fund - which dominated natural gas financial markets for most of 2006, until its ultimate collapse in September 2006. FERC charged that Amaranth manipulated prices paid in the **physical** natural gas markets by driving down natural gas **futures** contracts through massive selling during the last 30 minutes of trading for the March, April and May 2006 contracts. This then allowed the companies to profit from much larger short positions traded on the dark ICE market that bet on this price decline. FERC has proposed $291 million in penalties and disgorgement of unjust profits.

A June 2007 staff report by the Senate Permanent Subcommittee on Investigations, entitled *Excess Speculation in the Natural Gas Market*, found Amaranth's trading increased price volatility to the point that traders deemed the price "out of whack" with regard to supply and demand fundamentals. These "out of whack" prices may have cost industrial, commercial and homeowners as much as $9 billion.

When the regulated market NYMEX directed Amaranth to reduce its excessive positions in the natural gas contracts, Amaranth shifted 80% of its gas contracts over to the dark ICE market, allowing them to maintain - and even increase – their overall speculative position. **Chart 6** shows that on August 28, 2006 Amaranth held nearly 100,000 contracts for September on ICE. To put this in perspective, by holding 100,000 contracts, a mere 1 penny increase in price would result in profit to Amaranth of $10 million.

Amaranth's traders knew this move would be invisible to regulators. In an August 29 Instant Message about a large price move, Amaranth's lead trader wrote: "classic pump and dump…boy I bet you see some CFTC inquiries of the last two days… "

But another trader reminded him that most of the trades had taken place on the dark ICE market using swaps. He replied: **"until they monitor swaps, no big deal".**

No big deal? Tell that to the home owners across America who are paying record heating costs to heat their homes. Tell that to the domestic manufacturers who are paying exponentially higher energy prices to manufacture their goods. Tell that to the people who have been laid off because the manufacturing plant they worked in closed down and moved their operations off shore where energy and labor costs are lower. And tell that to the Municipal Gas Authority of Georgia, which buys natural gas for public utilities in 4 states, and took $18 million in losses which they contend was due to Amaranth's trading scheme.

In another case of market manipulation in July, 2007, FERC and CFTC charged that Energy Transfer Partners (ETP) manipulated natural gas prices by using its dominant market position in the Houston Ship Channel to force the price of natural gas down in order to profit from much larger short positions –many of which were held on the dark ICE market. This strategy earned ETP nearly $70 million in unjust profits, according to FERC. Driving down prices might seem to help consumers in the short term; however, in the long run distorting price signals will drive up costs to consumers.

I would now like to play voice recordings of individuals from the British Petroleum and Energy Transfer Partners cases. Here they are in their own words: (play power point)

So what are possible solutions to these problems of manipulation?

CFTC recently proposed legislation to regulate the dark markets. Witnesses today will explore whether this proposal goes far enough to restore integrity in energy markets, or will increased oversight of the dark markets drive energy commodity trading overseas to less rigorous regulatory jurisdictions? ICE Futures already trades oil, gasoline and heating oil swaps for U.S. delivery in London under the U.K.'s Financial Services Authority, which has weaker market rules.

Another tool in addressing manipulation is ensuring FERC's authority to police price manipulation trades that impact delivery of energy. Legislative intent on the part of this Committee is clear. We fully expect that the authority granted to FERC through the Energy Policy Act of 2005 will be upheld. We question whether CFTC, in trying to block FERC from enforcing its anti-manipulation authority, is circumventing Congressional intent. Consumers could pay dearly if CFTC prevails, and this Committee is unlikely to be a bystander should that unlikely event occur.

A third possible solution, which has been proposed by Professor Michael Greenberger who will testify before us today, is for the CFTC to close the loophole that allows US traders to avoid CFTC regulation by using less regulated foreign markets to trade energy commodities.

There are also several pending legislative proposals intended to address this problem: HR 3009, The Market Trust Act of 2007 sponsored by Representatives Barrow and Graves; HR 4066, Close the Enron Loophole Act, introduced by Rep Welch of Vermont; and HR 594, the Preventing Unfair Manipulation of Prices Act, which I introduced with Chairman Dingell.

In the end, what we need is less of the greed we just heard from traders own voices on the power point a few moments ago, and more honesty. We need to close the Enron loophole, to close the foreign market loophole, and we need additional enforcement by the CFTC and FERC to clamp down on the fear and speculation that lead to greed and market manipulation.

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