Running on Empty: The Effect of High Gasoline Prices on Small Businesses

Testimony
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## I. Excessive Speculation is Needlessly Driving Up the Price of Oil and Other Essential Commodities and Increasing Volatility in Commodities Markets[*]

Over the past five years the price of a barrel of West Texas Intermediate ("WTI") crude oil has radically changed: from $65 in June 2007;[1] to a world-record high of $147.17 in mid-July 2008;[2] to a low of $30 in December 2008;[3] to $75 in July 2009; to $110 in April 2011;[4] to $76 in October 2011;[5] and to $106 as of May 1, 2012.[6] Since the beginning of this month, the price of crude oil has dropped almost $9 and is now at around $97 a barrel—a remarkably fast price decrease. Needless to say, gasoline prices (a key derivative of crude oil) have risen and fallen accordingly.

There is widespread recognition that a continued and sustained increase in gas prices will undermine the country's fragile economic recovery, especially the viability of small businesses with their limited capital resources to withstand the price shocks, thereby raising the specter of a renewed recession with a substantial further increase in unemployment.

The majority of experts have concluded that the extreme volatility in crude oil prices is not completely related to corresponding changes in market fundamentals.[7] A host of prominent economic studies from, *inter alia*, Stanford, Princeton, Texas A&M University, and the London School of Economics, as well as analysis by such prominent market observers as Nouriel Roubini from the Stern School of Business at New York University, have concluded that the five year volatility in the price of crude oil is due in no small part to *excessive* speculation (i.e., far

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[*] A brief biography of Professor Greenberger is attached as Appendix B hereto.

[1] *See* U.S. Energy Information Administration, *Petroleum and Other Liquids: Cushing OK WTI Spot Price* (May 4, 2012), *available at* http://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=RWTC&f=D.

[2] Financial Markets Group Planning Division, *West Texas Intermediate (WTI): Medium Term Trend Reversal?*, Alpha Bank (July 18, 2008), *available at* http://www.alpha.gr/files/infoanalyses/Commodities_TechVista_20080718.pdf.

[3] U.S. Energy Information Administration, *supra* note 1.

[4] *See* LiveCharts.com, *WTI Crude Oil Price History (April-May 2011)*, *available at* http://www.livecharts.co.uk/futures_commodities/oil_prices_historical.php?type_symbol=futures_wi&start=240.

[5] *See* LiveCharts.com, *WTI Crude Oil Price History (October-November 2011)*, *available at* http://www.livecharts.co.uk/futures_commodities/oil_prices_historical.php?type_symbol=futures_wi&start=120.

[6] *See* LiveCharts.com, *WTI Crude Oil Price History (March-May 2012)*, *available at* http://www.livecharts.co.uk/futures_commodities/oil_prices_historical.php.

[7] *See* Henn, Marcus, *Evidence On the Negative Impact of Commodity Speculation by Academics, Analysts and Public Institutions* (March 28, 2012), *available at* http://www2.weed-online.org/uploads/evidence_on_impact_of_commodity_speculation.pdf (listing nearly one hundred studies and commentaries that conclude that excessive speculation is affecting the prices of staple commodities).

too much speculation) by non-commercial institutions in the crude oil derivatives markets.[8] There are well over 50 studies and commentaries to this effect,[9] including a recent report by the St. Louis Federal Reserve that concludes, "speculation accounted for about 15 percent of the measured rise in oil prices from 2004 to mid-2008."[10]

Supply and demand for crude oil (and for food supplies) have, for most of the last five years, remained in equilibrium and there is near unanimous agreement that there is now no shortage in the global supply of oil.[11] The disconnect between oil prices and supply/demand fundamentals was evidenced in mid-March of this year when, on nearly the same day, the Saudi King promised to increase crude oil production by as much as 25 percent to make up for any shortfalls from a threatened (but never acted upon) Iranian oil boycott[12] and President Obama strongly hinted that the United States might very well release crude oil from the Strategic Petroleum Reserve,[13] but the price of crude oil went up![14]

The disconnect between crude oil prices and market supply and demand—oil prices rising when supply increases—combined with clear evidence of physical withholding of oil from energy markets—undercuts ongoing attempts to explain high energy prices purely in terms of market fundamentals.[15] For example, Nobel Prize-winning economist Paul Krugman, who originally remained steadfast in his belief that crude oil prices were dictated by market fundamentals, ultimately embraced the argument that excessive speculative activity is driving up

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[8] For a full citation to the many studies and commentary showing that excessive speculation (and not market fundamentals) is causing bubbles in commodity staples, *see* Appendix (App.) A, item 1 at pp. 8-9; *see also id.,* item 3 at pp. 7, 9.
[9] *Id.* at p. 8.
[10] Fawley, Brett, Luciana Juvenal & Ivan Petrella, *When Oil Prices Jump, Is Speculation To Blame?,* St. Louis Federal Reserve, *available at* http://www.stlouisfed.org/publications/re/articles/?id=2232.
[11] App A., item 10.
[12] Daya, Ayesha, *Saudi Arabia Can Raise Output 25% If Needed, Naimi Says*, BLOOMBERG (March 20, 2012), *available at* http://www.bloomberg.com/news/2012-03-20/saudi-arabia-can-increase-oil-output-25-if-needed-naimi-says.html.
[13] Mably, Richard, *U.S., Britain Set to Agree on Emergency Oil Stocks Release*, REUTERS (March 15, 2012), *available at* http://www.reuters.com/article/2012/03/15/us-oil-reserves-idUSBRE82E0UM20120315.
[14] *See* LiveCharts.com, *WTI Crude Oil Price History (February-March 2012)*, *available at* (February-March), *available at* http://www.livecharts.co.uk/futures_commodities/oil_prices_historical.php?type_symbol=futures_wi&start=30; *see also* App. A, item 6 at pp. 6-7 (noting that investment vehicles used by speculators in the oil market are also used in agricultural commodity markets; food prices move in synch with oil prices and price bubbles in agricultural commodities markets have caused starvation in developing countries).
[15] *See* Robert J. Samuelson, *The Fallacy of Blaming Oil 'Speculators'*, WASHINGTON POST (May 2, 2012), *available at* http://www.washingtonpost.com/opinions/the-fallacy-of-oil-speculation/2012/05/02/gIQAk7bkwT_story.html (arguing that price volatility in the oil markets is caused by small shifts in supply and demand).

the price of oil.[16] As Krugman observed: "Last year I was skeptical about claims that speculation was central to the price rise . . . this time there's no question: speculation has been driving prices up."[17]

Also, when the price of a barrel of crude oil was reaching $110 in April 2011, the CEO of ExxonMobil testified to the Senate Finance Committee that market fundamentals only justified a price of $60 to $70 a barrel, thereby recognizing that supply/demand did not justify the then-existing high price.[18] By October 2011 the bubble in the oil markets temporarily burst and the price did in fact drop to close to the $60 to $70 price range.[19]

Indeed, President Obama has on at least on four occasions—June 22, 2008 (during his presidential campaign when crude oil was approaching its world-record high of $147 a barrel),[20] April 20, 2011 (when crude oil spiked to $110 a barrel),[21] on March 8, 2012 (when the price of a barrel of crude oil had again spiked, increasing from the October 2011 low of $76[22] to $106),[23] and on April 17, 2012[24] (as gas prices at the pump approached $4 per gallon)[25]—expressed an abiding concern that the repeated and extreme spikes in crude oil and gasoline prices were due to speculative malpractices by large financial players in the oil market. The President then analogized the present market disruption in crude oil and gasoline prices to the manipulation of the electricity market on the West Coast in 1999 and 2000 by Enron and its market allies.

Most recently, on April 17, 2012, the President, while proposing a $52 million plan to expand the CFTC's market manipulation surveillance and enforcement capabilities and increase the civil and criminal penalties for manipulating commodities markets and urging further work

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16 Krugman, Paul, *Oil Speculation*, N.Y.TIMES (July 8, 2009), *available at* http://krugman.blogs.nytimes.com/2009/07/08/oil-speculation/?scp=2&sq=speculative%20trading%20in%20oil&st=cse.
17 *Id.*
18 Lenzner, Robert, *ExxonMobil CEO Says Oil Price Should Be $60 To $70 a Barrel*, FORBES (May 14, 201), *available at* http://www.forbes.com/sites/robertlenzner/2011/05/14/exxon-mobil-ceo-says-oil-price-should-be-60-70-a-barrel/.
19 U.S. Energy Information Administration, *supra* note 1.
20 Bohan, Caren, *Obama Vows to Crack Down on Oil Speculation*, REUTERS (June 22, 2008), *available at* http://www.reuters.com/article/2008/06/22/us-usa-politics-obama-energy-idUSN2243134220080622.
21 Mason, Jason, *Obama Blames Speculators for Rising U.S. Fuel Prices*, REUTERS (April 20, 2011), *available at* http://www.reuters.com/article/2011/04/20/us-usa-energy-obama-speculators-idUSTRE73J1NN20110420.
22 *See* LiveCharts.com, *supra* note 5.
23 *See* LiveCharts.com, *supra* note 6.
24 *See id.*; *see also* LiveCharts.com, *supra* note 5.
25 *See* Cooper, Helene, *As Gas Prices Cast Cloud, Obama Calls for Scrutiny on Market*, N.Y.TIMES (April 17, 2012), *available at* http://www.nytimes.com/2012/04/18/us/politics/obama-urges-oil-market-scrutiny-as-gas-prices-cast-cloud.html.

by the Justice Department's gas price task force,[26] said, U.S. production is up and U.S. consumption is down.[27] In fact, the world's supply of oil is sufficiently stable that at the end of March the President found tighter oil sanctions could be imposed on Iran without affecting market fundamentals.[28]

**President Obama And Members of the House and Senate Have In the Past Successfully Tamped Down Excessive Speculation in the Crude Oil Market**

Legislative efforts to curb excessive speculation and manipulation in staple commodity markets have long garnered strong bipartisan support in Congress. In 2005, when natural gas reached world record prices, Chairman Graves partnered with Congressman Barrow (D-Ga) to sponsor market reform measures included in the CFTC Reauthorization Act of 2005 (H.R. 4473).[29] The bill aimed to strengthen the CFTC's ability to detect and prevent manipulation in the natural gas market by increasing recording requirements for large traders as well as civil and criminal penalties for market manipulation.[30] Indeed, the pricing crisis in natural gas, led the Republican controlled Congress to pass the Energy Policy Act of 2005, which gave the Federal Energy Regulatory Commission ("FERC") co-extensive jurisdiction with the CFTC for manipulation in the natural gas futures markets.[31] In July 2007, Representatives Graves and Barrow again co-sponsored legislation (H.R. 3009) that would require traders who hold large

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[26] *See* Obama, Barack, President of the United States, *Remarks by the President on Increasing Oversight on Manipulation in Oil Markets*, The White House (April 17, 2012), *available at* http://www.whitehouse.gov/the-press-office/2012/04/17/remarks-president-increasing-oversight-manipulation-oil-markets [hereinafter President Obama]; *see also* Cooper, *supra* note 25.

[27] *See* President Obama, *supra* note 27; *see also* Cooper, Mark, Consumer Federation of America, *Excessive Speculation and Pain at the Pump The Never-ending Story: Fixing the Long-Term Fundamentals and Addressing the Short-Term Problems Go Hand-in-Hand* (manuscript with author) ("Consumption is down by ten percent (2 million barrels per day). Domestic oil production is rising for the first time in over three decades. In addition, biofuel production is now equal to over ten percent of domestic crude oil production. Combined, the increase in production equals 1.2 million barrels per day, or about 7 percent of consumption. Imports are down to a level not seen since the mid-1990s. The downward trend of imports is greater than at any time since the price spikes of the 1970s. Spare refinery capacity is up.").

[28] Jackson, David, *Obama to Proceed With Iran Oil Sanctions*, USA TODAY (March 30, 2012), *available at* http://content.usatoday.com/communities/theoval/post/2012/03/ap-obama-to-proceed-with-iran-oil-sanctions/1#.T3pbozEgef4.

[29] App. A, item 18.

[30] *Id.*; *see also*, Alistair Barr, *Bill Limiting Natural Gas Speculation to Be Introduced*, MARKETWATCH (April 13, 2005), *available at* http://www.marketwatch.com/story/bill-limiting-natural-gas-speculation-to-be-introduced.

[31] Energy Policy Act, Pub. L. No. 109–58, 119 Stat. 594 (2005), *available at* http://www.gpo.gov/fdsys/pkg/PLAW-109publ58/pdf/PLAW-109publ58.pdf ("It shall be unlawful for any entity, directly or indirectly, to use or employ, in connection with the purchase or sale of natural gas or the purchase or sale of transportation services subject to the jurisdiction of the Commission, any manipulative or deceptive device or contrivance[.]").

positions in the natural gas market to report these positions to the CFTC.[32] At the time, Chairman Graves argued that prices in the natural gas market were "being driven by speculation and manipulation of the markets" and that Congress needed to act to prevent consumers from paying more for natural gas.[33]

FERC's aggressive investigation and prosecution of excessive speculation and manipulation in natural gas markets has kept natural gas prices at or near a ten-year low. The agency has made stopping market fraud and manipulation "an enforcement priority"[34] by passing regulations that ensure market transparency[35] and by rigorously enforcing its enhanced anti-manipulation regulations under the Energy Policy Act of 2005. In 2006 FERC sought penalties and disgorged profits of over $290 million[36] in connection with the alleged manipulation of natural gas markets by traders at Amaranth Advisors LLC.[37] FERC settled with Amaranth, but

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[32] *Lawmakers See Need to Put Limits on U.S. Electronic Energy Markets*, PUBLIC POWER WEEKLY 5 (July 23, 2008), *available at* http://www.nxtbook.com/nxtbooks/naylor/appaWeeklyDemo/index.php?startid=5.
[33] *Id.*
[34] Federal Energy Regulatory Commission, *Prohibition of Energy Market Manipulation* (April 21, 2011), *available at* http://www.ferc.gov/enforcement/market-manipulation.asp [hereinafter *Prohibition of Energy Market Manipulation*]; *see also* Scott DiSavino & Jonathan Leff, *Energy Regulators In New Push to Quash Manipulation*, REUTERS (April 12, 2012), available at http://mobile.reuters.com/article/topNews/idUSBRE83B06Z20120412 (reporting that "[e]mboldened energy market regulators are mounting an aggressive new campaign to stamp out a once-common trading practice" and that FERC "is leading the charge with advanced enquiries into several big energy firms and banks").
[35] *See* Clearly Gottlieb, *FERC's New Focus on Transparency and Protecting Against Manipulation of Natural Gas Markets* 1 (Jan. 17, 2008), *available at* http://www.cgsh.com/files/News/c30a1328-e321-4d45-a060-5d6a0bf6c3c6/Presentation/NewsAttachment/2c55bc4e-18c3-4e6e-a3db-6061618857c8/10-2008%20Natural%20Gas%20Alert%2020080117.pdf (commenting that FERC regulations require a broad range of market participants to report annually specified information related to their natural gas trades, such as the total volume of transactions for the previous year and the volume of transactions that were priced according to a particular pricing mechanism, like by reference to next-day gas price indices or to next-month gas price indices); *see also* Phillip Moeller, Commissioner at the Federal Energy Regulatory Commission, *Transparency Provisions of Section 23 of the Natural Gas Act* (April 19, 2007), *available at* http://www.ferc.gov/media/statements-speeches/moeller/2007/04-19-07-moeller-M-1.pdf ("I am confident that the proposed daily postings by the intrastate carrier will allow the Commission and other market observe[r]s to identify and remedy potentially manipulat[iv]e activity more actively by tracking price movements.").
[36] *Id.*
[37] *See* Federal Energy Regulatory Commission, *FERC Orders $30 Million Fine Against Former Amaranth Trader* (April 21, 2011), *available at* http://www.ferc.gov/media/news-releases/2011/2011-2/04-21-11-G-1.asp (explaining that traders at Amaranth allegedly amassed large amounts of NG Futures Contracts, which they then sold at one time in order to increase the value of the significantly larger short positions maintained by Amaranth in natural gas swaps).

continued proceedings against Brian Hunter, a former Amaranth trader, and eventually fined Hunter $30 million for his involvement in the manipulation scheme.[38] In 2011, FERC brought manipulation cases against Atmos Energy (for attempting to avoid FERC's posting and bidding requirements in order to create a long-term, noncompetitive discounted rate release)[39] and BP (for fraudulently trading physical natural gas and for trading points in order to increase the value of its financial positions).[40] FERC's relentless enforcement of its enhanced anti-manipulation rules has paid off: in April of this year natural gas futures closed at their lowest price since September 2001.[41]

Members of Congress have also repeatedly and successfully intervened to highlight and blunt the adverse impact of excessive speculation on the crude oil markets. On June 26, 2008, as oil prices were reaching their world-record high, the House passed H.R. 6377 by a vote of 402-19. The bill required the CFTC to act pursuant to its authority under the Commodity Exchange Act of 1936 and declare an "emergency" in the oil market and impose special limits on excessive speculative activity in crude oil futures markets.[42]

On July 15, 2008, S. 3268 was introduced by Senate Majority Leader Reid. That bill would have imposed tough congressionally driven limits on excessive speculative activity in the crude oil futures markets.[43] On July 25, 2008, that bill received 51 votes in favor with 93 Senators present, a majority of the Senate, but not enough to invoke cloture.[44] Despite the bill's defeat, certain Republican Senators voted for cloture and others indicated that they might support the legislation in the future.

On September 28, 2008, the House passed H.R. 6604, which imposed tough speculative position limits in the crude oil futures markets by a vote of 283-133.[45] Also, on July 31, 2008,

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[38] *Id*.

[39] *See* Federal Energy Regulatory Commission, *Staff Notice of Alleged Violations* (Aug. 12, 2011), *available at* http://www.ferc.gov/enforcement/alleged-violation/notices/atmos.pdf (alleging that Atmos violated section 1c.1 of FERC's anti-manipulation regulations).

[40] *See* Federal Energy Regulatory Commission, *Staff Notice of Alleged Violations* (July 28, 2011), *available at* http://www.ferc.gov/enforcement/alleged-violation/notices/bp-america.pdf.

[41] Powell, Barbara, *Natural Gas Sinks Amid Supply Glut: Commodities at Close*, BLOOMBERG (April 19, 2012), *available at* http://www.businessweek.com/news/2012-04-19/natural-gas-sinks-amid-supply-glut-commodities-at-close.

[42] Wisconsin AgConnection, *House Passes Legislation Requiring CFTC to Curb Oil Market Speculation* (June 27, 2008), *available at* http://www.wisconsinagconnection.com/story-national.php?Id=1516&yr=2008.

[43] ThomasNet, *ATA Applauds Senator Reid and Other Sponsors of S. 3268* (July 21, 2008), *available at* http://news.thomasnet.com/companystory/ATA-applauds-Senator-Reid-and-other-sponsors-of-S-3268-547049.

[44] Govtrack.us, *On the Cloture Motion (Motion to Invoke Cloture on S. 3268)* (July 25, 2008) *available at* http://www.govtrack.us/congress/votes/110-2008/s184.

[45] Press Release, House Committee on Agriculture, *House of Representatives Approves Bill to Strengthen Oversight of Futures Markets* (Sept. 18, 2008), *available at* http://agriculture.house.gov/press/PRArticle.aspx?NewsID=375.

under the bi-partisan leadership of Senators Wyden (D-Oregon) and Grassley (R-Iowa), a Senate Finance discussion draft was circulated, which would have taxed profits from passive speculative crude oil futures as ordinary income.[46]

The combination of Congress's efforts in 2008 led speculators to fear that legislators would soon pass legislation to limit the financialization of commodities markets and, as a result, passive betters in commodity index instruments abandoned these markets in droves. The mass exodus of passive betters from the crude oil market precipitated a radical drop in the price of a barrel of crude oil: the price dropped from its July 2008 world-record high of $147 a barrel to $30 a barrel by December of that year.

In the winter of 2009 when financial institutions realized that Congress would in fact not pass legislation stopping excessive speculation, the price of oil once again spiked. Oil prices rose for 54 days in a row in the spring of 2009 and by July 2009 the price of a barrel of crude oil reached $75.[47] By late that summer, the legislation that later became the Dodd-Frank Act began making its way through Congress. It was made clear that that legislation aimed to impose tough new limits on excessive speculation in commodity derivatives markets and to strengthen the hand of the CFTC by allowing the agency to more easily bring market manipulation cases. Indeed, by the time Dodd-Frank was signed into law crude oil prices had stabilized for almost 18 months—prices fluctuated between $75 and $85 a barrel.

## II. Crude Oil and Gasoline Prices Continue to Spike Unnecessarily as Implementation of Dodd-Frank Falters at The CFTC

In January 2011, the CFTC proposed its position limits rule under Dodd-Frank to curb excessive speculation in commodities markets. However, the agency staff's effort to dramatically limit excessive speculation in commodity markets was met with fierce opposition.[48] Three of the five CFTC commissioners expressed strong reservations about setting tough limits on excessive speculation. This highly publicized reluctance to impose rigorous position limits on excessive speculation as Dodd-Frank had intended unleashed the price of crude oil from the $75-$85 price range that it had been trading at since the summer of 2009 and caused the price of a barrel of oil to soon reach $110.

On April 21, 2011, President Obama stated that the price spike in oil was not a result of market fundamentals (which as usual were in equilibrium), but the result of crude oil market manipulation by non-commercial speculators. He therefore convened a Department of Justice-led inter-agency task force to investigate that manipulation. As a result of threatened prosecutions, by October 2011 the price of crude oil was back down to around $75—a price that, according to

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[46] Press Release, Sen. Ron Wyden, *Wyden-Grassley Staff Proposes Level Playing Field for Oil Trade* (July 31, 2008), *available at* http://wyden.senate.gov/newsroom/press/release/?id=681fc35e-e834-4b2d-b7dd-8b1e0e0828b1.
[47] *See* App. A, item 6 at p. 4.
[48] Rampton, Roberta & Sarah Lynch, *CFTC Advances Position Plan, More Hurdles Ahead*, REUTERS (Jan. 13, 2011), *available at* http://www.reuters.com/article/2011/01/13/financial-regulation-limits-idUSN1328349420110113.

statements made by the CEO of ExxonMobil in April 2011, accurately reflected market fundamentals.

However, on October 19, 2011, the CFTC issued its final position limit rule by a mere 3-2 vote with Commissioner Dunn voting in favor of the rule but stating on the record that he thought the rule would do more harm than good.[49] The difficulty of obtaining a third vote in support of the final rule meant that the final position limits were high and the final rule sent a fresh signal to speculative financial forces that they need not fear Dodd-Frank. As soon as the limited nature of that rule was made clear, the price of crude oil rose dramatically once again, going from $75 at the time the rule was finalized[50] to almost $110 by February 2012 over a mere four month period.[51]

## III. Congress and the Executive Branch Must Take Specific and Prompt Steps to Permanently End the Economic Pain Caused by Excessive Speculation in Commodities Staple Markets

As things now stand, three factors are clear.

*First*, Dodd-Frank's attempt to have the CFTC convert the statute's clear intent to limit substantially excessive speculation in commodity staples futures markets has been stymied. Rigorous position limits have been defeated by fierce and overwhelming lobbying before the CFTC—lobbying that has removed the possibility of a third vote in support of a tough limits on excessive speculation.

*Second*, the President's inter-agency task force has the potential to have a significant ameliorating affect on inflated crude oil prices. After the President convened the investigative inter-agency task force in April 2011, the price of a barrel of crude oil dropped from $110 to $76 (in October 2011). The President was prescient to reconvene that task force in March 2012 when confronted with the weak agency position limit rule, because the United States was then and is now faced with yet another crushing crude oil price bubble. Even the mere threat of criminal sanctions would cause speculators to pull back from these markets as they did after the task force was first convened in April 2011.

Without effective position limits on excessive speculation, the only option for immediate relief from rising gas prices is a tough investigation into market manipulation of the crude oil markets (as FERC has repeatedly done in the natural gas markets) led by the Department of Justice. History has shown repeatedly that even a simple, but clear, announcement by federal prosecutors of a serious investigative program will have an immediate ameliorative effect on commodities prices that are alleged to have been manipulated. That prosecutorial road now appears the best path to take in order to bring relatively quick relief to the American public and

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[49] App. A, items 14 & 15.
[50] *See* LiveCharts.com, *supra* note 5.
[51] *See* LiveCharts.com, *WTI Crude Oil Price History (February-March 2012)*, *available at* http://www.livecharts.co.uk/futures_commodities/oil_prices_historical.php?type_symbol=futures_wi&start=30.

to end rising gas prices as these prices constitute a major threat to the United States's economic recovery, including in the small business community.

In fact, the recent media scrutiny of Chesapeake Energy—"a powerhouse in the vast U.S. [energy] market"[52]—and its CEO Aubrey McClendon suggests that efforts to restore transparency to commodity trading may, in and of themselves, decrease the price of crude oil. Reuters reported that McClendon had managed a hedge fund that traded in oil and natural gas futures for four years while he was chairman and CEO of Chesapeake and directed the company's own oil and natural trades as well as its energy production.[53] This revelation is by itself a red flag for possible market manipulation[54] (e.g. raising the possibility that Chesapeake and McClendon's hedge fund executed classic manipulative and highly illegal trades between each other)[55] and, in and of itself, proves the ongoing need for rigorous government oversight of commodities markets in general and the crude oil markets in particular. In the week after Reuters released its Chesapeake/McClendon report on May 2, 2012, crude oil prices dropped by $8 a barrel.[56]

*Third*, the process of having Congress legislate broadly while allowing regulatory agencies to implement statutes with specificity appears to be flawed in the area of futures market reform. Those with large financial resources are overwhelming the regulatory process and have unending funds for lawsuits that challenge the CFTC's actions. The Senate effort in July 2008 with S. 3268 demonstrates that clear-cut limits on speculation enacted within a statute by Congress without resort to federal agency rulemaking is highly effective.

Accordingly, Congress should immediately and on an emergency basis enact legislation that bans the use of the two most damaging investment vehicles for speculation in commodity staples derivatives markets: commodity index swaps and exchange traded funds that are premised on synthetic bets on commodity futures price directions.[57]

Both of these investment vehicles allow wealthy speculators to bet passively on the upward direction of a synthetic "basket" of energy and food commodities that is heavily weighted toward crude oil. Persons who take and place these bets do not own any commodities. In this sense, these bets are like bets on a horse race. With regard to commodity index swaps, you can only bet that the price of the basket of commodities will go up. The betting on the upward price direction and the hedging of those bets in the real commercial-oriented futures

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[52] App. A, item 17.
[53] *Id*.
[54] *Id*.
[55] Driver, Anna & Brian Grow, *Special Report: Chesapeake CEO Took $1.1 Billion in Shrouded Personal Loans*, REUTERS (April 18, 2012), *available at* http://www.reuters.com/article/2012/05/02/us-chesapeake-mcclendon-hedge-idUSBRE8410GG20120502.
[56] *See* LiveCharts.com, *supra* note 6 (indicating that on May 2, 2012, the price of a barrel of crude oil was $105 and on May 8 the price was $97).
[57] For a full explanation of the deleterious effect of these passive investment vehicles for speculation, see App. A, item 1 at pp. 9-10, 15; *id*., item 3 at pp. 7; *id*., item 8 at pp. 12-13, 16.

market by big banks and other large financial institutions sends continuous false "demand" signals to the markets, causing commodity prices—despite the supply/demand equilibrium—to rise and spot prices to follow suit.

In this respect, the Halt Index Trading of Energy Commodities Act[58] ("HITEC") introduced by Representative Ed Markey on April 27, 2012, and co-sponsored by Representatives Barney Frank and Rosa DeLauro, represents a bold and important first step toward ending excessive speculation in commodities markets. The bill would prevent commodity index funds that trade in crude oil, natural gas, or derivatives thereof, from engaging in transactions with investors who are not bona fide hedgers.[59] Importantly, HITEC identifies commodity index funds as the main cause of speculative activity in staple commodities markets[60] and asserts that speculative activity has "added nearly $1.00 to the per gallon price of gasoline."[61] The bill's impact on speculative activity will likely be significant: oil prices dropped from $105 to $98 dollars a barrel in the week after the legislation was introduced[62] and is now at its lowest point since the beginning of 2012.[63] This mimics the drop from a world record high in July 2008 of $147 to $30 that December in the wake of strong bi-partisan legislative efforts in between those two months.

In addition to causing unnecessary spikes in commodity staples, commodity index funds and exchange-traded funds have proven to be bad investments. As one financial analyst explained: "The next time someone tries to sell you a commodities fund based on the Goldman Sachs Commodities Index, smile and say, 'Sorry, but I'm from Earth, and you're from planet *I Love Lucy*. Let's revisit this discussion in an alternate universe.'"[64]

A comprehensive legislative ban on commodity index swaps and exchange traded funds that are premised on synthetic bets on commodity futures price directions (which now consist of hundreds of billions of dollars in passive betting) would not prevent speculation in energy markets. In fact, persons who wish to do price directional bets will have other less deleterious investment avenues to pursue. They can buy or short stocks in companies that produce the commodities. They can buy the actual commodities. Or, they can buy long or short contracts in

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[58] Halt Index Trading of Energy Commodities Act of 2012, H.R. ____, 112th Cong. (2012).
[59] Natural Resources Committee (Democrats), *Markey, Frank, Delauro Go After Wall Street Oil Investment Products*, Press Release (April 30, 2012), *available at* http://democrats.naturalresources.house.gov/press-release/markey-frank-delauro-go-after-wall-street-oil-investment-products.
[60] Halt Index Trading of Energy Commodities Act, *supra* note 62 ("Almost all of this increase in speculation has been caused by a surge in trading commodity index funds.").
[61] *Id.*
[62] *See* LiveCharts.com, *supra* note 6.
[63] Khan, Chris, *Oil Price Drops to Lowest Point of* 2012, ASSOCIATED PRESS (May 7, 2012), *available at* http://hosted.ap.org/dynamic/stories/O/OIL_PRICES?SITE=AP&SECTION=HOME&TEMPLATE=DEFAULT.
[64] Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, *Excessive Speculation in the Wheat Market* (June 24, 2009) at 102.

the futures markets. Of course, these alternative and traditional avenues of investment require financial sophistication—they do not comport with the ease of walking up to the "commodity staples betting window" and placing a bet with a big Wall Street bank.

Thus, I would heartily endorse a strict legislative ban on passive investment vehicles that trade in crude oil and other staple commodities, leading the "casinos" to offset those bets by buying long in the corresponding futures markets, thereby creating paper contracts calling for the making or taking of delivery of commodities that far exceed the world inventory of those products.

Further, betting synthetically on the upward direction of commodity staple prices does not put money into energy or agricultural production. Rather, such betting puts money in the hands of the "casino." Today's commodity derivatives markets are overrun with speculation. A smooth functioning commodity staple futures market that adheres to supply/demand fundamentals normally comprises of 70 percent commercial and 30 percent speculative transactions. Today's futures markets are, however, 80 percent speculative and 20 percent commercial.[65] Having these commercial hedging markets being driven by four fifths of those who do not care about the price consumers pay for commodities is the very meaning of "excessive" speculation.

Indeed, these markets are so volatile that (as the 20% commercial participation figure suggests) many commercial businesses are abandoning hedging because futures markets are completely unpredictable. One need only look at the drop in crude oil prices from $147 to $30 in less than six months in 2008 to know that commercial hedging is not for the faint of heart. Having businesses abandon commercial price hedging means that consumer prices unnecessarily increase.

Again, Dodd-Frank did not ban speculation. As was true of the New Deal Congress that passed the Commodity Exchange Act of 1936, Dodd-Frank merely bans "*excessive* speculation."[66] In other words, Dodd-Frank bans speculation that exceeds what the commercial users of these markets need to obtain market liquidity.[67]

As I mentioned in my March 28, 2011, comment letter to the CFTC, banning excessive speculation is a "no lose" proposition.[68] All that such a ban would do is stop gambling in commodities markets—gambling that does not add to market liquidity (because it is "excessive") or to the production of the underlying commodity.

Even if one has doubts about the effectiveness of such a ban, no harm can come to the economy by stopping *excessive* speculation on commodity prices. The ban will close casinos—

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[65] Letter to Chairman Gensler, and Commissioners Chilton, Wetjen, Sommers, and O'Malia by Senator Bernie Sanders et al. (March 4, 2012), *available at* http://www.sanders.senate.gov/imo/media/doc/CFTCPositionLimitsLetter.pdf.

[66] *See generally* App. A, item 1 at p. 5.

[67] *Id*.

[68] *Id*. at p. 3.

nothing more. And, if the experts are to be believed (those who have produced over 50 academic studies and commentaries on this point),[69] a ban on excessive speculation would cause commodity prices to drop to the point where they would be dictated entirely by supply/demand market fundamentals.

Small business, as would be true of the economy as a whole, would thrive under those circumstances.

[69] App., item 1 at pp. 8-9.

## **Appendix A**
**Citations to Select Works Referred to in Testimony**

1. Comment Letter by Michael Greenberger to David Stawick, Secretary of the Commodity Futures Trading Commission, *Position Limits for Derivatives* (March 28, 2011), *available at* http://www.michaelgreenberger.com/files/Greenberger_PL_comment_letter-0328.pdf (arguing that rigorous position limits would combat excessive speculation in commodities markets).
2. Comment Letter by Better Markets to David Stawick, Secretary of the Commodity Futures Trading Commission, *Position Limits for Derivatives* (March 28, 2011), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=34010&SearchText=better%20markets (arguing that stringent position limits would combat excessive speculation in commodities markets and reduce the price of commodities).
3. Michael Greenberger, *Commodity Swap Position Limit Rule May Help Return Price-Risk Management*, BLOOMBERG BRIEF 7 (Oct. 28, 2011), *available at* http://www.michaelgreenberger.com/files/Final_Draft_Sent_Nov15.pdf (explaining how the Commodity Futures Trading Commission's final rule on position limits may reduce excessive speculation in commodities markets).
4. Michael Greenberger, *Business Day Live,* N.Y.TIMES (March 26, 2012), *available at* http://video.nytimes.com/video/2012/03/26/business/100000001452780/business-day-live-march-26-2012.html (discussing how speculators' activities are increasing the price of oil and the Department of Justice's failure to investigate manipulation in the oil market). Commentary begins at 4:40.
5. Michael Greenberger, *High Oil Prices Must Be Subject of Criminal Investigation*, REAL NEWS NETWORK (March 28, 2012), *available at* http://therealnews.com/t2/index.php?option=com_content&task=view&id=31&Itemid=74&jumival=8131 (arguing that manipulation, not supply and demand, is increasing the price of crude oil and other essential commodities and explaining how an investigation into manipulation in commodities markets would reduce the price of energy and food).
6. Testimony of Michael Greenberger before the Commodity Futures Trading Commission, *Excessive Speculation: Position Limits and Exemptions* (Aug. 5, 2009), *available at* http://www.michaelgreenberger.com/files/CFTC_AFR_Sign_On_Testimony_August_3.pdf (discussing how rigorous position limits would curb excessive speculation in commodities markets).
7. Truth-O-Meter, *Sherrod Brown Says Excessive Speculation Is Driving Gas Prices, Perhaps by 56 Cents a Gallon*, POLITIFACT (May 2, 2012), *available at* http://www.politifact.com/ohio/statements/2012/may/02/sherrod-brown/sherrod-brown-says-excessive-oil-speculation-drivi/ (confirming the truth behind claims that excessive speculation is increasing oil prices).
8. Javier Blas, *Saudi Arabia Moves to Calm Oil Market*, FINANCIAL TIMES (March 19, 2012), *available at* http://www.ft.com/intl/cms/s/0/49ec22cc-71ea-11e1-8497-00144feab49a.html#axzz1qtDEb7dC [registration required] (reporting that Saudi Arabia and other oil-producing countries like Iraq and Kuwait plan to increase their oil exports to offset the impact of U.S. and European sanctions on Iran).
9. Ali Naimi, Minister of Petroleum and Mineral Resources in Saudi Arabia, *Saudi Arabia*

*Will Act to Lower Soaring Oil Prices*, FINANCIAL TIMES (March 28, 2012), available at http://www.ft.com/intl/cms/s/0/9e1ccb48-781c-11e1-b237-00144feab49a.html [registration required] (promising to mitigate rising oil prices by increasing oil production).

10. Matthew Robinson, *Oil Falls as Saudi Arabia Seeks to Calm Markets*, REUTERS (March 20, 2012), *available at* http://www.reuters.com/article/2012/03/20/us-markets-oil-idUSBRE82B04920120320 (reporting that Saudi Arabia promises to increase oil production and insists that "there is no supply shortage in the market").
11. Annie Lowrey, *Obama Finds Oil in Markets Is Sufficient to Sideline Iran*, N.Y. TIMES (March 30, 2012), *available at* http://www.nytimes.com/2012/03/31/business/global/obama-to-clear-way-to-expand-iranian-oil-sanctions.html?scp=3&sq=president%20obama%20oil%20prices&st=cse (reporting that President Obama announced that there is sufficient oil in world markets to allow countries to reduce their reliance on Iranian oil).
12. Robert Lenzner, *Speculation In Crude Oil Adds $23.39 To The Price Per Barrel*, FORBES (Feb. 27, 2012), *available at* http://www.forbes.com/sites/robertlenzner/2012/02/27/speculation-in-crude-oil-adds-23-39-to-the-price-per-barrel/ (discussing Goldman Sachs's recent conclusion that oil prices are driven, in part, by speculation).
13. Javier Blas, *Oil Futures Spark Debate on $100 Level*, FINANCIAL TIMES (March 28, 2012), *available at* http://edition.cnn.com/2012/03/27/business/oil-futures-fall/index.html (reporting that a forward contract for crude oil to be delivered in December 2018 is $30 cheaper than the spot price for oil, which is $125 a barrel).
14. Asjylyn Loder & Silla Brush, *CFTC Votes 3-2 to Approve Limits on Commodity Speculation*, BLOOMBERG (Oct. 18, 2011), *available at* http://www.businessweek.com/news/2011-10-18/cftc-votes-3-2-to-approve-limits-on-commodity-speculation.html (discussing former Commissioner Michael Dunn's vote for the Commodity Futures Trading Commission's final position limits rule).
15. Brian Scheid, *A Position Limits Rule No One Likes, Partisan Fighting, and a Song*, PLATTS (Oct. 20, 2011), *available at* http://www.platts.com/weblog/oilblog/2011/10/20/a_position_limi.html (discussing former Commissioner Michael Dunn's vote for the Commodity Futures Trading Commission's final position limits rule).
16. Silla Brush*, Former CFTC Commissioner Dunn Joins Patton Boggs Law Firm*, BLOOMBERG (Feb. 7, 2012), *available at* http://www.bloomberg.com/news/2012-02-07/former-cftc-commissioner-dunn-joins-patton-boggs-law-firm.html (reporting that former Commissioner Michael Dunn joined the Washington law and lobbying firm of Patton Boggs LLP as a senior policy adviser).
17. Schneyer, Joshua, Jeanine Prezioso & David Sheppard, *The CEOs Secret Hedge Fund*, REUTERS 1 (May 2, 2012), *available at* http://graphics.thomsonreuters.com/12/05/ChesapeakeMcClendon.pdf (reporting that the CEO, and former chairman, of Chesapeake Energy Corp., Aubrey McClendon, managed a hedge fund and secured loans from Chesapeake subsidiaries and that may have created a conflicts of interest and even allowed McClendon to manipulate energy markets).
18. Dittrick, Paula, *CFTC Reauthorization Suggests Energy Trading Rules Changes*, OIL AND GAS FINANCIAL JOURNAL (March 1, 2006), *available at* http://www.ogfj.com/articles/print/volume-3/issue-3/features/cftc-reauthorization-suggests-

energy-trading-rules-changes.html (reporting on the market reforms proposed by Representative Graves and Barrow).

19. Graves, Sam, Representative, *Stop Rising Gas Prices From Killing Small Business*, POLITICO, (March 4, 2012), *available at* http://www.politico.com/news/stories/0312/73592.html#ixzz1uDPGMglE ("One of the biggest threats now to our recovery is gas prices, which have consistently increased over several weeks. The nationwide average jumped to roughly $3.76 a gallon, according to the motorist group AAA. It was $3.46 a gallon only a month ago.").

**<u>Appendix B</u>**
**Michael Greenberger: Brief Biography**

Michael Greenberger is a professor at the University of Maryland Francis King Carey School of Law and the Founder and Director of the University of Maryland Center for Health and Homeland Security (CHHS). At the School of Law, Professor Greenberger teaches, *inter alia*, a seminar on Futures, Options and Derivatives.

In 1997, Professor Greenberger left private law practice to become the Director of the Division of Trading and Markets at the U.S. Commodity Futures Trading Commission (CFTC), where he served under CFTC Chairperson Brooksley Born. In that capacity, he was responsible for supervising exchange traded futures and derivatives. He also served on the Steering Committee of the President's Working Group on Financial Markets, and as a member of the International Organization of Securities Commissions' Hedge Fund Task Force.

Professor Greenberger has often been asked to testify before Congressional committees, regulatory agencies, and investigatory committees pertaining to the regulation of financial derivatives, including the impact of poorly regulated derivatives on the high price of commodity staples. For a full description of Professor Greenberger's testimony, writings, lectures and media appearances pertaining to derivative regulation, see **www.michaelgreenberger.com**.

Professor Greenberger has recently served as the Technical Advisor to the United Nations Commission of Experts on Reforms of the International Financial System; and on the International Energy Forum's Independent Expert Group on reducing worldwide energy price volatility.

Prior to entering government service, Professor Greenberger was a partner for over 20 years in the Washington, D.C. law firm of Shea & Gardner, where he served as lead litigation counsel before state and federal courts of law nationwide, including the United States Supreme Court.

Professor Greenberger is a Phi Beta Kappa graduate of Lafayette College and the University of Pennsylvania Law School, where he served as Editor-in-Chief of the Law Review.